

Viewpoint

One of a series of opinion columns by bankruptcy professionals

Banks Can Serve As Change Agents For Troubled Borrowers

By John Tittle Jr.

Dickens' well-scripted phrase, "It was the best of times, it was the worst of times," immediately alerts the reader to the presence of dichotomy. As the reader, one quickly gets the picture of the have and the have-nots. What a contrast!

It would seem that we live in a world of dichotomies - nations, ethnic groups, organizations, companies and of heightened-interest of late, financial institutions. Bankers are front-page news. Are they taking TARP money? Are they lending money? What about the amount of their fees? Are they solvent?

In the financial news, bankers want to separate themselves from their competitors by espousing their monetary strength and capacity. There is clearly a developing dichotomy and there are, or will be, have and have-nots. While the winners and losers among financial institutions will be important in the restructuring community, another dichotomy is of keen interest to bankruptcy and turnaround professionals: The divergent treatment of troubled or potentially distressed borrowers by banks. It would seem that banks are either forcing borrowers out of their institutions at all cost, without regard to a viable alternative, or the institutions are allowing customers to languish without any significant demands or collection efforts.

Capital is now a very scarce resource. Liquidity is king, and it is understandable that banks and financial institutions would be very aggressive in collection and workout activities. That being said, to what source of capital are these borrowers supposed to turn? Within the part of the banking dichotomy that involves the resolute and forceful movement of credits out of banks portfolios, the borrowers on the other end of "lender fatigue" are forced into rapid liquidations and, in some cases, "fire sales." Enterprise value is being destroyed. Jobs are lost. Why? There is presently no source of affordable substitute capital for companies that would provide the time necessary for reorganization. If the company was having trouble making payments on its obligations prior to a restructuring event, how could it possibly service debt with interest rates of 19% per annum (if it could obtain the capital at all)?

Once companies are at this precipice with the bank, what is the answer? There must be innovation in the process. While it is understood that the banks need the swift return of capital, there must be some reasonable forbearance or creative solutions. What does the borrower need? Time. Operational turnarounds take time. Shedding unprofitable products or businesses requires time.

Financial restructurings and repositioning must be allowed time for measureable results to be achieved.

Part of the answer lies with the other part of the dichotomy. Some borrowers are allowed to languish or operate as they have in the past for an extended period of time. Companies are allowed multiple forbearances or in certain cases, "band-aids." When the companies do finally enter a restructuring it is too late. Why?

One answer is management. It is widely accepted that one of the primary causes of financial distress is poor management. Management will generally not take the necessary actions and make the tough decisions required by times of crisis. Some external force must be applied to spur action on the part of the management. One of the best change agents: the company's bank.

While being cautious of lender liability issues (I am not an attorney but I assume that bankers know the boundaries), the banks must be more proactive in suggesting to its borrowers that they seek and obtain advice and assistance. The step where the banks provide their borrowers three names of firms with which to consult must be taken much sooner than in the past. The sooner, the better. In forbearance arrangements, management must be strongly encouraged to seek advice and follow it! Then there will be time for turnaround initiatives to take hold and for results to be obtained. Hopefully certain financial targets or other benchmarks can be established and achieved and alleviate some of the extant lender fatigue.

Another issue has to be the concern over a bank's earnings. The treatment of borrowers as mentioned above could mean that credits would have to be classified sooner. This would accelerate the losses being reported by the banks. It would seem that this is a case of "pay me now or pay me much more later." Why not get all of the pain out of the way now? Companies are allowed to deteriorate because involving the credit in a workout or requesting that the retention of a consultant could require the classification or write-down of the loans. So "band-aids" are administered and the "patient" gets sicker. Once remedial measures are taken it may be too late. With little time to solve the problems, issues within the business are exacerbated and the downward spiral begins. At that point, the attempt is made to force the company's loan out of the bank and unless affordable substitute capital can be obtained, the borrower's assets are liquidated as quickly as possible. This paradigm must change.

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This does not mean that bankruptcies would be averted. Certainly some Chapter 11s would be avoided. However, just as borrowers should seek advice sooner, some companies should file for Chapter 11 much earlier - and do so in an orderly fashion. This strategy should benefit the secured lenders and the company. Cash may be conserved to fund a reorganization strategy, thus preserving enterprise value that would inure to the secured lenders and all stakeholders. Financing through DIP arrangements, with the company presumably in better financial condition, could be more readily available.

To add to the conundrum facing financial institutions, bankers must be change agents in helping their borrowers through this crisis. Action must be taken sooner to

encourage management take situational-appropriate actions and, if possible, avoid the death spiral. Hopefully early and swift action will help the borrower avoid the precipice with its bank. In this scenario, the companies that do end up on the cliff may deserve to be liquidated and cease to exist. This is still capitalism with its creative destruction.

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