K2 business partners

MANAGING YOUR BANK MANAGER

A DIRECTORS' GUIDE

MARK BLAYNEY
EDITOR

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Introduction

For most SME and mid market businesses, their bankers are usually:

- a key financial stakeholder in the business;
- a key potential independent source of advice and support when the banking relationship is working properly;
- but as a result of the bank's power in the relationship, a breakdown in this relationship can be a real threat to the business's survival.

So for a business owner, knowing how to manage this critical relationship to maintain bank support, and how to remedy any problems that may arise, can be critical to the survival of their business.

This guide is here to help you as a business manage this critical relationship.

If you have any queries or questions arising out of this guide or if it flags up any areas where you feel you may want support, please do contact us.

And finally, if you have found this guide useful, please do pass its details on to your business contacts so it may help them as well, and/or post reviews.

Thank you

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Executive Summary

1. To manage your banking relationship, try to understand how things look from **the bank and banker's point of view.**
2. Manage your banking relationship to be the sort of business your bank manager wants to have, **profitable and easy to support.**
3. If you want to borrow, **create a bankable proposition** for your manager to put forward.
4. If you find yourself being transferred into intensive care:
    - ensure you understand why and quickly **devise a proactive plan** for working with the bank to deal with their concerns and return to good book, and
    - **get experienced professional help** if you need it… particularly if you have to deal with an IBR.
5. **Take professional advice as** soon as you identify that an issue with the bank lending exists.
6. Despite all the complexity relating to the business involved, **the end game is usually a negotiation.** In an ideal world this should be on a win win basis, but being pragmatic one of the parties may get the upper hand and so obtain the result most favourable to it.
7. The **power in the negotiation will rest on three principal factors:**
    a. The facts of the situation,
    b. The knowledge of the negotiators,
    c. The experience of the parties.
8. **Banks are not entrepreneurs** and their time horizon is the length of the facility agreed. They are credit risk professionals.

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Chapter 01
Understanding Your Bank Manager

Introduction to managing your bank manager

When you first read the title of this guide you may well ask, 'Why would anyone want to manage their bank manager?'

The answer is quite straightforward.

For any business the support of its bank manager is a fundamental requirement and in good times is usually readily available. By acquiring the knowledge of how bank managers work and are managed, you will be better placed to manage your relationship with your bank manager, and through them the bank, and can ensure your business receives the maximum possible bank support.

By contrast, failure to manage your bank manager can lead to a deterioration in your bank relationship, resulting in a reduction in bank support and ultimately contribute to a business failure.

The classic adage about banks is that they will lend you an umbrella when the sun is shining, but will take it back when it starts to rain. In other words, a bank will agree to lend when financial information is satisfactory and forecasts are positive, but when information is unsatisfactory and/or there is a negative outlook, they will often not only decline to provide any further support, but will look to reduce their exposure by way of the amount lent or facilities provided, and may seek additional security for whatever they do allow.

So managing the relationship with this key financial stakeholder in your business is a vital task and that is where this K2 Business Partners Guide can help you.

Understanding your bank manager

To manage your bank manager, you first have to understand how they function and are managed by their employer, the bank. The insight that this knowledge provides will then enable you to respond effectively to them and to proactively manage your bank manager to the benefit of your business.

What drives your bank manager?

For all banks the overriding objective is to maximise profit, although bankers use the alternative description of 'maximising return on equity for shareholders'.

To achieve this, banks drive their commercial managers by setting annual targets/objectives focused on persuading quality businesses to switch from competitor banks and on the sale of a range of products and services across the existing accounts in their portfolios.

Progress against targets are usually reviewed monthly, with progress against key targets often subject to weekly scrutiny, placing managers under varying degrees of pressure.

Overall their objectives are to:

- Increase the income derived from their portfolio of accounts; and
- Exercise prudent credit judgment to avoid losses.

The number of accounts they are required to manage, together with the banks' onerous credit reporting systems, is usually sufficient to keep managers very busy, and because the banks keep a close focus on their costs, most bank managers have a heavy workload of customer relationships to manage. Bank managers have to complete detailed credit reports on businesses and their accounts at least annually (while intensive care managers also have to provide quarterly credit reports). Additional interim reports and updates are also frequently required by the local credit manager and the bank's central credit approval department.

As a result, bank managers broadly manage their book by exception and look at a customer when they come to the manager's attention because of an unsatisfactory incident or development.

Generally therefore, they do not have the time to get too close to your business. So they rely heavily on the information requested from you; both the financial management information they will expect your business to have and use, such as budgets, forecasts, costings, and management accounts, its operational key performance indicators, and your annual filed accounts, for their assessments of your business.

These basics will then occasionally be supplemented by use of reports from an investigative accountant or a financial turnaround professional.

In summary therefore, the financial information received by the bank is critical to the bank manager's perception of the business, the bank's credit assessment/credit rating of the business and the level of support the bank will provide. From this it follows that if your bank manager is looking to manage by exception, then you as a customer do not want to be seen as an exception as a result of any failure to provide expected information on a regular and timely basis, and for that information to be reliable.

What motivates your bank manager?

Bank managers are graded on their performance against targets as well as being benchmarked against their peer managers, which at annual review will determine their annual performance rating.

Their annual performance rating will then in turn decide:

- Amount of annual financial award – comprising salary and bonus;
- Level of job security – an important factor in an industry with regular rounds of headcount reduction exercises; and
- Promotion prospects – as strong performance ratings enhance internal job applications.

What your bank manager wants from existing business customers

To meet the targets they are set, your bank manager will be looking for a number of things from their existing customer portfolio.

On the income side these will broadly be:

- To retain the bank's existing income streams from the account such as arrangement fees and money transmission charges; and
- Opportunities to increase the level of income by selling in further products. There may be other funding types to which the bank may want to migrate its lending, such as invoice finance services, or other financial and insurance products such as hedging services or interest rate swaps, or key man insurance policies they wish to sell.

In addition they will want to:

- Have no increase in the perceived level of risk of the funds they have out on loan;
- Hit any other targets that the bank may have set as part of its own strategy, such as attracting more cash deposits; and last but by no means least,
- Enjoy ease of compliance with the manager's internal bank reporting requirements.

Reasons for your bank manager to want to retain you as a customer

From this it follows that the reasons your bank manager will want to retain your relationship are:

- If your business is growing and as a result, the bank's income is increasing; and/or
- If they see the potential for future sales of products and services to you which will result in increasing bank income.

Where you have built up a good relationship with your bank manager and are seen to be a 'well managed' account, personal loyalty to you as a customer also plays a part.

It is worth remembering that, even in cases where your business's credit rating is marginal, your bank manager may still want to retain and support your account and avoid it being downgraded and transferred to the bank's intensive care department, (which depending on the bank involved may be known as 'Business Support', 'Special Situations', or 'Restructuring').

Reasons why a manager might want to avoid this step include the time taken to complete a detailed credit downgrade application which will often involve discussion with the local credit manager and intensive care manager, while seeking approval from the credit department and answering their queries.

The manager can be concerned that this process will lead to scrutiny of their handling of the account and/or may mean that they have to 'own up' to not having succeeded in having the customer deal with the issues involved.

One effect of an account being transferred is usually a much sharper look at the quality and value of the available security as the bank will have an eye on this as its potential backstop position. Where the tangible security is then felt to be insufficient, this will lead to a downgrade of the account and an impairment charge or provision being raised (a loss being recorded in anticipation of the event), which may then reflect on the manager.

And finally, they may simply find it an unpleasant process, where they have to either face up to having to compile and issue a letter of concern, deal with the customer's reaction and attend an often uncomfortable meeting to hand over the relationship to intensive care, or step back, let the intensive care manager deal with these and run the risk of heavy criticism.

What does your bank manager see as threats?

The bank will regularly assess your business's credit risk and assign it to one of the bank's standard categories. Which category your business is in will dictate how the bank subsequently deals with the business, from the attitude towards further lending, to the level of margin they will be looking to achieve.

Loan defaults are seen by all banks as a major threat to their level of profit. If your bank manager downgrades the business's credit rating this indicates an increase in the estimated level of risk of your business ultimately defaulting on repayment. So this can then be expected to lead to a change in the bank's attitude towards your business, reducing its willingness to lend and increasing its rates, security requirements and information requests.

Your bank manager's view of your business is critical as this is a major factor in influencing the outcome of the bank's credit assessment.

This assessment is based on the credit application which the bank manager completes and submits for the consideration and decision of the bank's central credit approvals department. Their decision will largely depend on what information your bank manager includes (or omits), from their report, and how they present the business's situation and case for the credit rating they believe is appropriate.

The danger here is that a result of a lack of timely or accurate financial information can sometimes give your bank manager a negative impression of the financial position of your business without real justification.

This may translate into a problem if your bank manager's negative impression of your business then affects their reports and hence the bank's credit assessment.

