

Kind to be cruel

Ian Woodley takes a look at the continuing lack of growth and the real problems behind the banks not lending. Perhaps exporting to Mars is the solution ...

NO, it's not a mis-print, and maybe if Nick Lowe had been writing that song today he may have rethought the title.

One of the features of the recession (defined as when we were technically in recession) was that it didn't feel like a recession and whilst we were suffering negative growth, the jobless and corporate insolvency figures held up remarkably well.

The smoothing of the pain was to a greater extent influenced by government measures, the motivation of which being either a kindness or a burial of bad news in the run up to an election, depending on where your loyalties lay.

What is without doubt is that at the end of 2008 we were facing an economic Armageddon and the government at the time were in a very dark place. Slashing of interest rates meant that despite huge overnight reductions in revenue businesses could still make their interest payments. They didn't have enough cash to do much else but by normal bank measurements the payment of interest is an absolute minimum requirement to stave off a default. Three years later many businesses are still in exactly the same place, and the big bounce back in revenues to relieve the short term

smoothing measures never came.

Underlying this effect, the banks' main concern was that their security – mainly bricks and mortar – had in some cases halved in value, leaving banks carrying forward paper losses and rendering them powerless to act. There are many property deals where that situation still remains the case and the banks are looking at a ten-year work out or a substantial haircut.

The banks' own strategy towards managing ailing businesses has undeniably been affected by the hand of government; there is a collective fear of the negative PR of being seen to be villains by closing businesses down and losing jobs. Those banks under government ownership are doubly sensitive to the potential criticism that such an event could bring.

Whilst the stalemate exists in the relationship between banks and their customers, the wildcard that Gordon Brown played was HMRC. The Time To Pay deal was set up as a very short-term measure to help businesses to spread their unpaid tax. Crucially this was a loan, not a gift, so although it took the pressure off immediate tax payment the tax itself still had to be paid at some point, along with tax amassing in the current year. The Government's gamble

was that when revenues improved, businesses would simply get back on track. That hasn't happened. 300,000 companies are believed to be in arrangements with HMRC, which has now stopped advertising the numbers. The scheme looks like a ticking time bomb; many of the businesses in arrangements have permanent and unsolvable cashflow problems which will remain whilst there is so little demand for their product or service. HMRC as an unsecured creditor may have to write off huge sums of money if there is a wholesale increase in insolvencies.

It can be seen therefore that between the Government (which of course now includes all three major political parties over the three years in question), the banks, and HMRC companies have been given a huge amount of short term help which has bought them time and saved thousands if not millions of jobs in the process.

The future

An increase in interest rates, a more aggressive stance by HMRC or the banks calling a halt on what are unsustainable relationships would lead to a business bloodbath. Politicians will do all in their power to prevent that outcome on their watch. This is assuming that global events don't sideline national leadership and matters aren't taken out of their hands.

I guess we are all waiting for life to be found on Mars, which might open up a new export market?

If you were a blue blooded capitalist, you might say that many of the businesses caught in this trap are poorly managed, have flawed business models and insufficient capital and – let's be frank – you'd probably be right. You would also argue that if a business fails, its customers will buy from other stronger competitors that will then grow and take on more staff. You might further argue that by keeping weaker businesses afloat, the strong will eventually suffer too. Does this natural churn not stimulate momentum?

Taking that argument to its logical conclusion you could say that if the recession had been allowed to take its law of the economic jungle course then it would have been incredibly painful in 2008/09 but three years on could we be seeing some improvement and that mystical light at the end of the tunnel.

A tough call for any elected body to make, the social consequences would have been too great. What is now evident is that the chosen policy of administering heavy duty pain killers will mean that the



patient remains in a comatose state and recovery will be a much longer slower process as a result.

Intervention was a gamble, a gamble that the recession would prove short-lived, but that's not how it has played out. The result is the creation of what the insolvency profession have dubbed Zombie companies, whose life has been sustained by these measures but who have no real future. It's only a matter of time before they eventually fail. The concern for me is by sustaining broken businesses, can the underlying issues go unaddressed.

Looking at the common features of the Zombies, you can see weak management that place sustaining directors' lifestyles at the top of the priority list, sloppy practices, over loyalty to non-performing staff members, lack of financial control, and minimal planning. There aren't too many hard luck stories; there are solid reasons why these businesses are where they are. The economic downturn has done little more than expose frailties that were masked by the good times.

For the good of the nation's long-term economic health, maybe a painful recession would have acted as a shock to the system, a catalyst to review how well future entrepreneurs, managers and workers are prepared through the education system to compete in the global economy. For once the nation would have had to think about a plan for a generation rather than beyond the term of a parliament. Instead we remain in a land where the living dead roam the shopping centres, business parks and industrial estates.

Vince Cable says that we are at war, but wars have casualties who fall for the greater good? So have we been kind to be cruel?

Ian Woodley has spent 30 years in the finance industry, the majority of which being at senior management and director level. In 2005 he started a business which is now known as Now Financial, the business is colloquially referred to as a Solvency Practitioner raising funds for distressed companies.

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