Practical steps you can take to help your business survive COVID-19

BY MICHAEL BRANDESS AND SHELDON STONE

Conflict and disruption are woven deeply into the fabric of most family businesses. If there isn't an external threat occupying the family's attention, an internal one is ever present. Because of this state of existence — one requiring constant vigilance— family businesses are, in many ways, better prepared than their non-family peers to address an existential threat like COVID-19. But in family firms, since generally family members are the ones addressing these challenges, decision making is often accompanied by heightened emotions.

Although the current situation is perilous, there is a road ahead for family businesses during these troubling times. Here are some practical ways to navigate these waters.

Reducing liabilities

Most family businesses don't enjoy considerable cash reserves. Income is used to pay overhead, reinvest in the business or make shareholder distributions. When a force such as COVID-19 effectively shutters the market, dramatically reducing income, the business must in turn reduce its short-term liabilities to maintain profitability. There are three effective ways to accomplish this goal:

• **Reduce, defer or eliminate shareholder distributions.** When a family business is facing a crisis, the business must be managed in crisis mode. Ownership must remember that its first obligation is to the ensure that the business survives. Whether the reduction, deferral or elimination of shareholder distributions proves most appropriate, there will inevitably be difficult conversations with family members, some of whom may not be part of the business but rely on the distributions for their livelihood. Though awkward, those discussions are necessary. Shareholder distributions are the easiest short-term liabilities to reduce. And lenders tend not to be willing to renegotiate loan agreements if the business is still distributing cash to its shareholders.

• **Manage existing debt.** One common way to put a Band-Aid on a more general problem is to renegotiate, stretch or stop paying liabilities as they come due. For secured lenders (e.g., banks), renegotiation of existing debt is an exhaustive process and generally requires professional assistance. For trade creditors and landlords, however, the business should assess who requires immediate payment and whose payments can be deferred while the situation stabilizes. This is not a long-term solution and, if debts remain unpaid for a considerable amount of time, a bankruptcy filing becomes more likely.

• **Reduce workforce expenses.** Coronavirus threatens to impact the global economy for several quarters — with complete shutdowns of certain markets for multiple months. Absent meaningful income, payroll cuts might prove necessary. This can occur by reducing salaries, eliminating non-essential positions or furloughing entire shifts or departments with the hope of rehiring these individuals once operations resume. Prior to a layoff, management should seek the advice of counsel to avoid incurring unnecessary liabilities, such as those triggered under the

WARN Act. Unfortunately, the most fruitful way to reduce payroll is to adjust above-market compensation for family members or to cut the positions of relatives whose roles are not essential to run a scaled-back operation. Termination (or temporary layoff) of a family member, while challenging, is preferable to cutting an employee whose skills are needed to maintain operations.

Although a sudden reduction of liabilities can prove daunting, a decade of strong economic conditions has led to more lax internal fiscal policies for many businesses. Management should undertake a comprehensive overview of finances to determine how best to manage liabilities going forward — such as revisiting financial arrangements with family members. In the years to come, a family business that emerges from this episode might find itself far leaner and more profitable as a result of cost-cutting measures taken today.

Policing credit risk

The best way a family business can protect itself from a customer's financial distress (and a potential bankruptcy filing) is largely common sense — collect as much money as you can, as soon as you can. The following are options (ranked in order of preference) to protect your business from a potential credit issue:

• **Payment or cash in advance.** In an ideal world, businesses would receive payment in advance of providing goods or services or otherwise incurring any out-of-pocket expenses. While often an unlikely option, this ensures against a credit issue should a client file for bankruptcy or otherwise wind down.

• **Collect on delivery.** Collect on delivery, a form of advance payment where the delivery of product is not consummated until payment is received, dramatically limits credit risk by ensuring there is no lag time between providing the product or service and receiving payment.

• **Credit insurance or third-party guaranty.** Credit insurance is another way to protect against bad debt. It can be expensive, but an insurer might be inclined to offer credit insurance on a broad array of accounts for a discounted premium. Alternatively, if the customer is not the end user of a good (e.g., if it is a distributor), a third-party guaranty from the end user might prove viable.

• **Payment in terms.** Term payments carry the greatest potential risk for family businesses because customers could file for bankruptcy after the goods or services have been provided but before payment has been made. Should a customer file for bankruptcy or otherwise wind down its operations, the business could receive little to no money on account of the outstanding receivable. If terms are necessary, the business should insist on relatively stringent terms (the quicker the remittance, the better). The business should also be more diligent in watching for red flags, such as missed or late payments, bad news in public filings or any word on the street that would suggest the business should halt its dealings with its client.

