

## Board Briefing Series

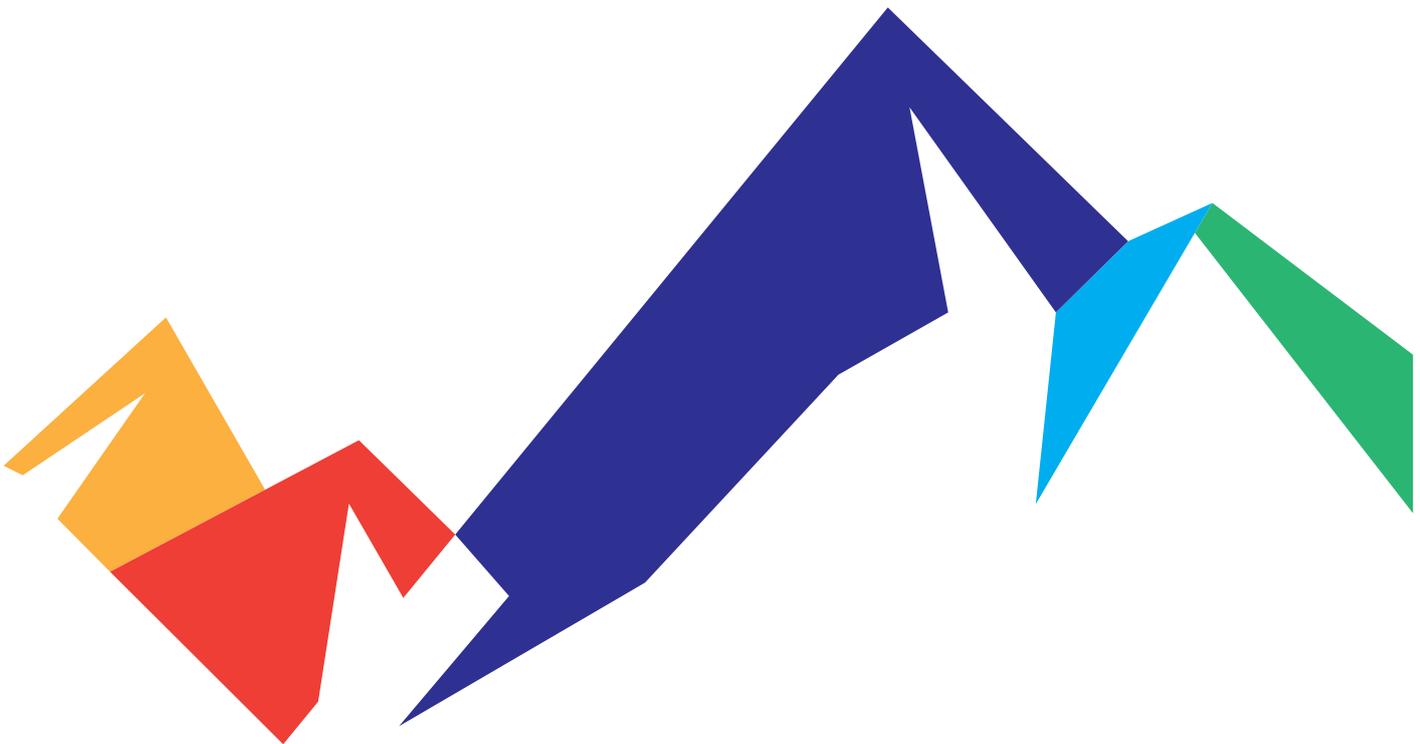
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# The Board and Ensuring Bank Support

Board Briefing Series ref no: CP05

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This article is one of a series of Board Briefings that consider the various challenges and opportunities facing directors which result from the turbulence for business caused by the Coronavirus Pandemic. It is written from our perspective as turnaround investors who have the benefit of objectivity and the desire to ensure that any businesses we invest in will both survive and grow.



Over 30 years' experience of backing directors by investing in their business

## Executive Summary

Banks and other secured lenders are always significant stakeholders in any company and the loss of bank support usually represents an existential threat to the business.

