

Board Prudence Amid Financial Distress

When a company faces financial distress, its directors stand at a critical intersection of fiduciary duty and operational urgency. In these moments, directors' actions are highly consequential, not passive or ceremonial. They must be decisive and take prudent action. A troubled company may or may not be insolvent—defined as either (i) unable to pay debts as they come due, or (ii) liabilities in excess of asset value—but regardless, safely navigating these moments requires sound governance.

If a turnaround or other favorable option doesn't materialize, and insolvency is unavoidable, several important measures will protect both board members themselves and the interests of stakeholders. Conversely, inaction or missteps from the board risk value destruction, job loss, legal exposure, and reputational harm.

Understand How Duties Shift Upon Insolvency

Board members have fiduciary duties of care and loyalty. As financial distress deepens, these duties become increasingly momentous. While boards of solvent companies prioritize shareholder interests, once insolvent, directors must prioritize creditor interests ahead of shareholder interests—since creditors become the residual claimants. This shift brings heightened scrutiny to board actions.

The business judgment rule no longer applies the same way once the company becomes insolvent. Boards should tread carefully in such moments—relying on company counsel and financial advisors, and continuously calibrating decisions in the interest of creditors. Given potential conflicts of interest, boards should consider appointing one or more independent directors.



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Seek Professional Guidance Early

The instinct to “manage through” distress without external input can often be costly. Experienced legal counsel and financial restructuring specialists bring both technical expertise and objectivity. They can pressure-test management’s assumptions, evaluate liquidity needs, and assess restructuring options under various scenarios. The board should ensure that advisors are engaged early, empowered with information, and operating under clear mandates. Importantly, the decision to seek outside expertise should be framed not as an admission of failure, but as a proactive step in fulfilling fiduciary responsibilities.

Communicate Transparently with Stakeholders

Credibility, once lost, is difficult to regain. Directors should insist on timely and accurate communication with key stakeholders, including lenders, trade vendors, employees, and stockholders. In practice, this may involve regular updates to lenders under credit agreements, clear messaging to employees regarding continuity of operations, and carefully managed disclosures to supply chain partners where applicable. Transparent communication reduces rumor-driven instability and demonstrates responsible board oversight.

Preserve Cash Relentlessly

Liquidity is the oxygen of a distressed company. As financial pressures intensify, the company must be prepared to make and implement difficult decisions in the interest of conserving cash. Directors should challenge management to rigorously review headcount and other overhead, delay non-essential capital projects, consider facility closures, and renegotiate supplier terms where possible. A robust 13-week cash flow forecast—which financial advisors can help create—should be maintained, frequently updated, and stress-tested under adverse scenarios. These steps ensure sufficient runway for restructuring alternatives, including—as a last resort—an orderly wind-down or insolvency proceeding.

Pursue an M&A Exit or Capital Infusion

A capital raise, whether debt or equity, can provide liquidity while strengthening the company's balance sheet. Alternatively, an M&A exit could maximize value in circumstances where stand-alone viability is in doubt. Refinancing existing debt, if market conditions allow, can extend runway and reduce near-term covenant pressure. Each of these options requires careful sequencing and competitive processes where feasible.

Prepare for Formal Restructuring Plans

In parallel with the pursuit of an M&A exit, capital raise, or balance sheet fix, boards should instruct management to collaborate with advisors to assess and budget for potential wind-down or insolvency process options. When a company cannot emerge from a state of distress through operational or financial measures alone, the company may be insolvent. If so, the board will likely need to either:

- (a) effectuate a restructuring option within its power, such as a bankruptcy or assignment for the benefit of creditors ("ABC"), or
- (b) face either a consensual or non-consensual proceeding brought by creditors, such as a foreclosure.

The board should specify decision triggers—for instance, a minimum liquidity threshold sized off statutory obligations—to activate one restructuring measure or another. A conservative budget should be prepared for each option that the board can consider. A disciplined approach to contingency planning allows the company to pivot quickly rather than react belatedly when options narrow.

Conclusion

Financial distress does not absolve directors of their responsibilities; instead, the circumstances heighten them. Boards that act decisively—by securing expert advice, preserving liquidity, engaging in contingency planning, and communicating with integrity—position the company for a soft landing. Should insolvency arise, directors must recalibrate their focus toward creditor interests and carefully weigh restructuring options. Ultimately, prudent governance during distress is not merely about navigating crisis; it is about safeguarding value and maintaining stakeholder trust in the face of adversity.

At G2 Capital Advisors, we understand the weight of governance in times of distress.

Our team brings a dual perspective, providing seasoned restructuring expertise while also serving as independent directors when boards require additional objectivity and fiduciary clarity. We help companies preserve value, protect stakeholders, and navigate insolvency proceedings with discipline and foresight. Whether strengthening board oversight, evaluating strategic alternatives, or executing formal restructuring processes, G2 stands as a trusted partner to boards facing their most critical decisions.