Listed below are some of the more common factors which you should seek to avoid:

- Unsatisfactory communication;
- A perception by your bank manager of some shortfall in cooperation;
- Misunderstandings;
- Not completing agreed actions within agreed timescales and without acceptable explanations;
- Unsatisfactory conduct of the bank account – such as unauthorised overdrafts, particularly where these are not quickly resolved;
- Delay in provision of requested information;
- Information giving a negative impression;
- Adverse surprises – for example management accounts showing a profit only for annual accounts to show a loss;

- Negative financial information; or
- Negative outlook.

Reasons for your bank manager not wanting to retain your account

From the above, you can see there are a range of factors that can lead a bank manager to conclude that they do not wish to retain and support your business.

A decision not to wish to support and retain you as a customer is usually made because the income the bank can earn both now and in the future from your business is believed to be falling at a time when the risk is believed to be increasing.

This can be because the bank perceives the business as heading towards difficulties, such as when their breakdown of the annual accounts shows a steady overall flow of cash out of the business.

It can also be a matter of your bank manager having to implement their bank's central policy, if for example the bank decides it has enough exposure to a certain sector, or even sometimes decides that it wishes to exit from it altogether.

Or it can be because the business is simply seen as being 'too much hassle'.

If the bank manager has continual difficulty in obtaining meaningful, timely and accurate management information; if you are seen as being difficult to deal with or very time consuming; or if your account is frequently reported in the morning for being out of order, with covering funds being deposited later in the day; then they may fundamentally take the view that your account is more trouble than it's worth.

For any business with a marginal bank credit rating, the impact of any of the above, or any other problems, can then result in the credit rating falling further and the account potentially being transferred to the bank's intensive care department.

The impact of such a transfer is usually very serious for a business and guidance on how to handle this is given later on in this Guide.

Chapter 02
Dos and Don'ts

Introduction to the basics of managing your bank manager

Your bank manager is the intermediary between you and the organisation providing your business with finance. When a bank manager has confidence in your business, they will present it to the bank in a positive light, which places you in a stronger financial position. Should you lose the confidence of your bank manager, the opposite will apply.

'Dos and don'ts'

Fortunately, the basic requirements for managing your relationship with your bank manager are some straightforward 'Dos and Don'ts' and as such, pretty much common sense.

The 'Do's' are:

1. Take the time and trouble to build a good relationship with your bank manager.
2. Always highlight the strengths, successes and achievements of your business. These always exist but can sometimes have been over-shadowed. Discuss with your accountant or adviser.
3. Stay off your bank manager's radar, they are busy and will focus their attention elsewhere.
4. Provide requested management information and annual accounts in a timely manner.
5. Your bank manager will look at these figures very closely. So always review draft information and accounts thoroughly with your accountants or advisers before submission. Ensure everything possible has been done to ensure all the information given is both reliable and presents the most positive picture and that you understand and can comment upon what the figures are showing. Review your accounting policies and how the information is presented with your accountant or adviser and provide a commentary highlighting all positive aspects.
6. Enclose a forecast of your business's prospects going forward; this must be realistic but ensure that you highlight all positive developments and opportunities.
7. Consider if you personally believe your business's performance to be wholly satisfactory or if it needs improvement, in which case you should advise your bank that you will be consulting appropriate experts. Showing that you are willing to identify requirements for help and then to obtain it when required builds bank confidence.

8. In any area where the bank may have a concern provide a commentary that provides a positive and realistic explanation of the action(s) being taken to bring about improvement.
9. Pay careful attention to all bank communications and action promptly.

   Should a letter irritate or annoy you, leave it for one or two days before replying and then consider why it has been sent before responding.

   Should a letter be received that is unusually formal in tone, telephone your bank manager to seek guidance as to what it means and why it was sent. Ascertain whether it is just a standard letter or whether it has been sent as a requirement of a credit manager or credit department. If so, refer as soon as possible to your accountant or adviser and ensure your response specifically and constructively answers each point in the letter.
10. Use your bank’s internet service to check the bank account every morning, to ensure it is not flagged up at the start of the day due to items being presented for payment without available funds or facilities. If there is a problem, take immediate action to resolve it and advise the bank as soon as possible of ‘an oversight that’s already been sorted out’, or if this is not possible, to advise how the position will be covered.

Meanwhile, here are the ‘Don’ts’:

1. Do not make contact unless it is really necessary. If you do need to make contact, have a good relationship with your bank manager’s support person and if possible deal through them.
2. Do not send unrequested regular good news updates as this creates the impression that there are actually problems which you are trying to cover-up. Good news carries more impact when imparted as part of a scheduled meeting.
3. Do not let any bank request for the provision of financial information become an issue and turn into a bank concern. If there is to be any delay, advise the bank and tell them why, the action being taken, and the anticipated timescale.

To a bank manager, a failure to provide financial information when it's asked for is taken to mean it is being withheld because it is so bad it will cause concern. This immediately creates the very concern you may have been trying to avoid and your bank manager, fearing the worst, will have less confidence in your business.

Any reasons given for a delay in providing information must be credible to the bank, such as the accountant having had specific operational problems, you are changing to a new accountant, or a new accountant is having difficulty unravelling the mess left by their predecessor. A letter/email from the accountant will assist but the timescale given must be sensible, although a further credible 'problem' would be justification for an extension.

4. Do not make a formal complaint unless there is a real problem.

   Doing so to try and strengthen your position with the bank can often backfire, resulting in the business being unofficially labelled a troublesome customer, which the bank manager will then often seek to manage away.

   On the withdrawal of the bank manager's support, any negative information may then be highlighted, the bank's credit rating of the account reduced, potentially followed by transfer to the intensive care department.

   If there is an issue concerning the bank with a financial impact on the business, always seek to resolve this in discussion and negotiation with your bank manager.

5. Do not ignore any concerns your bank manager raises.

   Do not argue, dismiss or create conflict, even if you feel fully justified. It will be to your advantage to maintain a good relationship.

   Where possible, actively deal with and remove the concern(s).

When this is not possible, either:

→ Seek to convince your bank manager there is no need for concern, or

→ Spin the subject around, highlight positive aspects, demonstrate you are in control of the situation, explain it is really a minor matter and seek agreement that no further action is currently required.

Failure to manage your bank manager's concerns will usually lead to the relationship deteriorating and eventually to the loss of your bank manager's support. Early warning signs are:

- Correspondence changes tone, becoming formal and impersonal.
- Telephone communication becomes brusque, reduces, or ceases altogether.
- The bank issues formal letters of concern setting out the bank's concerns and the actions required by you. This is a very strong warning sign and usually marks a watershed in your banking relationship

It is too late to manage your current bank manager when:

- The bank's credit assessment has reduced the credit rating of your business account to a level where the bank will not allow management to continue in mainstream commercial banking; and as a result,
- The process of transfer to the bank's intensive care department has begun.

Case study

A gradual breakdown took place in the relationship between the owners of a large, profitable North West clothing manufacturing business and their bank manager due to:

- slightly lax control of the bank account;
- late provision of financial information; and
- the delay in the repayment of bridging borrowing;
- combined with a perceived unwillingness to take on additional bank products and services.

These differences were not resolved due to strong personalities and fixed views on both sides. Communications then stalled, following which the company made a formal complaint comprising multiple grievances, which was rejected by the bank.

Following engagement to improve the bank relationship the following steps were taken:

- A dialogue was established between the owners and the bank manager to address grievances and agree the way forward.
- A system for much closer account control was implemented and account conduct became fully satisfactory.
- Financial information was produced in a timely manner and provided to the bank within agreed timescales.
- A vacant factory, which was proving slow to sell, was let with an option to buy, making a cost saving to the business of both rates and insurance.
- All the points in the bank’s letter of concern were satisfied.
- Positive details of new contracts were provided to the bank.
- The bank manager had an in depth tour of the main factory to fully appreciate the condition of the equipment and the manufacturing process.

As a result of the improvement in the bank relationship, the bank:

- Upgraded the credit rating.
- Additional charges were cancelled.
- And a new loan to refinance bridging borrowing was given.

Chapter 03
Borrowing from your Bank

Introduction to borrowing from your bank

The availability and accessibility of bank lending to SME businesses has altered substantially since the impact of the credit crunch.

The terms on which banks and other institutions are prepared to lend, and the level of risk they are prepared to accept in doing so, have both changed.

So business owners looking to successfully raise funding now need to:

1. Decide what types of funding they want and what terms they will accept;
2. Understand the funders' current lending processes, how to deal with these and what terms they can realistically expect to be offered; and
3. Ensure that their businesses and proposals are 'credit ready' so as to have the best chance of success.

Why and how the landscape has changed

In the years leading up to the credit crunch, thanks to a wave of liquidity providing funders with money to put out and new sources of finance being developed (such as by the use of securitization in the smaller commercial mortgage market), restrictions on lending criteria relaxed substantially compared to what had been normal previously.

As a result:

- Leaving aside any underlying inflation of commercial property values, the levels of risk taken by lenders went up (for example, the loan to value achievable on commercial mortgages went up from 60% to 70% to 75% to 85%, while self-certification mortgages were available for businesses with adverse credit histories); and
- Driven by competition, rates came down.

At the same time, the banks looked to lower their costs by moving more and more lending decisions making processes onto automated/credit score driven approaches, reducing their need for expensive bank mangers.

