

Tough but Necessary

Many companies currently face the specter of insolvency. Restructuring the business is a way around the cliff – though it involves hard choices.

By Cristina Stamboli and Iulian Sorescu



Over the past three years, many companies took on much debt, making them more sensitive to the current economical and financial crisis. Now, companies are facing various kinds of difficulties and are looking desperately for solutions. A simple daily perusal of newspapers is instructive in this regard; but an even closer look at the companies' legal and financial situation reveals that an increased number of companies will soon be interested in valorizing their assets as their values are rapidly going down. Lack of funds to pay due debts is usually what forces a company into insolvency proceedings – even if the company's assets are sufficient to satisfy the demands of its creditors and irrespective of whether the creditors have claims on company assets as securities. Insolvencies, however, are not always a result of legal necessity; there are many cases where the debtor voluntarily initiates a restructuring before a court of law in order to protect itself against enforcement of creditors' claims. Unfortunately, Romania does not possess a legal framework that would regulate a restructuring process as a preventive measure before commencing insolvency procedures. Nevertheless, there are various management measures that can improve a company's performance within a certain period of time if they are adjusted to the specific cases at hand. Backed by appropriate legal assistance during the negotiations with the creditors, suppliers and other business partners, these measures may save the company from financial shortages. It is always better to prevent a crisis than having to cure its effects.

Better before bankruptcy

The smartest way to avoid insolvency is to restructure the business before or during the first signs of weakness. Restructurings are not something new, brought to the fore by the global crisis. Even before that, companies would get into trouble because of bad management, critical exposure to the credit market or other unfavorable circumstances. By contrast, good management means to assess the level and riskiness of a company's cash flow and to structure financing in such a way that it maximizes benefits and preserves the flexibility to deal with new opportunities or adverse circumstances. You may think now that restructuring is tough – and you are right. Like any complex matter, however, the process can be split into small pieces and approached step-by-step. As an example, take a restructuring plan that aims at finding appropriate financial resources to covering a company's overdue debts. Such a plan can involve the following measures: **E** searching for potential investors to boost the company's capital by way of a share capital increase; **E** rescheduling trade debts to optimize the company's cash flow; **E** attuning payments to collection of receivables; **E** renegotiating loan agreements; **E** renegotiating contracts with business partners on discounts and other benefits; **E** downsizing merchandise inventory to the real needs of the sale structure. Theory always diverges from practice, of course, and every company should implement a restructuring plan only after it has completed a thorough analysis of its profitability to find the optimal solutions for improving its results.

Improving the cash flow

Consider the following case study of a smooth and sound restructuring that allowed a textile retail

Table 1: Measures before the crisis

	Revenue	Costs	Short term
Promote sales	↑		Yes
Undiscounted sales	↓	↓	No
Open new stores	↑	↑	No
Improve store management	↑	↓	No
Outsource logistics			No
Part time relocations/peak time management		↓	Yes
Tie sales force salaries to performance	↑	↔	Yes
Evaluate staff based on KPI		↓	Yes
Improve management of receivables and payables		↓	No
Monitor sales staff	↑	↓	Yes
Consolidate suppliers		↓	No

Source: Noerr

company to substantially improve its cash flow and diminish its exposure to the credit market over the past two years. The target of the restructuring plan was to significantly improve financial and cash positions so as to attract additional funding for regional expansion. The following case study only presents the cash improvement strategy. At the beginning of the restructuring, the company was generating a negative cash flow, both operationally and financially. There was no immediate risk of insolvency due to high cash reserves, which, however, were being eroded by the negative cash flow. The company's main concern therefore was to improve the process and find solutions to stem the financial difficulties that would eventually arise from the net cash outflow. The recommended actions included short and medium term measures. The short-term measures had already begun to show results before the crisis: The textile company successfully reversed its negative net cash flow and turned it into a positive net cash flow worth 5 per cent of operational cash outflow. After having implemented an integrated planning system with rolling forecasts and centralized purchasing activities for a year, the company was able to predict its cash flow for a period of six months, though the global crisis has again reduced that to two to three months. The three most effective measures were the following ones: eliminating slow-moving inventories through sales and promotions, closing down units that were unprofitable or generated little cash, and implementing effective cash management by, among other things, renegotiating payment terms with suppliers and customers.

Table 2: Measures during the crisis

	Cash flow	Short term
Close down/resize unprofitable units; focus on profitable ones		No
Cut costs	↑	Yes
Sell assets	↑	Yes
Improve collections	↑	No
Monitor payments	↔	No
Reschedule debts	↑	No
Renegotiate loans		No

Source: Noerr

Changed landscape

The nature of restructuring changes once a crisis sets in (Table 2). From that point on, the involved company must implement all measures very quickly as any delay can be a serious threat. Decisions must be taken fast and firmly even if they are unpopular and have negative social effects. Naturally, each company has to analyze the measures diligently and prioritize them according to its market or industry and its

individual situation. For instance, the current decline in real estate prices renders sale-and leasebacks of properties relatively unattractive though such transaction can be a solution for a temporary survival. Given that most companies face high financial risks, they should take measures that mitigate liquidity risk, interest risk and foreign exchange risk.

Not just a waiting room

Improving receivables collection is mandatory for companies as soon as they notice worsening payment behavior among their business partners. Some Romanian companies have already developed appropriate procedures or handling late payments such as tracking and following up on late payers or getting external help. They now focus on complementary strategies like selling only for cash, offering discounts for quick payments or renegotiating contracts to include up-front and progress payments instead of getting paid just at the end of the job. All these aspects, we hope, show that the restructuring is beneficial and not just the “waiting room” before bankruptcy, but more a key measure to help companies overcome the crisis. We agree: it is hard to decide to restructure during good times when the company runs relatively well. But now is the best time for rethinking the business and preparing it for the future.



Cristina Stamboli is Senior Associate and Iulian Sorescu Head of Financial Department at Nörr Stiefenhofer Lutz in Bukarest.
cristina.stamboli@noerr.com
iulian.sorescu@noerr.com