Given the uncertain economic environment facing many businesses as a result of the Coronavirus Pandemic, maintaining the support of the company's bankers is likely to be more important than ever, especially at a time when banks will be scrutinising the risk on their portfolio with extra care to manage their exposure.

Boards therefore need to ensure that they fully understand how their lenders view the company and actively manage their banking relationship to maximise bank support over this period.

This Board Briefing outlines some key considerations for the board of directors.

### The importance of managing the company's banking relationship

**A company's bankers (and/or other secured lenders) are key stakeholders in the business providing vital finance to support its trading. Maintaining their support is therefore critical to the survival of the business and loss of support in a crisis often leads to company failure.**

So understanding and actively managing the banking relationship in good times is good practice for seeking to ensure support during stressful times.

### Understanding the bank's and banker's perspective

**Banks see their role as secured lenders who never expect to write off loans. They are not entrepreneurs, they do not have an equity upside, so risk management of their portfolio of customers is key and takes the form of:**

- Ensuring sufficient security cover is in place for any loans; and
- Stringent risk assessment based on regular reviews of financial information and bank manager reports.

To understand how the bank will be viewing the company the business needs to understand:

- The bank's security position; and
- The bank's assessment of the level of business risk.

As a general rule the bank's valuation of its security is often less than assumed by management. Also the banks have early warning systems that flag levels of business risk usually well before management are aware of them.

At the same time, banks are businesses and are looking to make a return on the capital employed, so will also judge the attractiveness of a business as part of that portfolio on the actual and potential income stream generated from the relationship.

From a commercial point of view businesses looking to manage their banking relationship should ask themselves:

- What makes us an attractive customer to the bank and what can we do to maximise this?
- What makes us an unattractive customer to the bank and what can we do to mitigate this?

While credit scoring and automated systems have removed a lot of the personal element in banking decisions, it is a mistake to ignore the importance of the business's bank manager in the banking relationship.

As a portfolio manager for the bank, the bank manager plays an important role through reporting in to credit committee in setting the assessment of risk level.

Maintaining a good relationship with your bank manager and retaining their confidence is key as in effect they act as the company's representative or advocate when it comes to applying for facilities.

However being supportive of a business puts a manager's personal reputation and judgment on the line so they will not be inclined to take risks with a customer if they do not have confidence in the business or the relationship.

So taking steps to manage this relationship by making the account easy to manage through regular communication and the provision of regular, robust financial information will build vital 'capital' for when it may be needed.

## Obtaining bank support for a stressed business

As ever, you need to understand the bank's perspective.

If you were a banker, ask yourself:

- Would you lend money to the business?
- Are you confident that the loan will be repaid?

The bank has to judge its confidence in the Board's ability to use any funds advanced sensibly and to control the business.

Would you lend money to someone you thought was going to waste it (or run off with it)?

If your business is in any form of stress or distress, particularly if it has reached a crisis, then the bank's confidence in the company's management is likely to be significantly reduced.

The Board will therefore have to take action to demonstrate that they know and are in control of what is happening in the business (eg robust cashflow forecasting) and that they can take tough decisions (eg on cutting costs or staff) to restore the bank's confidence.

Every stressed business situation will have its own characteristics but banks will tend to seek to support when the following general conditions are met:

1. **The bank trusts your integrity** – the relationship has to be based on good faith;
2. **You talk to them in time (and seem likely to continue to talk to them)** – with open communication of the ups and the downs;
3. **You seem to be in control of your business (and its numbers)** – with reliable reporting;
4. **You have a plan** – which addresses the fundamental changes needed in the business;
5. **The plan sets out clearly what support you need (how much, how long, how it will be secured and how it is to be paid back)** – so there is clarity for the bank as to what is required from it;
6. **The bank is confident your plan can work** – in that it addresses the issues, is achievable, and if successful will deliver the right result;
7. **The bank is confident you can make it happen** – the bank needs to be confident the plan can be delivered;
8. **You are prepared to get in help where you need it** – bank confidence will be helped by a willingness to obtain expert or experienced assistance;
9. **Your plan does not materially increase the bank's risk** – in any stressed situation the bank will have a careful eye on its security position and degree of coverage or exposure and will usually be unwilling to compromise this position.

