



## **Restructuring Is Incentive Alignment Exposed Through Finance**

**When a deal changes the numbers but not the behavior, it has not solved the problem**

### **Executive Summary**

Restructuring is often presented as a financial exercise: debt is resized, maturities are extended, covenants are reset, interest is deferred and a new model is built. But in distressed corporate credit, the real test is not whether the numbers can be adjusted. The real test is whether the restructuring changes behavior.

This briefing argues that restructuring should be understood as incentive alignment exposed through finance. A stressed capital structure reveals who is prepared to contribute, who is preserving optionality, who is delaying recognition, who is protecting downside, and who is willing to accept discipline. If a deal changes the capital structure but leaves management conduct, sponsor behavior, lender rights, liquidity control and reporting discipline unchanged, it has not solved the problem. It has only postponed the next point of stress.



A durable restructuring therefore requires more than amendment language and financial modelling. It requires cash discipline, reporting cadence, milestone-based controls, sponsor contribution, lender decision rights, consequences for underperformance and creditor alignment. The model is not the answer. It is the instrument through which discipline, conduct and alignment are tested.

### **Key Takeways**

- An amendment changes terms; a restructuring changes conduct.
- A capital structure under stress reveals behavior: who is delaying, who is contributing, who is protecting downside and who is relying on narrative.
- Weekly cash reporting, 13-week cash flow discipline and variance analysis are not administrative tools; they are tests of management behavior under pressure.
- New money is one of the clearest incentive tests because it reveals who is willing to fund liquidity, under what controls, and with what consequences.
- A restructuring that changes the numbers but not the behavior is usually a delay mechanism, not a recovery solution.
- Proper incentive alignment requires liquidity controls, milestone discipline, sponsor contribution, lender rights, reporting obligations and consequences for missed performance.
- The quality of a restructuring is not proven at signing. It is proven in the quarters that follow, when pressure returns and the structure must hold.

## **Restructuring Is Incentive Alignment Exposed Through Finance**

### **When a deal changes the numbers but not the behavior, it has not solved the problem**

A stressed capital structure quickly reveals where the real interests sit. Management may speak about strategy. Sponsors may speak about long-term value. Lenders may speak about support. Advisors may speak about options. But once liquidity tightens, reporting quality deteriorates, covenant waivers recur, suppliers shorten terms, and cash starts to matter more than presentations, the discussion changes. Financial terms begin to show what each stakeholder is actually willing to do.



The restructuring process does not only test debt capacity. It tests conduct.

### **Amendment Is Not Restructuring**

The first distinction is simple but often ignored: an amendment changes terms; a restructuring changes conduct.

An amendment may extend maturity, reset covenants, reduce amortization, capitalize interest, waive a breach, or defer principal. It may be necessary. It may even be useful. But it does not automatically solve the underlying problem. If it leaves the behavioral architecture unchanged, it has only deferred the next point of stress.

If a deal reduces debt service but does not improve cash discipline, it has not restructured the problem. If maturities are extended but reporting remains weak, control has not improved. If covenant relief is granted but asset disposals remain open-ended, the structure has only bought time. If sponsors retain upside without contributing liquidity or accepting tighter control, incentives remain misaligned. If lenders continue to waive underperformance without gaining meaningful oversight, the credit has not been stabilized. It has simply been postponed.

A true restructuring introduces discipline. It tightens control. It shortens reporting lines. It forces decisions around liquidity, asset sales, governance, sponsor support, cost reduction, working capital, and downside allocation. It creates consequences for underperformance. It moves the case from narrative to execution.

The model is not the answer. It is the instrument through which discipline is tested.

### **A Capital Structure Is a Map of Behavior**

Before distress, most capital structures appear coherent. Senior lenders have priority, collateral, controls and covenants. Mezzanine capital sits between protection and upside. Equity carries the residual risk and upside. Management is usually rewarded for growth, EBITDA delivery, expansion, and strategic execution. In a stable environment, those interests can coexist.

Under stress, the same structure behaves differently.