There is now less money available within the system and the banks are facing regulatory requirements to carry greater capital reserves to match the risk of the loans they make. So their lending criteria have become much tighter, the credit approval process more rigorous and their terms more expensive.

At the same time the division within the banks between the sales function and the credit decision is (with a few exceptions) becoming ever stronger with a view to managing risk. This is reducing the level of discretionary lending and local authority, while the banks have little appetite for increasing costs by investing in more managers.

So the trend towards 'the computer says no' lending decisions is likely to continue for smaller loans, while the appetite of bank relationship managers to put anything other than the best prepared and presented proposals up to credit in larger situations will be limited.

What is achievable and what will it cost?

Borrowing money needs to start with a clear understanding of:

- what sort of funding is appropriate and what is likely to be 'doable' and
- what terms you are prepared to accept for the funding available.

The reality is that there is a 'new normal' in the world of lending which drives both what is achievable and how much it costs, that business owners have to deal with.

Appropriate and doable

Banks are not equity investors providing risk capital to your business. They are providers of:

- secured long term lending at conservative loans to value ratios for the purchase of business assets; and
- short term revolving facilities to cover temporary working capital requirements that then swing back into credit.

The new normal is in effect a return to old fashioned lending in this sense where only high quality (in banking terms) propositions can expect to be in with a chance of credit approval.

So what is a high quality application? Banking lending checklists are discussed later but essentially a proposal has to be:

- Well presented by a strong business and management team with a strong business case; and
- Appropriately structured requirements (such as matching of the funding term to asset life); with
- Strong security and an adequate equity element provided to cover the remaining risk; and
- Strong cash flows demonstrating clear serviceability.

If you are not confident in your ability to prepare the necessary documentation to the levels required to give your application the best chance of success, then you should seek help from your professional advisors.

Terms

As is referred to a number of times in this guide the lending world has changed enormously since the period before the credit crunch, yet some business owners still seem to be expecting funders to be providing loans not only at pre-crisis levels of risk, but also of pricing.

If seeking funding in the present environment you need to have a degree of realism about what terms you would be prepared to accept in respect of funding, both of pricing and of any additional security such as personal guarantees which may be requested.

What are lenders' current priorities and what does this mean for you?

Your bank manager's appetite to put your request forward

Given the changes and challenges being faced by banks discussed above, the key dynamic driving much bank behaviour at present is that the safer the loan, the less bank capital is required to back it. So if the banks have a limited amount of capital, it makes sense for them to apply it preferentially to the types of loans classified as safest. Hence you may see signs of the domestic mortgage market loosening while riskier lending to small businesses remains tight.

As already discussed, bank managers are employees with targets and personal positions and careers to look after, and so will seek to work in a way that looks after their own interests given current bank policies.

Current bank policies are (in general, there are always exceptions) a desire to maintain, not expand their books and to focus the use of their capital on the safest and most secure lending. In practical terms this means that bank managers will not be motivated to stick their heads above the parapet by putting forward applications for credit and will only support very strong applications with a good chance of getting signed off.

But funder appetites vary

It is usually easiest to seek funding from your existing banker as in theory they will know the business and be better placed to make a judgment on the risk involved in the proposed loan, as opposed to a new funder without that experience. After all this is in many ways the perceived benefit of relationship banking.

However, as relationship banking based around bank managers with discretionary powers to lend has fallen away, this benefit has in many ways fallen away as well.

Businesses however continue to approach their existing bankers with their funding requirements rather than testing the market more widely. While this is understandable, it is important to realise that:

- there is a wider funding market out there than just your existing provider, and
- different funders will take different views on funding requests.

Each funder will have its own policies, not just about what sectors it will or will not deal in, but also as to how much exposure it wants to a particular type of loan.

So if the Co-op has turned down your proposal to fund expanding into trading guns for tobacco, a major factor is likely to be due to their overall ethical policies and other banks may not have such bars.

However if any bank turns down your proposal for developing properties in your area it could be because that bank:

- has decided property development is too risky and does not want to fund the sector at all; or

→ it is happy to fund this type of development in general but just feels it has sufficient exposure to the type you propose in the particular geographical area you are looking at.

None of the above reasons for a decline have anything to do with the quality, viability or inherent bankability or otherwise of your proposed project.

So it is usually best to shop around to see what is available in addition to your own bank (either directly or using a finance broker or advisor who knows the market).

This then becomes particularly important if your bank declines your application. In these circumstances some businesses cease to explore their options, rationalising that if their own bank won't do the deal, then an unknown bank is less likely to do so. However this can be a mistake, since as illustrated above, the underlying reason for the decline may be largely unrelated to your individual application.

Bank processes

With some exceptions, your bank manager will not have the ability to approve your loan application themselves and will need to forward it to a credit committee for approval.

However in most institutions the relationship manager's write up and presentation of the proposal will carry some weight, particularly as lenders are increasingly wanting to focus on 'quality of management' as part of their criteria, and in particular this will tend to involve assessment of management's financial awareness and demonstrable production and use of management information.

Ensure you, your team and your proposal are 'credit ready'

You only get one chance to make a first impression, as the old saying has it, and as you will never get to meet anyone in the credit committee to discuss your request, your business plan/proposal has to speak for you.

As will also hopefully be clear from what has gone before, you are realistically only likely to get one shot at getting a proposal through credit committee in the present climate.

You therefore need to ensure your proposal is as well constructed as possible so as to give it the best chance of success.

When judging any proposal, a long established banking checklist is known as CAMPARI:

- **Character** – Does the lender see you as honest, credible and reliability?
- **Ability** – Do you and your management team have the necessary skills and ability to run the business and achieve the plan?
- **Means** – How much are you worth and do you have a history of making money?
- **Purpose** – What are you intending to do with the money? Is it a feasible idea, which matches funding against the need appropriately? Are you also looking to do something that the lender finds acceptable given its own policies?
- **Amount** – How much equity are you risking; and do you have enough to see the project through to completion?
- **Repayment/return** – How long do you need the money for and how is it to be repaid?
- **Insurance** – What sort of security is available to cover the loan from the business assets or you by way of a personal guarantee (PG) which may also be backed up by a charge over your personal assets (supported PG)?

It is worth noting the degree to which this checklist focuses first on the management team and how backable they are, before looking at the lending proposition itself, which points to the need to ensure you and your business and its management are backable, as well as the particular project for which you want finance.

Chapter 04
Bank Early Warning Systems and Business Deterioration

Introduction to bank early warning system and business deterioration

Businesses (generally) do not drop dead unexpectedly.

Those growing like a rocket sometimes also end up behaving like fireworks in other ways too, as they explode having been stretched too far by the pressures of overtrading, in both its financial and managerial senses.

But most business deaths are the inexorable result of companies succumbing to the long term and insidious effects of BPD (or Business Performance Deterioration), a condition which if left untreated, becomes first chronic, and then acute, at which point without an effective intervention, a rapid decline can set in which is often fatal.

The good news however, is that the earlier the condition is detected, the better it responds to early treatment, avoiding the need for more radical and risky surgery later on.

So from both the bank and the business's point of view, prevention is always better than cure and when there is a problem, early diagnosis usually helps in ensuring effective treatment.

Diagnosis of business performance deterioration (BPD) – FAQ

Should a slight deterioration in business performance be a cause for concern?

Most definitely – unless the cause of the deterioration has already been correctly identified and dealt with effectively.

Business Performance Deterioration (BPD) is usually caused by fundamental business problems such as changes in buyers' requirements, competition, costs, or the market place.

Unless the underlying problems are accurately identified and effective improvements implemented, BPD is likely to worsen until ultimately the business may fail.

BPD can occur gradually, can initially be masked by imprecise financial controls and may be compounded by a degree of complacency.

Delay in taking action can prove terminal.

How important is the speed of the response to BPD?

Absolutely vital. Any delay reduces the options available.

With fewer options the financial cost of BPD to the business rises substantially as can be seen in 'The Decline Curve' diagnostic illustration in this Guide.

The sooner BPD is recognised and turnaround action taken, the less damage is done to the business and the cheaper the solutions required, so in the case of BPD the old adage 'time is money' really does apply.

What action is recommended to screen for signs of BPD?

Thankfully, screening for early warning signs of BPD is possible and there is a self-diagnostic tool available by using the 20 question BPD diagnostic checklist later on in this chapter.

Business owners and their bankers should therefore undertake periodic reviews and maintain vigilance for BPD early warning signs as discussed in the next section.

Where BPD is identified, the business owner and banker should ensure a realistic turnaround plan is effectively implemented, which will frequently require the skills of a turnaround professional.

How do you recognise the symptoms of BPD early enough?

Depending on the underlying cause of the condition, BPD usually presents a range of symptoms which can act as early warning signs of its onset.

