Stopping the March of the Zombies

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Recent economic news has not made good reading. We are now well into the second dip of a double dip recession, the Eurozone crisis just won't go away and nobody seems to think things are going to improve any time soon. And yet recently published figures for company insolvencies in the second quarter of 2012 show an underlying decline and are running at an historically low rate.

Many attribute that counter-intuitive situation to so called Zombie Companies. For those that haven't heard the term, it normally refers to businesses that are able to pay the interest on their debts, but not reduce the debt itself. Such businesses struggle to generate enough cash to pay suppliers and payroll and have little or nothing left for investment. They truly are the corporate living dead and any significant rise in currently low interest rates or any other shock will almost certainly trigger insolvency.

The reasons for this are largely a product of low interest rates and the unwillingness of the banks to rock the boat. As long as interest is paid they do not have to recognise it as a non-performing loan hence they are happy to maintain the status quo as they repair their own balance sheets. They will renegotiate loan terms to help ensure that situation is prolonged – known euphemistically as "extend and pretend".

A recent study for R3, the UK's main professional body for Insolvency Practitioners estimated there are 146,000 zombie businesses teetering on the edge. It is a huge number and of course the insolvency profession is licking its lips at the prospects of so much business to come.

Many politicians are no doubt relieved at this. Apart from the benefit to bank balance sheets it has meant an absence of the wholesale redundancies that characterised previous recessions. But in reality it is not a good thing. Capitalism is founded on survival of the fittest and the culling of the weakest. The normal processes of capitalism are being prevented from working. It is also a very inefficient use of capital for the banks.

Left to continue it is corrosive. Who wants to manage a business where you just live hand to mouth every month? The business can't grow, can't invest, spends most its management time on survival and will likely fall into insolvency once interest rates start to rise. Not really something to motivate anybody and there is a real risk that management fatigue sets in. So what can be done about it?

There is nothing new in the management of a business turning to experts when confronting areas where they have little or no expertise themselves. There is nothing unusual about consulting a lawyer for legal advice, an accountant for tax advice, IT specialists for computer systems advice etc. But when it comes to consulting an expert in business turnarounds, management seems strangely reluctant. Somehow there seems to be a whiff of failure about it or just plain denial that help is needed.

In reality it is no different from consulting any other expert. Turnaround management is not a huge industry but those that work in it are experts in the very situations that zombie companies find themselves in. They spend their working lives advising and helping businesses in the twilight zone of near insolvency. They have seen it many times before and have a wealth of expertise to offer.

There is often some confusion about what exactly constitutes a Turnaround Manager and how that overlaps with Insolvency Practitioners. Insolvency Practitioners (IP's) are required by law to be licensed to undertake formal insolvency proceedings. Many also offer pre-insolvency advice, often under the banner of Turnaround, Restructuring or Recovery. They are nearly always associated with accountancy firms or have been in the past. Some have genuine experience of helping and advising companies to avoid insolvency while others are only really able to offer limited advice and primarily only handle formal appointments.

Others style themselves as what might be termed "Pure Turnaround Managers" or "Company Doctors" as they used to be known and are not licensed IP's. They have no interest in seeing a company enter formal insolvency as their role is over at that point. Many have a background in industry rather than the professions and are more comfortable rolling their sleeves up and getting involved with a client. They range from one man businesses through various mid-sized boutiques to large international firms.

As the present climate of extend and pretend runs on into what might be termed "Delay and Pray" more zombie companies should be seeking help. Management often believe they have done all that can be done but most turnaround managers have rarely come across a situation where their fresh and experienced eye cannot uncover significant opportunities to improve the situation as long as they are called in early enough. They are also highly experienced in the management of all stakeholders and handling difficult negotiations with creditors. In such difficult situations this can help reduce the pressure on management and stabilise matters as a plan is developed and implemented to steer the business to recovery.

Neither need the help of a turnaround manager be a cost that a struggling business cannot afford. In many cases the rapid improvements made will easily cover the fees. In addition, many turnaround managers will offer an initial review of the business at a reduced or even zero cost. Many are also agreeable to an arrangement for lower fees and an eventual success fee. In reality the question is not so much can you afford the turnaround managers services but can you afford not to have them.

Those involved with a struggling business, whether as a lender, shareholder or manager should not tolerate the continued march of the zombies. It really is time to address the problem before it is too late. It doesn't need a swashbuckling super hero; just a good turnaround manager.

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