Equity becomes more sensitive to dilution. Sponsors become more selective about where fresh money goes. Management becomes defensive and tries to preserve room to maneuver. Senior lenders stop listening to the story and start focusing on time, cash, collateral and recoverable value. Junior creditors may prefer delay because optionality is worth more to them than immediate recognition. Suppliers may continue to support the business, but increasingly on the assumption that someone else will absorb the downside if the situation deteriorates further.

None of this is unusual. It is the normal progression of stress. The question is whether the restructuring recognizes it honestly.

Too many distressed situations are approached as if the problem can be solved by resizing the balance sheet while leaving the behavioral architecture broadly intact. That rarely works. If management still reports late, if sponsors remain reluctant to support liquidity, if disposals are continuously "under review," if working capital leakage continues, if related-party transactions remain insufficiently controlled, and if lenders grant repeated waivers without stronger rights, the economics may have changed on paper but the incentives have not.

In that situation, the structure remains unstable.

A stressed balance sheet does not only show leverage. It shows posture. It shows who is defending value, who is delaying decisions, who is protecting optionality, who is still hoping time will repair what discipline has not, and who is willing to bear economic pain before asking others to absorb it.

### **Where Incentives Break**

In most restructuring situations, incentive failure is visible before the legal default becomes decisive.

Management wants flexibility, time and limited intrusion. That is understandable, but under stress flexibility can easily become delay. A management team that resists weekly cash reporting, avoids variance explanations, delays the data room, or treats every forecast miss as a timing issue is not only managing a liquidity problem. It is preserving discretion.

Sponsors want to protect upside. That is also understandable. But if a sponsor requests lender support while refusing new money, resisting dilution, delaying asset disposals, or avoiding



governance concessions, the restructuring is not aligned. It is asking creditors to finance optionality without receiving enough control.

Senior lenders want capital protection. But they may also delay recognition, avoid classification pressure, or continue waiving because enforcement would crystallize loss. Junior lenders may prefer an aggressive valuation case because their recovery depends on upside. Trade creditors may tighten terms just when liquidity is weakest. Advisors may protect mandates, defend models, or extend processes beyond what the liquidity runway can support.

Each party has a rational position. The problem begins when the restructuring pretends those incentives are already aligned.

They are not.

A serious restructuring does not assume alignment. It designs for it.

### **Stress Reveals Incentives Before Default**

The early warning signs usually appear well before formal default. They are rarely dramatic at first. They appear in reporting quality, forecast reliability, liquidity behavior, working capital movements, and the growing distance between internal optimism and external reality.

Aggressive add-backs preserve covenant headroom that no longer reflects true earning capacity. Inventory quality weakens but remains treated as fully available collateral. Receivables stretch. Collections slow. Forecast misses are explained as timing differences. Capex that was supposedly deferred reappears in a different form. Related-party balances become harder to explain. Supplier pressure is described as temporary. Management explanations become longer while cash conversion becomes weaker.

The issue is not one isolated data point. It is the pattern.

Once those patterns repeat, they usually indicate that the business is no longer being managed for durable stability. It is being managed for time.

That distinction matters for any lender, workout team, investment committee, credit committee, or board. A borrower genuinely addressing stress behaves differently from a borrower trying to survive the next reporting cycle. The first accepts tighter oversight, stronger cash controls,



more frequent reporting, and harder decisions earlier than it wants to. The second resists those controls while asking for flexibility.

In restructuring, behavior is usually visible before the formal event of default. The warning signs are there in the quality of information, the timing of disclosure, the consistency of liquidity forecasts, the willingness to accept discipline, and the speed with which difficult decisions are made.

### **Why Cash Reporting Matters**

Weekly cash reporting is one of the most important tools in a workout context. Not because reporting cadence is an administrative preference, but because it exposes behavior quickly.

A weak cash bridge, recurring forecast misses, unexplained variances, delayed reporting, or repeated requests for tolerance are not merely operational issues. They are evidence that the incentive system has not yet been brought into line.