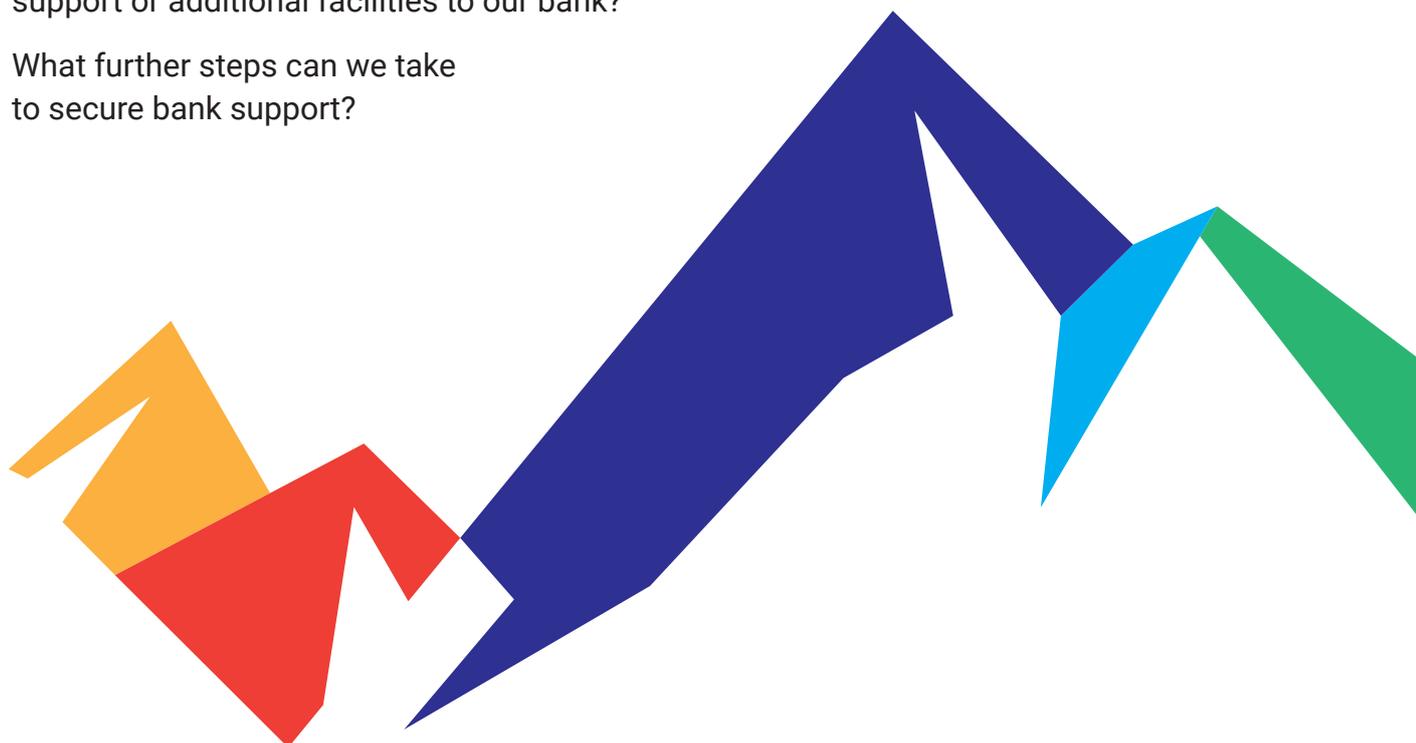
## Questions for the Board

Do we actively seek to manage our banking relationship by making the business an attractive one for both the bank and our bank manager to have in their portfolio?

Do we understand the bank's current view as to its level of risk and security position?

Are we going to need to put proposals for support or additional facilities to our bank?

What further steps can we take to secure bank support?



### 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](http://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](mailto:info@k2-partners.com)