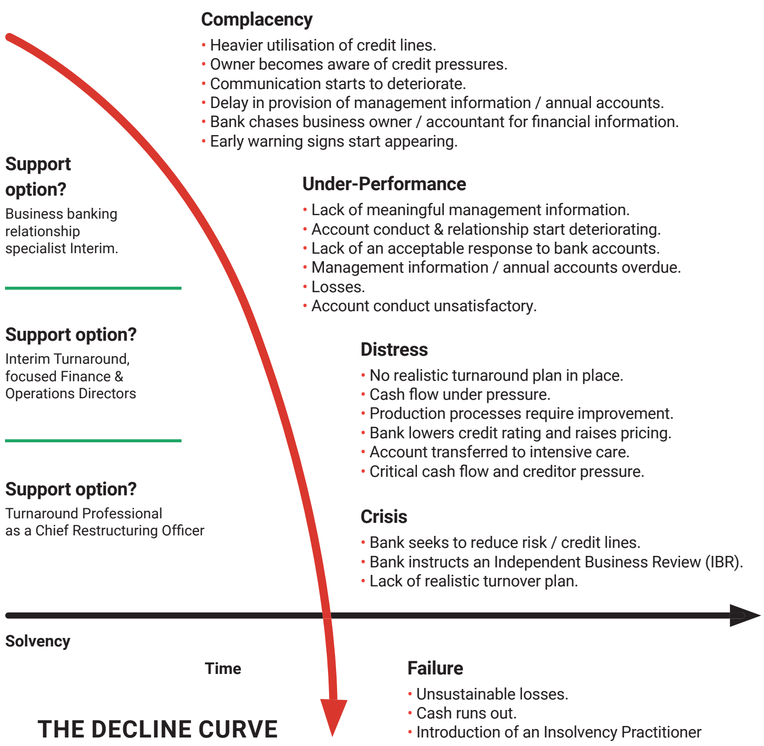
These can include:

- A lack of sufficient investment into the business to maintain efficiency and ultimately, competitiveness.
- Substantial reliance being placed on one customer or one project, in which case the business is taking excessive risks by placing all its eggs in one basket.
- The order book shortening as the market moves away and customers place orders elsewhere.
- Business owner disputes and/or key individuals leaving as individuals within the business begin to feel the stress and consider their positions.
- Provision of information requested by the bank is delayed, incomplete or inadequate, or simply ceases altogether as there is an unwillingness to recognise or share the signs of problems.
- What management information and/or accounts are provided show the financial symptoms of BPD such as declining turnover, margins, profits, stock turnover and asset valuations, and increasing stock levels, debtor days, creditors, and losses.
- Pressure from the Crown for payment of arrears of PAYE, NI and VAT.
- Pressure from trade creditors, credit lines restricted, and threat of CCJs or other recovery action.
- The overdraft limit is fully utilised and no longer swings into credit showing that a hard core of long term borrowing has built up as a result of cash pressure.
- The overdraft limit begins to be exceeded with unpaid items being returned, loan payments defaulting and arrears building up.

The decline curve

When a business has problems it can be difficult to notice at first as the symptoms may be minor and may be difficult to distinguish from the normal ups and down of the marketplace.

Once problems begin to be noticed however, it can then be easy to defer taking action because it will involve energy, time, expense and often difficult decisions. However, as time passes, turning a business around becomes more difficult as a decline can set in and become increasingly difficult to reverse as is illustrated by the decline curve.



BPD diagnostic 20 question checklist

		Yes	No
Banking relationship			
1	Is bank account conduct fully satisfactory?		
2	Are annual accounts and management information provided to the bank in a timely manner?		
3	Is the business maintaining profitability?		
4	Does the business have a credible action plan to achieve its future objectives and to deal with any changes in the market place?		
5	If profits are declining or negative, is a turnaround plan in place?		
6	Does the business have a good credit rating with its bank?		
7	Do the business owner and banker have an excellent relationship?		
Cash management			
8	Is cash flow sufficient to meet all current creditors as they fall due?		
9	Are payments to the Crown for PAYE/VAT up to date?		
10	Are cash flow forecasts produced?		
11	Will sufficient cash be available over the next 12 months?		
12	Are debtors payment timescales within the industry norm and is the debt collection process efficient?		
13	Are profit margins monitored overall and specifically on products and customers?		
14	Are budgets set to monitor costs and variances investigated?		
15	Does the business have a Finance Director?		
Operational performance			
16	Have the stock and stock levels been reviewed and optimized?		
17	Has stock procurement strategy been recently reviewed?		
18	Have stocking processes been reviewed and optimized?		
19	Have production/service processes been reviewed and optimised?		
20	Does the business have an Operations Director?		

Assessment of the BPD diagnostic

Any 'No' answers indicate areas that are either under-performing or are unsatisfactory and require immediate attention to halt any further decline.

It is important to realise that a business cannot overcome BPD simply by treating the symptoms such as cash flow pressures as this provides only temporary relief.

To successfully treat BPD and prevent a future recurrence the underlying causes of the condition have to be addressed. A successful turnaround requires a more in-depth solution by identifying and solving the problems that are creating the symptoms.

It is vital to act promptly because with the passing of time the available options diminish.

Sources of treatment for BPD

There is a range of professional support available, and the appropriate level of help or intervention for businesses with BPD will depend on the stage the condition has reached and the severity of the symptoms.

Stage of BPD	Professional advisor	Service provided
Complacency	Accountant	Production of appropriate management information
Under-performance	Consultant	Business improvement
	Turnaround professional	Business performance improvement
Distress	Turnaround professional	Business turnaround and financial restructuring
Crisis	Turnaround professional	Financial restructuring and business turnaround
	Investigative accountant	Business viability review
Failure	Insolvency practitioner	Business wind up

How a good business banking relationship helps in the treatment of BPD

To maintain success when the economic climate becomes more challenging and to seek to out-perform competitors, it is necessary to continually perform better and more efficiently. In effect, it is necessary to 'run faster to stand still'.

So for business owners and their bank managers to both achieve their individual objectives, it is therefore more important than ever that they work together to forge a strong partnership which is mutually supportive and will engender a win/win relationship.

The benefits for the business owner of a good business banking relationship are primarily:

- Maximum possible bank support including guidance, advice and financial assistance.
- Company information is likely to be viewed in a positive light, which is a plus factor when the bank manager undertakes a credit appraisal of the business and/or seeking approval for additional facilities.

The benefits for the bank manager of a good business banking relationship are primarily:

- Easier management of the relationship.
- Greater opportunity to increase business, grow income and maximise the provision of services/products.

The requirements of a good business banking relationship

A successful relationship is a two way street and relies on each party understanding each other's basic needs and, as far as possible, meeting these.

What is required from the business owner:

- Account conduct
  - Daily monitoring of the account to ensure no problems.
- Financial information
  - Knowing what the bank requires and providing it on time.
- Cooperation
  - Working with the bank to achieve positive outcomes.
- No surprises
  - Ensure bank informed promptly of any significant news, developments or changes.

What is required from the bank manager:

- Know the business
  - Understanding of the business's dynamics and cycles.
- Transparency
  - Clear communication and explanation of any bank concerns.
- Proactiveness
  - Services and products recommended as appropriate to meet different business needs during periods of growth, consolidation, contraction or deterioration.
- Responsiveness
  - Assistance provided in a timely manner.

Business banking relationship breakdown (BRB)

Unfortunately, one of the side effects of BPD is often a breakdown in the business banking relationship.

There can be specific disagreements which lead to a business owner and their bank manager 'falling out', but usually relationship deterioration is caused by the personal pressures and worries of a business owner stemming from the impact of BPD and the consequent reaction of the bank manager.

This is typified by a disconnect in communication, misunderstandings, mistrust and resentment.

In severe cases the relationship can gradually worsen to a level where it becomes a barrier to the implementation of a realistic business turnaround plan. The end result is often a stalemate of non-cooperation resulting in the least favourable outcome for both parties.

The symptoms of BRB

There may be passive symptoms of BRB such as a business owner entering a state of denial, putting their head in the sand and becoming evasive.

There may be more aggressive symptoms such as the bank being accused of errors or lack of support and heated exchanges may ensue.

Faced with a difficult relationship the banker may become somewhat distant and so appear uncaring, or may proceed on a more formal basis and appear impatient.

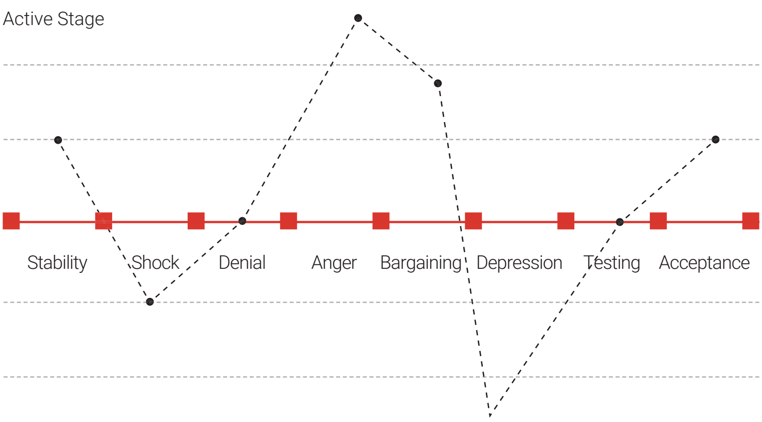
The causes of BRB

When facing BPD, business owners who are committed to their businesses not unnaturally tend to feel a range of emotions including disappointment, frustration and anger at business reversals.

