contract is high-value or if the deliverable is instrumental in your client's operations, the selection process should involve significant time and financial analysis to ensure that the right supplier is contracted.

Although the supplier will principally be graded on the product or service it delivers, its financial health should be assessed to make sure that the supplier can continue to provide your client with the deliverable in the future. Here are four things your clients should keep in mind for due diligence while evaluating potential suppliers or vendors:

1. Calculate Profitability Ratios: The profitability ratios are probably the most important set of metrics to analyze when selecting a supplier because if the supplier is not profitable, it will not operate for long. And if a supplier closes business, it would strain your client as they try to find a replacement. Profitability ratios are used to assess a supplier's ability to generate earnings compared to its expenses.

2. Calculate Liquidity Ratios: The liquidity ratios can give your clients an inside look into the supplier's ability to meet short-term obligations, and while the supplier may not be paying your client, liquidity also impacts its sustainability.

3. Calculate Activity Ratios: The activity ratios measure a supplier's ability to convert different balance sheet accounts into cash or revenue. These metrics will show a business how the potential supplier is managing receivables with its other clients, the number of times payables turn over during the year (higher numbers are better), and its inventory management. All of these metrics will give your clients insight into the potential supplier's operations and will help them avoid potentially risky business partners.

4. Compare to Industry Averages: The last piece of the puzzle is to compare all the

However, if the potential supplier is a private company, the analysis is more difficult —even accessing their financials will require help from their accounting department.

For benchmarking a private supplier, your clients should use public company data if there are comparable firms, or look for data on private firms from industry associations.

Relationships with suppliers can critically impact your client's business, so the process of selecting a supplier does merit attention. If done correctly your client will have a supplier that will be in good financial health, which will lessen the risk for your client's business.

Depending on your industry and needs, more analysis might be needed, but these four steps are a great place to start. These pieces of advice can help your clients increase efficiency and mitigate risks, while also ensuring that they think of you as a trusted business advisor.

———————————-

Lauren Prosser is the Director of Professional Services at Sageworks, Inc*, a financial information company that provides financial analysis applications to accounting firms and private companies.*

John Formento Jr. contributed to this article.