Cash reporting forces operational reality into the discussion. It shows whether management understands the business at the level required for distress. It shows whether liquidity is being actively managed or passively consumed. It shows whether working capital assumptions are credible. It shows whether the company is still funding non-essential leakage. It shows whether supplier pressure is being managed or merely deferred. It shows whether the business is stabilizing or simply moving stress from one week to the next.

For special assets teams, the cash bridge is often more revealing than the annual budget. The budget tells you what management wants to believe. The cash bridge tells you what the business is actually doing.

A 13-week cash flow is therefore not just a liquidity tool. It is an incentive test. It shows who is prepared to live under control, who is still negotiating for discretion, and who is willing to turn financial discipline into daily behavior.

By the time waivers become routine, the question is usually no longer whether the structure requires reset. The question is whether the parties are prepared to accept the consequences of a real reset.



## **When the Numbers Change but Behavior Does Not**

The weakest restructurings often look reasonable at signing.

The maturity profile is extended. Interest is deferred. Amortization is reduced. Covenants are reset. The business plan shows recovery. The model balances. The credit paper explains the rationale. The term sheet appears to create breathing room.

But the actual behavior remains unchanged.

Reporting is still late. Forecasts still miss. Variances are still explained rather than corrected. Asset sales are still "in progress." Sponsor support remains conditional. Management still controls the information flow. Cash leakage remains insufficiently restricted. Lenders still receive explanations after the fact instead of control before the event. The borrower still treats every missed milestone as a request for another discussion.

That is not restructuring. That is a financed extension of the old problem.

If the deal changes the numbers but not the conduct, the next crisis is already being built into the structure.

## **Finance Becomes Prescriptive Under Stress**

The practical purpose of restructuring is not simply to buy time. It is to use financial controls to change conduct.

That normally starts with liquidity. When cash is under pressure, stakeholder positions become easier to read. Lenders demand tighter cash management, better reporting, clearer approval rights and stronger control over leakage. Management is forced to prioritize. Sponsors must decide whether they remain economically committed or are already managing toward a different outcome. Asset sales stop being strategic options and become execution milestones.

This is the point where finance stops being descriptive and becomes prescriptive.

Cash dominion matters because unrestricted leakage destroys creditor optionality. A 13-week cash flow matters because it forces operational reality into the discussion. Weekly reporting matters because it prevents underperformance from being hidden inside monthly narratives. Governance rights matter because weak oversight allows optimistic assumptions to survive



longer than they should. Disposal milestones matter because without time-bound execution, “portfolio review” becomes another form of delay. Sponsor support matters because a restructuring in which lenders provide time while equity provides only narrative is usually misaligned.

A restructuring is therefore not defined by the elegance of the financial model. It is defined by whether the model creates enforceable discipline around liquidity, governance, control, contribution, and execution.

### **New Money Is the Clearest Incentive Test**

Few issues reveal incentives more clearly than new money.

When a distressed borrower needs fresh liquidity, every stakeholder’s position becomes more explicit. Management asks for runway. Sponsors test how much support lenders will provide before equity is required to contribute. Existing lenders ask whether new money should prime existing debt, rank *pari passu*, receive enhanced collateral, or be conditional on stronger controls. Junior creditors may resist dilution. Trade creditors may ask why they should continue supporting a business if financial creditors are not aligned.

The question is not only who provides liquidity. The question is what behavior the liquidity buys.

New money without control may simply finance delay. New money without milestones may preserve optionality for equity. New money without reporting discipline may disappear into working capital leakage. New money without priority may be unavailable when it is most needed. New money without sponsor participation may transfer too much downside to creditors while leaving upside insufficiently shared.

A serious restructuring links liquidity to discipline.

Fresh money should normally be connected to information rights, use-of-proceeds controls, liquidity reporting, milestone compliance, asset-sale progress, sponsor contribution, and consequences for non-performance. Otherwise, the structure may solve the immediate cash gap while leaving the incentive problem untouched.

### **Serious Restructuring Creates Consequences**



The clearest distinction between serious and cosmetic restructuring is whether the structure puts real pressure on behavior.

If underperformance continues, what happens?

If reporting slips, what happens?