These emotions are then often exacerbated by the stress induced by the impact on them of BPD, which not only affects the business owner's financial position but also hurts their personal pride in their business achievements. It can create deep embarrassment from the sense that their standing has been undermined in the eyes of their family, business contacts and community.

Dealing with severe BPD is akin to grief and can involve going through a number of emotional stages which the banker involved in the situation will need to be aware of and deal with appropriately and sensitively.

Grief or Change Curve



In dealing with grief or significant change, people go through a series of stages typically:

- **Shock** where they are initially paralysed at hearing the bad news.
- **Denial** where they try to avoid facing up to the inevitable.
- **Anger** where there can be a frustrated outpouring of bottled-up emotion.
- **Bargaining** in which they seek in vain to negotiate a way out.
- **Depression** as they finally realise and accept the inevitable.
- **Testing** as they seek a realistic solution.
- **Acceptance** when they finally find the way forward.

As can be seen, anger and denial are significant early stages in the process.

In the case of dealing with BPD it is therefore easy to see how these can result in the business owner refusing to accept and admit to the situation; or finding the bank as one of the easiest scapegoats to blame in looking for answers and trying to explain events and apportioning responsibility.

Which is not to say that banks do not make mistakes in handling customer accounts.

Avoiding BRB

Particularly in hindsight, bank action to help a customer is often seen to have been taken quite late in the day.

Currently most customers beginning to suffer from BPD are effectively left to their own devices and to fend for themselves, while relationship bank managers do not automatically, or rarely, make their customers aware of the turnaround help that is available to them.

Since the problems and causes of BPD are less threatening and easier to resolve in their earlier stages, this makes the treatment required more difficult when it is eventually required. It would therefore appear to be in the banks' own financial interest to intervene with help further up the decline curve.

Earlier intervention, perhaps presented as business performance improvement advice, can therefore reduce the level of potential conflict and emotional intensity involved, compared to the levels that can arise in a distressed or crisis situation, and so avoid the risk of BRB.

In addition, particularly in the current economic and political circumstances it might also appear to be in the bank's own reputational interests to be seen to be actively supportive of SME customers in trading difficulties; and to not only identify signs of BPD but to also help the customer by strongly recommending as early as possible that turnaround action be implemented without delay.

Banks should therefore consider:

→ What support does the bank give to customers facing trading difficulties?

- How early does an intervention happen?
- Are good book customers made aware of the support available from Turnaround Professionals by their relationship managers?
- Does intervention only ever happen on or after a transfer to intensive care?

If proactive intervention to help customers in difficulty as early as possible is not happening within good book then the bank should take steps to improve its capability to intervene and help business customers before the need arises to transfer accounts to intensive care.

The cure for BRB

Good communication is the key.

Conflict is damaging to all involved and a resolution of differences meeting must be held, if not to accept, at least to understand each other's point of view and agree the benefits of working out a way forward.

To be successful, both parties will need to:

- acknowledge the downside of a relationship deterioration;
- put any personal differences to one side and make the effort to see the other's point of view;
- accept any inevitable aspects;
- focus on damage limitation and cooperate for mutual benefit on reaching an agreement on, however painful, the best possible mutually acceptable outcome to a difficult situation.

This is an area where experienced turnaround and banking relationship advice on the customer's side can help facilitate the process enormously.

The business owner's worries need to be addressed with information, explanations and guidance on how events are likely to unfold.

Pressures can be lowered by discussion, clarification and agreement on the actions to be taken by the business owner and by the bank.

Help in managing relationships and mediation, cash management and operational efficiency can be obtained from turnaround professionals.

Case study

Business Performance Deterioration (BPD) was experienced by a North West company distributing specialised non-alcoholic drinks to top-end leisure sites.

The symptoms of BPD were recognised only when cash flow dried up, leaving the company unable to meet its commitments to the bank and to its suppliers.

The bank reduced the company's credit rating, transferred the account to the bank's intensive care unit and in light of a perceived increase in risk, increased the overdraft debit interest rate and introduced a monthly management fee.

The cause of the BPD was under-investment combined with vulnerability to small margins, compounded by a gradual on-going expansion leading to over-trading.

The early warning signs were there for the bank manager to see but were not picked up. If a review had been undertaken by the bank or the business owners, such as the BPD diagnostic 20 question checklist, the impending problems would have been instantly flagged-up and solutions could have been put in place well before the problems became critical.

The business owners were unaware of the approaching crisis due to their preoccupation with sales, operational matters and personnel issues. There was also a degree of complacency due to the gradual nature of the increase in BPD.

Following a review of the options available to the company and its position on the decline curve, a turnaround plan was drawn up and successfully managed, as detailed below:

- The two directors borrowed personal funds to make temporary cash injection.
- A good relationship with the company's bank manager was established and maintained.

- The bank agreed to a three month temporary increase in the overdraft limit.
- The bank also agreed to a three month repayment holiday on the four loans.
- Negotiations with creditors ensured no supply problems.

Having dealt with the immediate cash flow pressures, steps were then successfully taken to secure longer term funding and an excellent relationship with the bank manager:

- A negotiation took place over several weeks and three meetings with the company's main supplier, finally resulting in agreement to an improved contract and improved terms of trade.
- Individual customer profitability was reviewed and the least profitable discontinued.
- The bank agreed to reschedule security, taking a charge over a new property and releasing their charge over a property which was refinanced, funding a further capital injection.
- With financial figures based on growth projections two government sponsored business expansion loans were obtained, secured on second and third debentures over the company.
- The bank account was monitored daily to ensure it was conducted satisfactorily.
- New annual accounts, in which the directors had taken a reduced dividend, showed a net profit, with management information projecting an increase in profit levels based on increasing turnover.

Following a total of six months in the bank's intensive care unit the company's account was upgraded, returned to mainstream commercial banking and the monthly management fee cancelled.

Chapter 05
Intensive Care Banking

Introduction to intensive care banking

As discussed in our guide 'Understanding Your Bank Manager', your relationship bank manager is the intermediary between you and the organisation providing your business with finance.

When a bank manager has confidence in your business, they will present it to the bank in a positive light, which places you in a stronger financial position. Should you lose the confidence of your bank manager, the opposite will apply.

It is however too late to manage your current bank manager when:

- The bank's credit assessment has reduced the credit rating of your business account to a level where the bank will not allow management to continue in mainstream commercial banking; and as a result,
- The process of transfer to the bank's intensive care department has begun.

You then need to manage a very different situation and deal with an intensive care manager who will have a specific and more proactive agenda than you will have experienced in your good book banking relationship so far.

Moving into intensive care

Failure to manage your bank manager's concerns usually leads to relationship deterioration and loss of your bank manager's support.

Early warning signs of the correspondence changing in tone, becoming formal and impersonal, and telephone communication becoming brusque or ceasing altogether can eventually lead to the bank issuing a letter of concern.

This is a very formal letter listing the bank's concerns and the actions they require you to take. The number of such letters you receive will depend on not just your bank manager, as their local credit manager or central credit department may instruct they are sent. This is a very strong warning sign and usually marks a watershed in your banking relationship.

If you receive a letter of concern which does not contain the consequences of non-compliance, it may not be too late to rescue the situation.

At this juncture it is pointless to look backwards at what has happened historically and comment on the customer view of the relationship.

Receipt of such a letter should be treated as a severe reality check of the state of the banker/customer relationship, and if it has not done so already, the bank is very likely to imminently:

- Adjust the company's bank credit rating downwards;
- Take a much harder line in requirements and consequences; and
- Begin to transfer the management of the account to its intensive care department.

What happens if your account is transferred to an intensive care manager

For this guide we will use the term intensive care manager because whilst each bank uses its own terminology to describe the function, such as Business Support, Special Situations, or Restructuring, this is the most accurate description.

In this guide we have also used the term credit rating for ease of understanding by non-bankers. Within many banks however a grading system is used, so when the standing of an account falls, bankers refer to it as having been downgraded.

Not only do different banks use different terminology, they also have slightly different systems and procedures for dealing with downgraded accounts.

In most banks, the responsibility for a downgraded account will pass from your mainstream manager to a specialist intensive care manager who will be an experienced banker, responsible for a relatively small number of customers.

A minority of banks will however leave some or all downgraded accounts with the original managers in mainstream commercial banking, although intensive care managers will give guidance and therefore the fundamentals in managing the relationship as described in this guide remain broadly the same.

An intensive care manager is given a range of targets but the three basic objectives are to:

- Reduce the risk to the bank – this is usually achieved by a combination of reducing or cancelling facilities such as overdrafts, charge cards and trade lines, obtaining repayments and seeking additional security.

  Generate income – primarily from fees, bearing in mind the higher level of attention that the account will be receiving from highly experienced bankers and the higher risk nature of the account. When calculating a department's income, some banks also include an element of the income value retained from accounts rehabilitated to mainstream commercial banking.

