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American Staffing Association
277 South Washington Street, Suite 200 ▪ Alexandria, VA 22314-3675 ▪ 703.253.2020 ▪ 703.253.2053 fax ▪ americanstaffing.net

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Contact:

Brittany Sakata
General Counsel
703-253-2038
bsakata@americanstaffing.net

Edward A. Lenz
Senior Counsel
703-253-2035
elenz@americanstaffing.net

Managing Risks in MSP and VMS Arrangements

Managed service provider (MSP) and vendor management service (VMS) arrangements provide significant value to staffing buyers and staffing agencies alike, which is why they have become so prevalent in the past 20 years.

Staffing buyers and staffing agencies assessing whether to use such services tend to focus primarily on the MSP or VMS providers' software and service capabilities, often overlooking the providers' financial strength. That is an oversight that can put buyers and agencies at substantial risk.

MSP or VMS providers effectively act as the staffing buyers' agent for paying the staffing agencies that supply the workers. Because payments flow through the agent, staffing buyers and suppliers face financial risk if the MSP or VMS provider is financially unsound.

The risk becomes especially acute during economic downturns. During the 2007 to 2010 industry downturn, several MSP and VMS providers went bankrupt—causing disruption and financial harm to the staffing buyers and staffing agencies that supplied them.

Warning Signs

Based on historical patterns, MSP and VMS providers go bankrupt for three primary reasons.

1. **Too much debt**. Often debt is secured by staffing agency receivables. Downturns may trigger financial covenants requiring MSP or VMS providers to pay down their loans or refinance. Highly leveraged MSP or VMS providers may be unable to do so, forcing bankruptcy.
2. **Unpaid short-term obligations** (e.g., taxes or supplier payables). Highly leveraged MSP or VMS providers without adequate cash on hand or borrowing capacity to pay their obligations may be forced into bankruptcy.
3. **Overdependence on venture capital**. During downturns, investors may become less willing to finance losses, especially for historically poor-performing MSP or VMS providers, forcing them into bankruptcy.

If the MSP or VMS goes into bankruptcy, the money paid to it by the staffing buyer does not go to the staffing agencies as intended, but becomes entangled in the bankruptcy process. This can cause chain reactions if the staffing agencies do not have the funds to pay their employees or continue providing services to the staffing buyer. Fortunately, there are steps staffing buyers and staffing agencies can take to avoid these dire consequences.

How to Mitigate Financial Risk

Staffing buyers and agencies can mitigate the risks of dealing with MSP or VMS providers that may be financially troubled by taking certain preventative steps. To protect themselves, staffing buyers and staffing agencies should establish sound financial risk management protocols when doing business with MSP and VMS providers, which should include

- **Annual audited financial statements.** To protect against MSP or VMS providers that may be operating at a loss or have high levels of debt, staffing buyers and staffing agencies should request annual audited financial statements to assess the providers' financial viability.
- **Protect staffing agency receivables.** To protect the money owed to staffing agencies, staffing buyer and agency contracts with MSP or VMS providers should expressly provide that the provider can use money paid by buyers for staffing agency services only to pay agencies for their services and cannot be used as collateral for MSP or VMS loans or any other purpose.
- **Credit checks.** Staffing buyers and staffing agencies should run periodic credit checks on MSP or VMS providers to monitor for signs of financial deterioration.
- **Escrow accounts.** Staffing buyers or agencies that have concerns regarding the financial strength of an MSP or VMS provider should request that the provider set up escrow accounts to hold the funds buyers pay for the services provided by agencies. The MSP or VMS contract should explicitly state that buyers (not the MSP or VMS) own such accounts and that the funds can be used only to pay agencies for their services and not for any other obligations of the MSP or VMS.
- **Option to pay staffing agency directly.** The MSP or VMS contract should expressly provide that the MSP or VMS is acting as the buyer's agent for payment of staffing agency services and, if the MSP or VMS doesn't timely pay the agencies, that the buyer may pay the staffing agencies directly or through another third party.