No business is an island these days – one enterprise's problems ripple out across the commercial pond when financial stresses threaten its survival. They wash up not just on the shores of its lenders, but also affect its many other stakeholders, whether they are customers, suppliers, credit insurers, shareholders or employees.

As a result, those who are responsible for an entity's cash resources, liquidity and risk control need eyes in the back of their heads and a clear understanding of what is likely to happen if their own funders or those of a key business partner become concerned about their exposure.

Once upon a time, the fear would be that a secured lender would step in to take control of the situation. More often than not, this would take the form of first commissioning an independent review of the financial situation, then triggering a formal insolvency procedure, ensuring the appointment of its favoured professionals and calling all the shots to maximise its recovery – even if this might be to the detriment of the prospects for a rescue of the business and represent a cost to unsecured creditors or dependent customers.

Since the global financial crisis, however, the lender workout world has been transformed and not remotely in the way expected by pundits. Instead of the traditional initial rash of formal insolvencies, followed later by a higher peak caused by working capital starvation as growth returned, insolvency statistics around the world have spiralled steadily downwards since 2009. The corporate failure figures for Q4 2015, recently published by the UK's Insolvency Service, were at levels last seen in 1998, for instance. Insolvency professionals around the world are seeing a similar downturn in their workloads.

'Zombie' companies

At the same time, the 'zombie' company phenomenon has grown to unprecedented levels. Research published in late 2014 by the corporate financial health-monitoring firm Company Watch revealed that there were 240,000 companies in the UK with balance-sheet deficits of more than £5,000, which represented a staggering increase of 219% since 2009. These are not just overstretched small businesses. Their combined shortfalls totalled £72bn, up 231% since 2009, meaning that the average shortfall was some £300,000.

Here, too, this is a worldwide problem. Among the 500 biggest companies by sales in South Korea, 85% earned operating profits in 2014 that were below the level of their interest liabilities.

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Out of pocket

WORKOUT PROCEDURES HAVE MOVED ON SINCE THE FINANCIAL CRISIS, BUT CORPORATES STILL NEED TO KEEP A WEATHER EYE ON THEIR EXPOSURES AND THOSE OF BUSINESS PARTNERS. NICK HOOD EXPLAINS WHAT TO EXPECT WHEN LOANS GO BAD

Why are insolvency numbers falling and why are so many apparently unviable companies being allowed to struggle on? The sustained ultra-low-interest-rate environment continues to be a key driver. Another factor in some jurisdictions has been the reputational damage suffered by banks and financial institutions because of their perceived role in precipitating the global financial crisis. Bankers are understandably reluctant to be accused of pushing businesses into insolvency, especially when depressed asset values make it unattractive to trigger defaults and crystallise losses against their collateral.

Even if a return to rapid growth or a rise in interest rates might change this scenario, pushing up insolvencies and reducing the zombie army of the walking corporate dead, other pressures will continue to curb the role of lenders in taking the lead when a borrower is under pressure.

In just the past six months, a dozen countries have either announced or implemented significant changes to their corporate insolvency regimes, including major economies, such as Australia, India, France, South Korea and the UK.

A core objective of much of this rush to reform has been to limit the power and influence of secured lenders, and enhance the rights of unsecured creditors, as well as to encourage rehabilitation and limit the use of value-destructive liquidation procedures. This is not to suggest that secured lenders will not have any say in how struggling companies are dealt with; instead, they are likely to play a far-less-assertive part, while continuing to influence in a more consensual way how the process works and, vitally, how it is funded. There will be more seats at the workout table, but lenders may well act as the chair of discussions, or perhaps as mediator.

What drives behaviour

So, if a loan has gone sour at a business partner or other related party to your business, it is important to know that, in any event, the behaviour of lenders when their exposure is at serious risk is driven by a wide range of both old and new factors, some commercial and others more psychological in nature. The interplay of these in any particular situation will vary according to the size and the culture of the financial institution. The major international banks have sophisticated workout units with established procedures, although not necessarily in every jurisdiction in which they operate.

Not everyone will agree with the decisions these units take, least of all those borrowers foolish enough to forget that using external finance implies that one day they might be asked to repay the money. But these decisions will usually be based on a rounded consideration of all the pressures affecting a business and a deep well of experience on which a judgement about the best way forward can be based. Nevertheless, the call made by a lender will reflect its own interests first and foremost, as it should. Other stakeholders' agendas may be taken into account and will be accommodated whenever possible.

These specialist units are not simply financial hatchet men, far from it these days; they are turnaround and restructuring experts and have seen it and often done it all before. Some are even incentivised to return a problem credit to the 'good bank' side of the institution, rather than just find the least-expensive exit route. Equally, some 'good bank' executives are incentivised to hand an impaired credit to their workout unit for the appropriate intensive care. But to an outsider, some of the decisions will seem brutal because, quite rightly, staff members have no emotional attachment to the debtor or to the lending.

The more challenging scenario is when the troubled finance has been provided by a smaller institution with limited workout expertise and resource or, worse still, by a non-financial source, such as an individual associated in some way with the borrower. Here, there is uncertainty on all sides and often some pretty toxic psychology, usually based on inexperience and fear. It can lead to irrational decisions and situations that rapidly spiral out of control.

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How should a stakeholder react?

The first essential is to get a seat at that proverbial workout table, preferably one close to the chair. This means establishing a dialogue with the lender and other stakeholders as early in the process as possible. This can be achieved either through threats or by offers of support, usually best by a judicious mix of the two techniques. This means understanding where the power in the situation lies and what levers you can pull to be 'in the game'.

Other stakeholders will have professional advisers (either disclosed or behind the scenes); so must you. They should be wise in the ways of the workout and insolvency world, which has its own mafias and pecking orders when it comes to influence. Even in the largest and most-sophisticated jurisdictions, this is a small world where most professionals know each other and many owe each other favours. It is also a world where individuals matter more than firms.

Speed of reaction is vital. The sooner you engage with the problem, the better prepared you can be for the fight ahead. Equally, the earlier you bring in your own specialist advice, the fewer the chances that in the first skirmishes you will inadvertently put yourself at a serious and potentially fatal disadvantage. Needless to say, doing nothing is the highest risk strategy of all.

Thankfully, restructuring has come a long way from the dark days of even 10 years ago. Engage with the process positively and professionally, and the outcomes can be surprisingly good.

Nick Hood is a business risk analyst at Opus Business Services Group