Existing and new lending options

COVID-19 has had (and will continue to have) widespread implications for the lending industry.

For existing loans, one of the consequences of an economic meltdown is that lenders are not fiscally able to default all deficiencies in their portfolios without putting themselves at risk. Both lenders and their borrowers are facing the coronavirus crisis together. The phrase "amend and extend" is often used to reflect the lending policies during the Great Recession in which lenders entered into forbearance agreements with their borrowers and extended the loan terms. It is expected that lenders will adopt similar policies with their existing borrowers this time around.

In addition, family businesses can look to alternative sources of capital during the crisis. For example, the Small Business Association (SBA) has several programs designed to help businesses weather COVID-19. The SBA's Economic Injury Disaster Loan Program and its Express Bridge Loans can help businesses during this downturn. The Economic Injury Disaster Loan Program provides small businesses with working capital loans of up to $2 million that can provide vital economic support to help small businesses overcome the temporary loss of revenue they are experiencing. The SBA's Express Bridge Loan Pilot Program allows small businesses that currently have a business relationship with an SBA Express Lender to access up to $25,000 with less paperwork.

Unlike the Great Recession of 2008-09, banks' balance sheets are strong and capital is available. The family should determine their cash needs by creating a 13-week cash flow analysis. Once this is complete, and if cash is needed beyond what is generated from operations, they should contact their lender(s) and/or take advantage of the aforementioned government programs.

Reorganization, sale or winddown

Whether a lender's knocks on the door have grown louder and more persistent or lawsuits from unpaid vendors have started to mount, few moments are sadder than the realization that reorganization, sale or winddown of a family business is inevitable. In times of crises, such as the one presented by COVID-19, the hard answer is often the only answer.

From an emotional perspective, it is important to understand two important points: (1) it's not your fault; and (2) a liquidity event is not necessarily the end of the road. Many business owners facing such daunting decisions seek the counsel of a mental health professional who can help alleviate some of the emotional burden.

The following are several commonly available logistical options to help address an untenable fiscal situation:

• **Out-of-court workout.** Given the breadth and impact coronavirus will have on the economy, it is likely that lenders will prove more willing to negotiate out-of-court workouts of existing debts than they had been in past years when their loan portfolios were much stronger. The restructuring of debt can provide a company with breathing room and potentially free up additional capital. However, it is important that in negotiating a new or revised agreement, the business does not offer improper concessions like excessive monthly payments or significant personal guaranties. If personal guaranties are deemed necessary, the business should consider allocating potential liability among shareholders.

• **Reorganization.** Reorganization is generally accomplished through bankruptcy. The filing of a bankruptcy petition immediately ceases all out-of-court collection activity and provides the company with the freedom either to address a trade creditor problem — one in which the company cannot pay its outstanding receivables in a timely fashion — or to renegotiate the terms of a considerable liability (e.g., loan agreements or pension liabilities). Many companies of all sizes use bankruptcy successfully to reorganize their debt and emerge leaner and healthier. Additionally, a recent amendment to the Bankruptcy Code has made reorganization much more affordable for smaller businesses. There are downsides, such as the need to publicly disclose the company's books and the potential that creditors might derail the process and force a sale. Transfers of the company's assets to "insiders," including family members, might be subject to clawback, and shareholders might ultimately be divested of their equity, depending on the case. But overall, reorganization is a powerful strategic tool when used correctly, and can save a family business from sale or winddown.

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• **Sale.** Whether accomplished in or out of court, the sale of a family business under circumstances such as these might prove necessary. In selling the company, the family can address certain intangible concerns, such as ensuring that the company's name is in good hands. Additionally, employment for family members already involved in the business may be saved. If the sale is being undertaken at the behest of a secured lender, the family can extract concessions, such as the elimination of personal guaranties to motivate the family to cooperate in the marketing and sale process.

• **Winddown.** For a family business, this is the least preferred option. If the decision to wind down has been driven by a secured lender, as with a sale, the family can seek to extract certain concessions, such as the elimination or reduction of personal guaranties. In circumstances such as those brought on by COVID-19, the family should work together to ensure that the winddown of the business doesn't leave any family member destitute. Open dialogue in these situations is imperative so that once the winddown has been consummated, healing can begin and family relationships can remain intact.

During troubling times such as these, it's important to remember what matters most — health, happiness and loved ones. By making hard decisions early, a family business can avoid harder ones down the line. FB

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