Mini-guide to Dealing with Creditors

As a business becomes more distressed, relationships with creditors become increasingly difficult but at the same time increasingly important to the survival of the business. In addition, the directors' legal responsibility to creditors changes.

There are different types or groups of creditors:

- Banks and other financial lenders
- Trade creditors or suppliers
- Employees
- Tax authorities
- Landlords
- Pension schemes
- Others including any contingent liabilities

Most management teams in distressed situations dislike dealing with creditors. It is uncomfortable dealing with people with whom a good relationship existed previously. Often, the dialogue has gone through stages of denial of the problem, claims that it is just temporary, numerous broken promises and not communicating at all. The result can be outright hostility from the creditor and a risk that they will take steps to place the business into formal insolvency.

One of the first things we as turnaround practitioners do is to calculate roughly what the outcome of insolvency would be. This is never a precise science but it is possible to work out roughly what the various creditors would get in such an event. The creditors rarely know this themselves but it is important information for any future discussions with them.

In analysing that outcome, the question of security arises. Who has what security over what assets of the business? Is it valid? Banks will frequently have some security and asset based lenders definitely will. This can give rise to a potential danger whereby a secured creditor who stands to get all their money back may be quite happy for the business to go into formal insolvency and may think it the best outcome.

As well as the security and insolvency analysis it is also important to understand who the largest creditors are and which are business critical. In group situations it is also essential to understand the inter-company position, especially if it is cross-border. Ultimately it is about understanding the position of the various creditors and their motivation and leverage.

Banks and financial lenders are often owed the most and are the most sophisticated creditors in a distressed situation. Management often finds it a shock when the relationship manager disappears to be replaced by somebody from the "workout team". No more convivial lunches; they are at risk and want to know how they are going to be repaid. It is a very different relationship.

Traditionally, banks have asked for an Independent Business Review (IBR) by a firm of accountants at the company's expense. This large and often irrelevant report takes weeks to prepare and is very expensive when time and money are in short supply. At BM&T we believe that time and money is better spent focusing on the problems and taking action as early as possible.

While a bank's request for an IBR can be just standard practice, it can also be the result of poor communication. As mentioned earlier, denial, broken promises and a simple lack of communication can leave lenders feeling frustrated and losing confidence in management. They will see an IBR as a means to gain an understanding of the problem.

Other complications can arise. These days debt is traded much more than in the past and it is not unusual for a business to suddenly find that somebody has bought their loans from the original lender. Again, understanding who and what their motivations are is critical.

Another complication is potential inter-creditor disputes. These can arise where creditors want different outcomes or feel a proposal is more advantageous to others than to themselves. These can complicate and slow down negotiations.

Ultimately, dealing with creditors in distressed situations comes down to certain basics:

1. Understand the facts. Who is owed what, has security been given and who would get what in a formal insolvency?
2. Who are the most important, business critical creditors and what is their motivation and their desired outcome? What leverage do they have?
3. Focus on the business problems and their solutions. Don't make promises unless they can be kept. Develop a robust and credible turnaround plan that you can "sell" to creditors.
4. Communicate openly and actively with all creditors. Explain the problems and how they will be overcome. Leverage your proposals against the threat of a worse outcome in a formal insolvency.

Proper advice is needed throughout from people who understand these situations. Their involvement will often give confidence to weary, frustrated creditors. Experienced, independent and objective advisers will greatly increase the chances of a successful outcome.

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