Working it out

Many of our readers have not seen a recession of the scale likely in the near future, says **Jon Moulton**. How much can we learn from history?

As this year unfolds, many – if not most – companies will inevitably have weaker cash flows. Some will need money to cover losses and/or to fund restructuring (mainly, perhaps, expensive redundancies). Some will simply trade less well and will find themselves discussing the consequent breach of bank covenants with much less malleable lenders.

It is possible that since earlier recessions a change in the attitude of private equity investors towards maintaining employment may mean shareholders are willing to put more money into companies than previously would have been the case. Will general partners and limited partners be more supportive in a crisis nowadays and put social priorities above returns? We will find out over the coming year, I think.

For most companies, however, the issue will centre on borrowings that cannot be sustained or that banks will not provide. Rattling the can for equity money will be a last resort. In a UK buy-out context, during previous downturns far and away the most important lenders were the main clearing banks.

Emergency care

I spent a good part of my career dealing with the workout units of the big banks. Some were good. Some were hysterically bad. Midland Bank (of fond memory) had an 'intensive care' unit of unforgettable quality. In one case we breached covenants in style, told the bank of the issues then took 10 months to sort things out and repay the bank in full. After we had made the repayment, we were asked to our first meeting (a liquid lunch, as was normal in those days) with the intensive care team, which wanted to help us for a modest monthly fee. It rapidly became obvious that none of the team knew what our bank balance was.

This is not news, but at one point in the late 1980s, NatWest had so many troubled cases that its workout unit simply stopped taking phone calls and unplugged the fax machines. This was more than inconvenient when you needed consent and funding to pay your employees. One member of a company team spent two whole days sitting in NatWest's reception hoping to talk to someone. He failed.

The main banks are now, mostly, much more rational and controlled – which is more boring – but you can usually have a sensible discussion resulting in practical actions. Certainly, they are much less likely to just 'send in the receiver' – they also get better information than used to be the case.

Different times

Today, we also have a considerable amount of lending from a range of non-clearing banks, and even non-banks. The majority of these lenders are new to a distressed economy and I suspect their behaviours will be very varied. Lacking the capital requirements of their clearing bank competition, they may be susceptible to occasional role reversal.

If you are a lender with limited equity and a modest number of relatively sporty loans, then the borrower can move from the normal supplicant role to a threatening position: "If you don't extend and increase our facility we will push the company over." You can add the directors' personal liability and a pre-pack as arguments to add to the pressure. The lender may not be willing to take the loss and will defer the bad news/write-off to hopefully happier times. Perversely, and pretty obviously, this game works best if you owe the lender a lot.

These tactics, on a grander scale, were used by the big banks themselves to get through the global financial crisis of 2007/8. Governments preferred to relax capital rules and bank accounting rules to avoid losing a big bank – especially after Lehman's collapse.

Cost reduction, resetting targets, tight cash management, stable funding, controlling pay, trying to manage inflation, being nice to lenders – welcome to 2023. Happy new year; we can work through this.

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ILLUSTRATION BY DAN MURRELL