  Many banks will use a pricing matrix to set their monthly fees, often based on a percentage charged on the value of all the bank facilities including any invoice finance, asset finance, or trade lines.

  While the level of these fees are usually closely monitored by the bank, the terms of payment may be more flexible.

  For example, it may be possible to negotiate agreement that monthly fees can be rolled-up to assist cash flow. To do so usually requires an understanding of the bank's position and the ability to present a suitable case providing sufficient justification, an example might be so as to match the rolled up fees as a lump sum to be paid out of an asset sale's proceeds. However there is always the risk the bank may then ask for a slightly higher rate to make the proposal attractive.

Actively manage accounts out of the intensive care department – ideally this will be by way of managing a turnaround and so upgrading the account back into mainstream banking.

Alternatively it can be by exiting through achieving a rebanking elsewhere, refinancing, or asset sales (hopefully involving full repayment); or from an insolvency process.

In this context it is worth noting that a turnaround in these terms consists primarily of satisfying the bank's concerns, and not addressing business underperformance or inefficiencies.

Too often the first notification to a customer that the management of an account has been transferred to a bank's intensive care department, is when an extremely formal letter of concern is received from the newly allocated intensive care manager. And often, the fact that the relationship manager has not been in touch or made the customer aware of an issue, is a source of considerable resentment by the customer.

The intensive care manager's initial letter of concern will usually:

- List the bank's primary concerns and then, to strengthen the bank's position and the justification for its actions, often includes any other areas of concern the bank may have, even if these have not been previously advised or highlighted to the customer.
- List the actions the bank requires to address its concerns. This may include the revaluation of security, requirement for additional security and/or the commissioning of an Independent Business Review (or IBR, see later chapters).
- List the consequences of its concerns not being addressed.
- Provide notice of any reductions or cancellations of facilities.
- Provide notice of an increase in pricing, often involving an increase in debit interest rates and the introduction of a monthly management fee which can be substantial. Any subsequent facility renewal fees will usually be charged at a much higher level.

The tone and content of the letter of concern can come as a huge shock.

Unfortunately, many mainstream bank managers find it too difficult a task to advise the actions the bank is taking and leave it to the intensive care manager to explain that:

- The credit rating has been slashed;
- Facilities will not be increased (and will most likely be reduced); and
- Pricing will be significantly increased.

Having been labelled ‘intensive care’, for an account to qualify for a turnaround back to mainstream commercial banking it will be necessary to address:

- All the concerns; and
- All additional concerns

There can be a substantial initial disconnect between the bank and the customer, who does not understand why the bank’s position has hardened so much.

It is pointless to rage against the letter of concern, which will not be changed or amended.

Accept the position, move on, and focus on extricating the account from the intensive care department at the earliest opportunity.

Chapter 06

Surviving an Independent Business Review

Introduction to surviving an independent business review (IBR)

Many businesses find their relationship with their bank stretched at the moment and, as a result, the perception may be that the bank is not being supportive and in some cases is moving, or has moved, into recovery mode.

So if you are told by the bank that they wish to instruct a firm of reporting accountants to carry out an Independent Business Review (IBR) a number of questions will probably come immediately to mind:

- What is the bank's agenda?
- Is this the end of the relationship, or even our business?
- What input will we have into, and control of, the process?
- What are the likely outcomes? and
- What will it cost!

It is important to make no mistake about how serious an IBR is for the company; since with the wrong findings, an IBR can be the tipping point that crystallises a potential business failure.

However, a successful IBR can provide a real opportunity to help you to improve your business, set it on a firmer footing and rebuild the relationship with the bank.

So if faced with an IBR it is vital that you both understand and manage the process to obtain the best result.

Avoiding an IBR in the first place

Many directors' first reaction to such a request is to ask themselves why the bank needs this type of review to be carried out.

The answer usually lies in a series of failures to deliver information or performance on their own behalf which has led the bank to ask themselves what is actually going on.

The preventative steps a board can take can be split into two types:

- managing the relationship; and
- doing the simple things right.

From the bank's perspective your account is one of a portfolio of relationships a corporate manager has. If the relationship is properly managed in an open and collaborative way there is every chance you will fly 'under the radar' and even minor blips will be easily dealt with and overcome.

A key part of managing your relationship with your bank involves keeping their confidence in you and your management of the business and its numbers.

So if your account is one that comes up on a regular basis on watch lists for overdue diary dates for the supply of agreed financial information such as management accounts or forecasts, or regular breaches of lending covenants, there is little doubt that you will soon become a cause for concern.

In these circumstances the bank may then seek a review both in order to ensure it understands the financial position, as well as to investigate the reasons for the problem.

However, given the number of businesses that the banks deal with and the volume of accounting information that they see across all business sectors, it is also important to remember that the banks have some quite sophisticated 'credit scoring' and benchmarking systems in place. These are intended to enable the bank to spot warning signs of potential business problems as early as possible, so that they can begin to manage their levels of risk before any problems become serious.

In some cases therefore the bank's requirement for a review will be triggered by a concern about the business's underlying trading performance. Often the bank will, through its systems, become sufficiently concerned to start to look hard at the account, well before the company's directors realise that there is, or is perceived to be, a potential problem.

But remember that the bank is a business that is looking to earn profits from a relationship with its customers. So, from the bank's perspective your business is valuable to them. The modern banking world is competitive and it requires a lot of time and energy to bring new accounts into a portfolio. It therefore follows that banks will be reluctant to lose a relationship and that they will do everything they can to keep things on track.

So directors can, by doing the simple things right, mitigate the risk of being forced into a potentially damaging and challenging process by:

- Maintaining a regular and professional dialogue with your bank;
- Providing management information on time as agreed with the bank and ensure it is accurate;
- If you promise to do something, do it, or communicate the reasons why you can't;
- And if there is the possibility of a problem ahead discuss it with the bank at the earliest opportunity.

How banks manage their relationship with you

All banks operate by giving staff the ability to deal with their customers up to a specified level of authority or discretion.

When the relationship between banker and customer is working well, there is usually little interference in the relationship between the bank manager and the customer for any item within the manager's discretion.

Where a customer has a requirement that goes beyond the manager's level of authority then this will generally be referred upwards for decision by the relevant credit committee.

However, when the bank's systems flag up a relationship as being a potential concern, for one or a combination of the reasons set out above, the first stage is for them to move responsibility for the management of the relationship either up a level, to a more senior manager, or across to a new manager in a specialist intensive care or business support department.

This change in itself tends to create issues as a new individual, with little knowledge of the business or individuals involved, takes over. They will initially form an opinion of the relationship based on what he or she sees on the bank's files and once they have completed this initial appraisal the relationship manager will usually introduce them to the company's directors.

It is at this point that the immediate future strategy is usually decided and is generally the first point at which the new manager considers whether they want to instruct an IBR.

There are a number of points of guidance for this initial meeting which are extremely important:

- Find out what the bank's agenda is and what it sees as the reasons for this escalation in supervision. Establish if the bank's concerns can be allayed at this stage as it is not unknown for the bank to have misunderstood the position!

- Listen to and ensure you understand what the bank is looking for and try to agree what is reasonable, what isn't, and how it will be delivered.
- Don't be afraid to assert your position and contribute to an agreed plan of action rather than just going with the flow.
- Understand what the additional costs are, what the timescale of the intensive care process is, and what the criteria are for a return to a mainstream banking arrangement.
- Ensure you communicate that you have a business plan to which you are working and look to see how this matches the bank's requirements for the return to a mainstream relationship.
- If commitment to provide information or deliver performance is required by the bank, ensure you both clearly understand every point and are confident they can be met. If not, negotiate.

If as a result of this meeting, or any later development, the bank does require an IBR, it is important to appreciate what will be involved in managing the process and its seriousness for the business.

In all of the above, the better you can appreciate how your business is being assessed by the bank in terms of, for example, security calculations, as well as more generally in terms of the bank policies, processes and priorities, the better you will be able to manage the discussions and work with the bank to obtain the best result for both sides.

If this is not something you are familiar with then you should strongly consider seeking some support, either from your existing advisers, or from specialists in this field.

Before the review begins

The ultimate aims in dealing with an IBR have to be:

- for the review to be as smooth, efficient and collaborative as possible;
- to ensure that the day to day running of the business is not disturbed unnecessarily by the review; and
- to obtain the optimum result for the business in terms of both:
    - ongoing bank support; as well as
    - input into the business's strategy and performance (after all if you are paying for a review then you need to ensure you obtain best value from it).

Preparation is the key, both to ensure you have everything ready for the reporting accountants, and that your management information is up to date, accurate and reliable; as well as to be in a position to present a credible plan for returning the business to 'good book'.

Whilst there is a danger in over preparing which could use up time and resources unnecessarily, it is important that you ensure that not only is the information required available when the review work commences but that you have reviewed it, understand it and can explain it to the reporting accountant. It is very common for the directors to present reams of information but when questioned by the reporting accountant, are unable to explain it!

Most IBRs will be confirmed by an instruction letter issued in advance by the bank which the director(s) will be asked to sign. It is important that you satisfy yourself that the letter confirms what has been agreed in terms of scope, responsibility and timescale.