If cash leakage continues, what happens?

If asset sales stall, what happens?

If sponsors refuse support, what happens?

If covenant relief becomes recurring, what changes?

If the borrower misses milestones, who has the right to intervene?

If the business plan fails again, does the structure still protect value?

If the answer is only "another discussion," the restructuring is probably too loose.

A sound restructuring does not rely on goodwill. It relies on incentives, controls, consequences and governance discipline. That is what makes it durable.

This is particularly important because distressed situations tend to reward delay unless the structure prevents it. Management may delay difficult decisions. Sponsors may delay fresh money. Creditors may delay loss recognition. Advisors may delay uncomfortable conclusions. A serious restructuring reduces the economic benefit of delay and increases the cost of non-performance.

That is where finance becomes governance.

### **The Model Can Balance and Still Tell You Very Little**

One of the persistent mistakes in distressed credit is to overestimate the comfort of a balanced model. Forecasts can be adjusted. Assumptions can be smoothed. Pro forma leverage can be made to look manageable. Recovery cases can be shaped around preferred outcomes. Valuation ranges can be defended. Sensitivities can be presented selectively.

None of that is difficult.



The harder question is whether the model is supported by conduct that is realistic under pressure.

This is where many sophisticated processes lose discipline. Too much time is spent discussing forward multiples, theoretical upside, refinancing capacity and valuation ranges, while too little time is spent assessing whether management can operate under tighter constraints, whether sponsors are genuinely aligned with the proposed solution, whether asset sales are executable, whether new money is properly controlled, and whether lenders have secured enough rights to intervene before underperformance becomes another crisis.

In distressed credit, fragility often sits less in the spreadsheet than in the assumptions about behavior behind it.

A business may look refinanceable if execution is clean, working capital normalizes, trading improves, asset sales complete on time, and sponsors remain supportive. But if those assumptions depend on optimism rather than enforceable structure, the model is not a solution. It is a presentation of best intentions.

### **Behavior Is the Real Sensitivity Case**

Every restructuring model contains sensitivity analysis. Revenue downside. Margin compression. Working capital stretch. Capex delay. Exit multiple pressure. Interest rate movement. Refinancing delay. Collateral value reduction.

But the most important sensitivity is often behavioral.

What happens if management misses reporting deadlines?

What happens if sponsors refuse new money?

What happens if asset sales are delayed?

What happens if working capital does not normalize?

What happens if lenders lose patience?

What happens if suppliers tighten terms?

What happens if the borrower uses every waiver as a bridge to the next waiver?

What happens if the restructuring adviser's recommendations are ignored?

What happens if the governance rights are too weak to force action?



These are not soft issues. They are financial issues expressed through behavior.

A model that does not test conduct is incomplete. It may calculate debt capacity, but it does not test restructuring durability. It may show theoretical recovery, but it does not show whether the structure can survive the next period of pressure.

That is why experienced credit risk and special assets professionals place significant weight on reporting discipline, cash conversion, stakeholder willingness to absorb pain, governance quality, lender control rights, and the credibility of execution milestones. Finance is indispensable, but it is only useful if it is attached to decisions people will actually honor when pressure returns.

### **The Real Test Comes After Signing**

The quality of a restructuring is not best judged at signing. It is judged in the quarters that follow.

If the restructuring is real, the post-deal business should behave differently. Reporting should remain disciplined. Liquidity should be monitored with realism. Management should have less room to defer difficult decisions. Equity should understand where its upside begins and where creditor protections prevail. Lenders should not be relying on optimism to preserve their position.

This is where weak solutions reveal themselves. Maturity extensions with limited control enhancements may create temporary calm, but they often leave the original behavioral fault lines intact. After a few months, the same issues return: underperformance against forecast, renewed covenant pressure, delayed disposals, working capital explanations, liquidity requests, and another appeal for flexibility.

A stronger restructuring leaves guardrails behind it.

Those guardrails may include tighter controls on leakage, enhanced consent rights, improved reporting obligations, cash monitoring, disposal milestones, sponsor support conditions, mandatory review events, independent monitoring, governance rights, or a capital structure that more honestly reflects where economic value now sits. The instruments differ from case to case. The principle does not.



