The Three Rs for Lenders for the 1990s: Re-analyze, Restructure, Recover

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In today's increasingly challenging economic environment, conventional solutions often do not apply to problems faced by lending officers dealing with financially troubled companies. A number of factors are prompting lenders to emphasize patience, support, mutual cooperation and a willingness to stand by creditors who may have been cut adrift just a few years ago: among them tougher scrutiny by lending institutions of the creditworthiness of potential borrowers; shortage of available cash from potential outside investors; growth in the number of financial reorganization specialist; and increasingly wide acceptance of bankruptcy as a business tool.

Largely as a result of the serious conditions confronting businesses today, lenders are not eager to provide credit to the marginal borrower. Consequently, lenders can no longer be bailed out of troubled credits by other lenders. At the same time, many alternative sources of capital support for the troubled business have all but dried up. Venture capitalists, for example, find it difficult today to bolster their capital reserves. Investors, another traditional source of cash, now prefer to sit on the sidelines.

The troubled company's competitors, another potential source of capital, are now struggling with their own cash problems, with little appetite for taking on another company's problems. With future earnings in doubt, stockholders and principals of troubled companies are now advised to hold their personal assets outside the company. As a result, those assets are not generally available for use by the company as additional collateral or for liquidation.

As they devise solutions for financially troubled companies, lenders today face increasingly sophisticated debtors, who now have the option of turning to a wide array of turnaround and workout specialists. The substantial growth in specialty departments of major law firms, along with the willingness of accounting firms to work toward solutions for their troubled clients rather than abandoning them during financial difficulties, provide debtors with a source of support and information previously unavailable.

Add to this base of support the multitude of professionals who have left legal and accounting firms with years of experience guiding businesses through financial reorganizations, and the crisis manager, as he is known today, emerges. Today, the sophisticated debtor views bankruptcy as another business tool, without the stigma that it once carried. This widespread acceptance of bankruptcy by creditors and lenders as a viable method of corporate restructuring only adds to the frustration of the lender who seeks methods of resolving the credit problem.

Lending officers now realize that the company's problems often cannot be cured by principals themselves. Lending officers who once were anxious to recommend abandoning the troubled company are now eager to assist it in the rehabilitation.

Reanalyze

The first step in any workout strategy is to confront the company's management with the need to change. In such scenarios, the lending officer is often forced to act as a psychologist, dealing with the issue in a frank but friendly manner. At the same time, the loan officer must undertake the difficult task of positioning the business for the long haul while avoiding lender liability.

Cooperation between lenders and debtors - and their respective teams of advisors - is the best approach to resolving portfolio problems. Compatibility of the professionals working to resolve the issues is key. For example, if the lender's attorneys and the debtor's attorneys are antagonists on other cases, the affected parties can suffer the consequences. It can be difficult, if not impossible, for these individuals to forget past differences and focus on today's challenge.

The first step in dealing with a troubled loan is to go back to the reason for the loan in the first place. This forces the workout or lending officer to focus on the time the credit was first booked and to remember that, as the saying goes, "every cloud has a silver lining." Among the factors to be considered in developing a long-range solution is management's relationship with its suppliers, customers and employees and the considerable investment of time spent in developing these relationships.

After focusing on the company's history, an in-depth analysis, supported by RMA ratios and other data, must be developed. This financial analysis should focus on three questions: 1) Where has the company been? 2) Where is the company now? and 3) Where is the company going?

Restructure

Solving a business credit problem today requires cooperation between lender and debtor. I strongly recommend that the lender give something first, asking the debtor to match its offer if it wants support. The debtor's support can come in several forms: the willingness to restructure unsecured debt; downsizing the operation; and the financial support of principals, which can include personal guarantees or additional collateral. Vehicles for the principals' support can take the form of subordinated loans or junior participations, where the withdrawal is either pari passu or a full junior participation.

Once the restructuring has taken place, the lender and the company can then look to the future and travel the road together. Going forward, the first step is a plan to monitor the company's financial results, which are examined during a meeting after the company has maneuvered through the first 90 days. The lender and the customer should have already agreed on a plan at the time of the original restructuring. At the end of 90 days, a decision is made either to continue the operations, to modify the plan or to proceed with a peaceful liquidation, which can usually be structured more easily after the lender has exhibited a willingness to provide the company with every opportunity to survive.

Recover

If the business continues to operate, financial reporting for at least the first year should take place on a monthly basis. The company should provide the lender with a monthly comparison of results to the original projections within 30 days after the end of each month. Additional support information should include complete agings (not just summaries) of payables and receivables and schedules of cash receipts and disbursements for the period. This enables the lender to scrutinize exactly how the debtor is using its money, and to quickly detect any potential deterioration of receivables.

Importantly, an annual business plan, properly monitored, is the key element in returning a company to profitability. At the very least, such plans provide in-depth information for both borrower and the lender, plotting the future needs of the borrower during the year. The business plan should be designed to force realism on both the borrower and the lender by forecasting portfolio growth as well as the commitment of a portion of that portfolio to the borrower.

In the end, weathering stormy economic times with a troubled creditor can only be successful if both the lender and the debtor learn from the experience. For lending officers, today's lagging economy requires a higher degree of cooperation with troubled creditors and a willingness to provide support at every stage of the recovery process.