The letter will also usually contain a list of information to be provided and confirm both the fee agreement and the mechanism for payment. It goes without saying that this letter should not be signed unless agreed. Don't hesitate to question any areas that are either unclear or at variance with your understanding of what has been agreed.

As stated above, the engagement letter usually includes a list of information required by the reporting accountant. It is important to ensure this information is provided on time and in the right format. Misunderstandings at this stage can often lead to problems later on in the review process so are best avoided.

Ensure there is clarity of communication between the bank, reporting accountants and yourself. Many IBRs have been seriously inhibited because the three parties did not either agree or stick to reporting lines. Establish a regular line of communication with the reporting accountant but leave them to get on with their work. At the same time ensure the bank is able to speak to you when they need to, before, during, and after the process.

Do not forget to manage the message with staff. IBRs usually take place at a time of uncertainty for the business and staff will naturally be nervous even before the men in suits arrive. Failure to communicate internally will without exception exacerbate the difficulties the business is facing.

It is therefore important that the management group agree the message to staff and deliver it before the review commences and maintain the internal communication as the process continues. Whilst there will inevitably be confidential and sensitive discussions which cannot be shared, this process, properly managed, will pull staff together and focus them on the objectives necessary to take the business forward.

And finally, keep notes of meetings as this will be invaluable during the process where inevitable disagreements arise.

The IBR process

It is important that all parties are clear on the scope of the review as set out in the initial engagement letter and that this is referred to regularly during the process.

The engagement letter and the associated discussions should have established the specific areas of responsibility. It is fundamental that during the course of the field work the right balance is struck between being available to the reporting accountants as they require and not interfering.

A brief discussion at the start of each day to establish an outline plan is in our experience simple and effective. Remember that there is still a business to run during the course of the review.

The timescale should have been agreed in advance but will inevitably flex as the process runs its course. Whilst it should not detract from the outcome of the review, a failure on behalf of the management team to provide information on time will create a poor impression of management's efficiency in the minds of the reporting accountant.

It is normal for the cost of the review to be fixed in advance but the engagement will usually allow flexibility if additional work is needed. IBRs are not cheap and it is a fundamental contradiction that at a time when cash is tight, the business is faced with a significant additional cost. We would therefore advise that great care is taken in ensuring costs are managed very carefully.

Once the fieldwork is completed the reporting accountants should sit down with the management team to give an overview of the report's findings and set out the next steps. If the reporting accountants are reluctant to communicate at this stage seek clarification of their agenda and timescale.

It is common practice for the reporting accountants to produce a draft report for discussion with the company's management team prior to finalisation.

This provides a good opportunity to iron out any factual inaccuracies, identify any areas of disagreement and give management a flavour of the report. From the reporting accountant's perspective they will be keen to get consensus and buy in to the report and should seek to be cooperative at this stage.

However not all of the report may be made available for review sections, such as the bank's estimated security cover, and the reporting accountant's recommendations to the bank, are often kept confidential.

In practice, experienced advisers in this field can usually create an estimate of what these sections are likely to say based on the draft report which can obviously assist the business in any negotiations which may then follow.

The immediate post review phase

The best advice in the immediate post review period is Don't Panic.

As discussed, it is usual for the reporting accountants to provide a first draft soon after the completion of the fieldwork. There will however then be a period between this and the production of the final report which usually results in a meeting with the bank and the reporting accountants to discuss the findings.

This period can be a time of great anxiety and uncertainty for the management team, however it does give time to consider, based on the review copy of the report that you have seen, what your strategy for any discussion with the bank should be.

Having a structure to this post review thought process will help prepare for action when the report is issued and key points to consider are:

- What issues were discussed in the completion meeting? Do you agree with them and if you do, how can you begin to deal with them immediately? Being able to demonstrate action has already been taken by the time the follow up meeting with the bank takes place is often a big positive step.

- Plan what you propose to do in the short to medium term. The structure of a 30-60-90 day plan is always a good start. There will be no expectation that all the issues can be fixed in a few days but a recognition that the issues are being addressed and a structured plan is in place will again creative a positive impression.
- Analyse who are the recipients, what their respective agendas are and how you need to deal with them when they receive the report.
- Be patient. Do not worry if you don't hear anything from the bank or reporting accountants in the period between the completion of the fieldwork and the scheduled date for issue of the report. But do be proactive in chasing the report if it is not issued on time.

The report

IBR reports can come in many different varieties and styles.

Much time and money has been spent agreeing standards between the banks and the reporting accountants.

There will inevitably be a lot of analysis, some jargon and as a result of the wide ranging nature of the bank's general instruction letters, some sections which may be irrelevant to your business or situation; so a disciplined approach will be required to analyse this report.

A view from an independent professional with experience of this work at this stage will often be invaluable.

Whatever you are presented with, the key areas you should ensure you focus on when reading it are:

- Check and challenge the report. Are the numbers correct? Does the report fairly reflect what was discussed at the exit meeting? If not act to clarify immediately.
- Concentrate on the substance which will be the recommendations as to business strategy and performance issues; and don't be distracted

by the extraneous detail. What are the key conclusions and points of the report in so far as they are disclosed to you? What strategies or business improvements are being recommended? Do you agree with them? Form your own view of these recommendations and if you disagree with them, prepare your arguments and supporting information with which to counter them.

- Form your own opinion of the report and discuss with the reporting accountant as necessary.
- Ensure you understand the bank's likely position in response to the report, including consideration of their likely estimated security position. Obtain specialist advice if required to help you assess this and prepare your position.
- Integrate and refine the plans that you have put in place since the review was completed, ready for the bank meeting.
- Prepare for the follow up meeting with the bank ensuring the report that will be used as the basis for discussion is an agreed final version.
- Set your own agenda for the meeting and what you want to achieve from it. It is important to take control of the process at this stage so establish key performance indications (KPIs) and benchmarks for discussion and agreement at the review meeting.

Remember it is important to the bank and the reporting accountant that they have added value by preparing this report. They will need to receive this vindication from the client company at this stage. Use this to help you to get what you want out of the report process.

Agreeing a strategy

We have already discussed the importance of being pro-active in planning the work required following the review.

Whilst the bank and the reporting accountants will have considerable input in helping you to shape the business's strategy, neither party are directors of the company and will not have the responsibility to deliver implementation.

It is easy to say from the outside 'this needs to be done by then' but it is a completely different thing to implement it. There therefore has to be some negotiation when considering the review and arriving at a practical final strategy.

At this point it is useful to remind yourself of the bank's agenda. The bank will want to see their customers flourish and grow and will, in the majority of cases, want the review process to be a jumping off point for recovery and growth. They will want to see a strategy that is positive for the business and is realistic, measurable and achievable.

It is also vital to have the buy-in of key stakeholders to the strategy and care should be taken not to commit on behalf of third parties until you are happy that what is required can be achieved.

When finalising the strategy, care should be taken that the bank agrees the reporting timescale and content for the short to medium term and that this can be met.

And finally, don't forget to communicate the strategy agreed to employees and shareholders as applicable to achieve their support and buy-in.

Implementation of the strategy

Many, many business reviews have concluded with a real determination on the part of the directors and management to turn things around and use the review as a basis for real change and improvement.

But then the immediate enthusiasm fades as the pressure from the bank is perceived to have eased and the reality of implementation and the hard work hits home.

This then comes to a crunch when the directors receive the call/email from the bank wanting to follow up on the report and assess progress.

In order to achieve effective implementation and real recovery and growth additional resources are often required. This can range from an independent professional being a critical friend monitoring progress and providing guidance and advice, through to 'hands on' support in delivering the change, or assistance with finding new or alternative sources of finance.

The cost of this type of support will often be an issue for the business, and indeed is one which, together with issues of independence, often precludes the reporting accountant who will usually be part of a Top 10 accountancy practice (as these provide the 'panel firms') from fulfilling this role.

But this type of support can deliver real business value in both demonstrating to the bank management's desire to implement the necessary changes, which is important for maintaining and growing the bank's confidence in the business, but also for actually implementing the changes.

We would advise all directors to consider talking to K2 Business Partners at this stage, if you have not already done so earlier, as we are able to provide this support and have significant experience of delivering in such situations.

Case study

The company undertook specialist construction contracts in different sectors under different business names, but also had many property development situations.

The financial director had resigned, its management accounts were three months behind, the managing director had no idea whether its contracts were making money, the bank account was up at its overdraft limit, there were substantial disputes arising over the property development situations, and to cap it all the company was facing an employment tribunal claim from a dismissed employee.

The bank commissioned an IBR to understand the company status, its prospects and where the bank should continue to support it or not.

In order to produce information to enable the IBR to be conducted the business brought in, with the bank's help, experienced advisors to work within the company who were able to:

- Rapidly bring the accounts up to date;
- Get cash under control;
- Investigate each contract to establish its profitability;
- Produce meaningful business forecasts;
- Enable the reviewer to complete their review.