If incentives have genuinely been rewired, pressure does not disappear, but it becomes more manageable. If they have not, the structure usually fails at the next point of stress.

### **Incentive Alignment Applies to Creditors Too**

The same principle applies at creditor level. Lenders also reveal incentives under pressure.

Some seek quick exit. Some prefer enforcement. Some want to preserve relationship exposure. Some are driven by provisioning treatment. Some need time for internal approvals. Some continue to support because they believe in the turnaround. Others support because they are not yet ready to recognize loss.

Those incentives must also be understood and governed.

A borrower-side restructuring cannot be durable if the creditor group itself is misaligned. In stressed situations, structure determines recovery not only within the borrower, but also within the creditor process. Where creditor incentives fragment, value leaks. Where incentives are aligned through governance, information and consequences, recovery becomes more controllable.

This is why creditor coordination, information transparency, standstill discipline, new-money rules, enforcement protocols, voting thresholds, and common recovery objectives matter. A restructuring that rewires borrower behavior but leaves creditor behavior fragmented is still exposed. The process may fail not because the business cannot be saved, but because the creditor architecture cannot hold.

### **What Proper Incentive Alignment Requires**

Proper incentive alignment is not created by a supportive paragraph in a term sheet. It must be built into the economics, controls and governance of the restructuring.

It usually requires a common liquidity baseline, credible cash reporting, clear use-of-proceeds discipline, milestone-based restructuring terms, sponsor contribution or dilution consequences, lender consent rights over material actions, tighter control over asset sales,



independent monitoring where needed, and consequences for missed reporting, missed milestones or repeated forecast failure.

It also requires clarity around who is absorbing pain.

If creditors are giving time, what is equity giving?

If lenders are providing new money, what control do they receive?

If management remains in place, what reporting discipline applies?

If asset sales are part of the plan, what happens if they do not occur?

If covenants are reset, what replaces the lost protection?

If debt service is reduced, how is cash leakage prevented?

If recovery depends on future growth, who bears the cost if growth does not arrive?

These are not theoretical questions. They determine whether the restructuring is a financial reset or merely a delayed recognition exercise.

### **What This Means for Credit and Special Assets Teams**

For credit risk, restructuring and special assets teams, the practical lesson is straightforward: do not evaluate restructuring proposals only by how they reshape the balance sheet. Evaluate them by whether they change behavior in a way that can hold under pressure.

Look closely at cash discipline. Look closely at reporting cadence. Look closely at variance explanations. Look closely at how quickly management accepts controls it previously resisted. Watch what sponsors do when fresh liquidity becomes necessary. Watch whether asset disposals are genuinely executable or simply included because the model needs them. Pay attention to recurring waivers, because they often say more about the underlying structure than the covenant schedule itself.

The right questions are often simple:

Does the restructuring reduce liquidity leakage?

Does it improve reporting quality?

Does it create real consequences for delay?

Does it align sponsor behavior with creditor protection?

Does it give lenders sufficient control before the next crisis?



Does it make management behavior more disciplined?

Does it preserve value better than the previous structure?

Does it convert time into action, or merely into another waiver period?

If the answer is no, the restructuring may be financially attractive but behaviorally weak.

### **Discipline Matters More Than Design**

A restructuring that does not change conduct is not a restructuring. It is a delay mechanism.

This is why restructuring is ultimately a governance exercise expressed through finance. The numbers reveal the stress. The controls shape the conduct. The incentives determine whether the structure will hold.

In the end, restructuring is not about producing a more elegant capital structure. It is about forcing a more realistic alignment of interests. Finance is the medium through which that alignment becomes visible, measurable and enforceable.

When alignment is real, execution usually improves. When it is not, the symptoms return, regardless of how polished the presentation looked at signing.

That is why, in stressed credit, I trust conduct more than narrative and discipline more than design. The numbers matter. But under pressure, they matter because they reveal who is truly aligned, who is merely waiting, and who is already protecting downside.

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