As a result of this work and joint discussions between the company, the bank, the reviewer and the supporting advisers, the company was able to:

- Regain control of profitability going forwards.
- Devise a strategy to divide the business up into separate trading and asset holding entities, so that each part of the business, and its relevant risks and assets, could be properly managed.
- Obtain the support of its bank to this strategy.
- Recruit in a new permanent financial director to both help implement the changes required and to properly manage the finances.

The group is now highly profitable and successful with substantial cash reserves.

Chapter 07
Managing in and out of Intensive Care

Introduction to managing in and out of intensive care

It is very important to build a good relationship with your intensive care manager who is usually highly experienced, reasonable, and wants to work with you.

As a bank manager, all the basic rules about managing your relationship with them still apply, so we have included our Dos and Don'ts list in the next section.

The starting point for dealing with them is likely to be the contents of their letter of concern.

Telephone your intensive care manager to acknowledge receipt of their letter of concern and request a meeting to explain how the bank's concerns will be addressed.

In doing so, ensure you do not come across as either defensive or aggressive. Instead ensure you present yourself as a reasonable person to deal with and make it clear you want to work with the bank to resolve the issues.

In this, of all meetings, first impressions will count.

At your meeting:

- Go through the letter of concern point by point and, in order, discuss each concern.
- Provide specific answers and be constructive and convincing. Provide assurance that going forward they will be remedied or set out a credible turnaround plan.
- Explain how your business functions. Seek to engage their interest in your business.
- Be forward looking and exude a very positive attitude.
- Discuss any proposed increase in pricing. The bank can impose increases but would normally prefer these are reached by agreement.

Try to negotiate both the quantum of the increases in terms of rates and charges, and their terms. It may be advantageous for example to request regular fees be rolled-up and applied at a time more easily accommodated by the business cash flow.

- Agree that either the intensive care manager, or if necessary yourself, will provide a letter setting out:
  - What you as the customer have agreed to do and the timescales.
  - What the intensive care manager has agreed, particularly in terms of what action you need to take, such as a specified period of satisfactory account conduct, following which the account will be upgraded and returned to mainstream banking.
- If your intensive care bank manager raises the idea of commissioning an Independent Business Review, see the later chapters for guidance on the steps to take.

Once the initial meeting is dealt with and the respective actions are agreed, you then need to both complete the actions you have committed to and manage your relationship with the intensive care manager as set out in the next section.

The basics of managing your intensive care manager

The 'Do's' of managing the relationship are set out below:

1. On meeting your new intensive care manager for the first time remember, it is not their fault you are where you are. They had probably never heard of you, or your business, until a few days before.

   This is your first opportunity to start managing your intensive care manager. Ensure you are properly prepared for the meeting, are positive, discuss the way forward, and establish a good rapport.

2. Try to interest the intensive care manager in your business. Provide a brief history, highlighting past successes and achievements to evidence your business acumen. Explain the causes of the subsequent deterioration in business performance. Outline your plans for turning around the business.

   Your aim is to start building up your intensive care manager's support for you and your business.

3. Following your initial meeting, complete any items that have been agreed but also try and stay off your intensive care manager's radar. If your account does not come to their attention they will gain the impression that the business is running smoothly and you are managing it efficiently.

4. To continue to make progress in your banking relationship it is important that any annual accounts and/or management information that has been requested is provided within agreed timescales.

5. Your intensive care manager will look at these closely. Review your accounting policies and how the information is presented with your accountant or adviser before forwarding them to the bank. A commentary should be included highlighting all positive aspects of the account.

   It is beneficial to also enclose a forecast of business prospects going forward, to evidence business activity and reasons for optimism.

6. Should your business performance not be satisfactory or require improvement, advise the bank that you will be consulting appropriate experts. By showing that you are willing to identify requirements for help, and then obtain it when needed, you will build the bank's confidence in your management of the situation.

7. In any area where the bank has a concern, provide a commentary outlining the steps that will be taken to address the concern.

8. Always respond promptly to bank communications, demonstrating you are well organised, in control and confident about your business. Should you receive a formal letter refreshing the bank's concerns and the actions they require, refer it to your accountant and ensure

a prompt response is sent providing constructive answers to each point in the letter.

9. Arrange for the bank's internet banking service to be accessed each morning to ensure there are sufficient funds in the account to meet items presented for payment. If there is a problem, ensure it is resolved as soon as possible and advise the bank, or if this is not possible advise how the position will be covered.

Meanwhile, the 'Don'ts' are:

1. Do not make contact unless it is really necessary. If you do need to make contact, have a good relationship with your intensive care manager's support person and if possible deal through them.
2. Do not send unrequested regular good news updates as this creates the impression that there are actually problems which you are trying to cover up. Good news carries more impact when imparted as part of a scheduled meeting.
3. Do not let any bank request for the provision of financial information become an issue and turn into a bank concern. If there is to be any delay, advise the bank and tell them why, the action being taken, and the anticipated timescale.

   To an intensive care manager, a failure to provide financial information when it's asked for is taken to mean it is being withheld because it is so bad it will cause concern. This immediately creates the very concern you may have been trying to avoid and your intensive care manager, fearing the worst, will have less confidence in your business.

   Any reasons given for a delay in providing information must be credible to the bank, such as the accountant having had specific operational problems, you are changing to a new accountant, or a new accountant is having difficulty unravelling the mess left by their predecessor. A letter/email from the accountant will assist but the timescale given must be sensible, although a further credible 'problem' would be justification for an extension.

4. Do not make a formal complaint unless there is a real problem.

   Doing so to try and strengthen your position with the bank can often backfire, resulting in the business being unofficially labelled a troublesome customer, which the intensive care manager will then often seek to manage away.

   If there is an issue concerning the bank with a financial impact on the business, always seek to resolve this in discussion and negotiation with your intensive care manager.

5. Do not ignore any concerns your intensive care manager raises.

   Do not argue, dismiss or create conflict, even if you feel fully justified. It will be to your advantage to maintain a good relationship. Where possible, actively deal with and remove the concern(s). When this is not possible, either:

   - Seek to convince your intensive care manager there is no need for concern, or
   - Seek to manage the issue, highlight positive aspects, demonstrate you are in control of the situation, explain it is really a minor matter and seek agreement that no further action is currently required.

Case study

The business account of a company running a country hotel, restaurant, lodge and functions venue was transferred into its bank's intensive care department as a result of:

- three years losses;
- an insolvent balance sheet;
- a negative cash flow; and
- defaults on its loan repayments.

The bank perceived the risk of further loan defaults and the likelihood of formal insolvency proceedings to be high. As a result the bank's approach was that:

- no further finance would be made available;
- the monthly loan repayments would continue to be required; and
- a substantial monthly fee was introduced.

The bank introduced an independent consultancy, who were engaged to undertake a thorough review and provide a report with recommendations for the business. However, although the recommendations were implemented, the company continued to incur losses and serious consideration was given as to whether a distress sale of the business should be sought to provide an exit.

All the available data was analysed and a meeting was held with the managing director to discuss the way forward, following which agreement was eventually reached on the steps required to achieve a turnaround, the key actions being:

- The customer arranged for internet banking to be used daily to ensure the bank account stayed in order;
- Cost efficiencies were made in staffing rotas;
- The majority shareholder agreed to make a cash injection to clear the loan arrears;

- Turnover was increased by refurbishing signage and updating the web site;
- Regular management information was provided to the bank; and
- The company's assets were professionally revalued, resulting in an uplift in the fixed assets on the balance sheet, making it solvent.

As a result of the operational changes implemented the business cash flow became positive and annual accounts were produced shortly after the year end demonstrating a net profit.

The business's account was then upgraded and returned to mainstream banking.

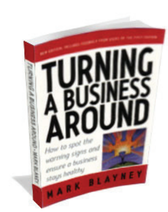
Mark Blayney profile

Having worked for PwC's business rescue and insolvency practice in the UK and overseas, including secondment into a bank's intensive care unit, Mark has subsequently been involved in conducting and investing in business turnarounds for twenty years at director level.

Mark speaks fluent bank. He specialises in managing stressed banking relationships and implementing financial and strategic restructuring of SME businesses to address cash flow, achieve a return to sustainable profitable trading, and create realisable business value.

Operating independently he has been involved as an advisor, investor and/or CEO / COO / CRO (Chief Restructuring Officer) across a wide range of businesses ranging from a PE owned charter airline, a listed electronics manufacturer, through to entrepreneurial tech enterprises, and family owned construction, shop fitting, manufacturing and service businesses.

He has a mission to transfer business skills, has been actively involved in management training and is the author of a number of books for business owners including Turning A Business Around (How To Books).



About K2 business partners

Trading as K2 business partners since 2001, we are turnaround investment partners, each of us with over 30 years' experience of backing directors by investing our time and expertise in the turnaround of their business and the realisation of business value.

We focus on companies with £5m-£20m turnover led by committed boards and with assets that other investors find difficult to value.

K2 invests in companies that manufacture and supply house building and construction products and services; IT & technology service providers; database, branded and intellectual property businesses; and industrial manufacturers.

For more information visit **www.k2-partners.com**

Are there any topics you would like us to cover in our Board Briefing series? Please let us know at **info@k2-partners.com**