

Commercial outlook

Perspectives on risk and insurance issues from our Commercial team



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Welcome

I was appointed Chief Executive Officer of UK Commercial in September and have come in to the business at a time of significant change in the economy. It is a time in which we must use all of our strength and experience to create appropriate products and services to support you through the coming year. We will rise to this challenge and will work with you to find ways to navigate the changing risk landscape.

The starting position for small and medium enterprises will be a review of risk and insurance arrangements in this changed risk landscape. The key objectives of such a review will be to ensure the delivery of value without compromising on the quality of the programme constituents such as service, risk management support, innovation and – particularly with economic conditions as they are – insurer security.

Our newsletter will give you some action points to consider when reviewing your risk profile. You will also find articles on our new trade credit helpline, how to prepare for a changing insurance market and guest articles from Barclays Corporate Bank and Pannone LLP, who each give their views on aspects of trading through the downturn.

We want to help you be as prepared as you can for the changing conditions so that you can enjoy a successful 2009. Please contact your Client Relationship Manager to see where we can help you manage risk in your business next year.

Julie Page

CEO, UK Commercial

Commercial – delivering value without compromise



Trade credit update

Trade credit insurance is designed to protect firms' cash flow and balance sheets from bad debt and defaulted payments. Mounting fears of a UK recession have led to a sharp increase in the sale of these policies – the number of enquiries Marsh has received has more than doubled over the last 12 months.

However, the current volatility, particularly in the non-food retail and construction sectors, is driving changes in underwriters' behaviour and appetite towards trade credit insurance.

Tim Smith, leader of our Trade Credit Practice, comments "From 2002 to 2007, the ratio of insurers' losses as a percentage of premiums written averaged between 40% and 50%. This year, ratios are already exceeding 60% and fast approaching even higher levels. We expect this

trend to continue to 2009. As a result, insurers have become increasingly cautious in their approach to new business acquisition and far more rigorous in assessing the risks associated with customers, making it more challenging for firms to secure trade credit insurance."

"Companies seeking to buy trade credit insurance must be able to present clearly to insurers how they audit and review their current exposures, along with how they manage these key risks."

"Being able to demonstrate sound credit management procedures is also important for discussions with insurers. Despite the current conditions, the market continues to be receptive, with cover, positive policy structuring and competitive pricing available for good and well-run businesses."

Our trade credit insurance helpline

In response to the real and continuing concerns Marsh has launched a trade credit helpline to help UK businesses address issues related to trade credit risk. This facility is available to any business, whether Marsh clients or not.

If your business or any business you trade with:

- has had credit lines cut by credit insurers
- is worried that payments from debtors may be missed due to default or insolvency
- is currently re-negotiating lending facilities with reluctant bankers
- is seeking guidance on the best ways to optimise credit management
- is looking for guidance and support from a trusted adviser.

then contact us at either of the points below:

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Trading in a downturn – review your contract conditions



At times when trading is tough, it is critical to understand and, perhaps, seek to amend contract conditions. In this article, Simon Wallwork, a Partner and Head of the Corporate Department at Pannone LLP, outlines the issues to consider.

In an economic downturn businesses may find that their suppliers are hiking prices due to increased costs, or even becoming insolvent. From a supplier's perspective, they may be faced with customers who are unable to pay for the goods or services supplied. Now is a good time for businesses to review their existing contractual arrangements and to think carefully before entering into new agreements, to ensure that contracts contain the protections they need for trading through the downturn.

Payment terms

Payment terms are crucial in the current economic climate: suppliers should ensure their right to receive payment is clearly set out and that they have adequate remedies should the customer be unable to pay or if the supplier believes the customer is about to become insolvent. Suppliers may consider other payment protection provisions such as requiring advance payment, a guarantor, performance bonds or similar.

Customers, on the other hand, will want to ensure that they are not penalised for delaying or missing payments. Customers should look out for default interest which will be payable on late payments – if the contract is silent on the point, the supplier may be entitled, as a matter of law, to charge interest at 8% above the Bank of England base rate.

Contract terms

General rights of termination and other remedies will be important, especially with regard to possible breaches of contract (a distinct possibility where, for example, suppliers are making cutbacks).

Other considerations could include imposing minimum purchase levels on customers to try to ensure a guaranteed income and to help with cash flow predictions. However, both customers and suppliers should be careful not to be tied into minimum obligations which they may struggle to meet if they have to make redundancies, or if their own customers or suppliers cease to trade or if resources or raw materials become prohibitively expensive.

Suppliers may also want the ability to change the prices charged under their contracts, to take account of rising costs, but customers need to watch out for this, particularly where minimum purchase levels are imposed.

A robust retention of title clause is another 'must' for suppliers – traders selling goods should seek to retain ownership until the customer has paid for the goods in full. To give full effect to a clause of this nature, suppliers should ensure they have the right to access premises and retrieve the goods if the customer subsequently fails to pay. Of course, customers may want to take ownership of goods from the point of delivery, even if they have not been paid for, as a means of trying to obtain increased protection for the continued operation of its business in using or onward supplying those goods should the supplier become insolvent.

Insurance considerations

Customers will not want to insure goods before they are delivered, whereas for suppliers it is advantageous to have the customer insure from as early a point as possible. It is also important that traders have in place insurance as far as possible against losses resulting from customers and suppliers being unable to fulfil their contractual obligations. Some protection may also be gained from a 'force majeure' clause to reduce or exclude liability where obligations can not be performed, or performed on time, due to circumstances which are outside of its control.



Cash is king – maintaining profitability through the downturn



Currently many businesses are experiencing tough trading conditions. In this article Eric Savill, a Business Support Director at Barclays Commercial Bank, provides some advice on how to deal with the problems.

At Barclays Commercial Bank we recommend a three-step procedure. First, ensure the business is stable and cash is flowing smoothly. Second, seek to improve profitability. And third, examine the management to ensure you have a strong team and where necessary are receiving correct, informed advice from qualified professionals.

Step one: Cash flow is of paramount importance

Businesses don't go bust because they make losses but because they run out of cash. Remember: cash is king.

Even well-run firms benefit from improving cash flow control. Options for improvement can include invoice finance; renegotiating payment terms for suppliers and creditors; resolving inter-company cash transactions and raising additional funds.

Never neglect your cash flow forecasting. You need to keep on top of your inflows and outflows. What will you do if a debtor is late in paying? Who are your late payers and what condition are they in?

Step 2: Look to improve profitability

When stability is assured, you can look at boosting profits. Barclays Commercial Bank work with businesses to understand where their profits come from. It is important to understand profitability by business units, outlets and customers so businesses can understand the contribution of each component. If a product or division is not performing, do the directors have a plan for turning it around or closing it?

Step 3: Review the management

Take a look at the structure of the business; check whether the right people are in the right positions

and if anyone new needs to be brought in. As businesses grow and market conditions change, different types of expertise might be needed.

How healthy is your business?

Below is a useful checklist – provided by Barclays – to help businesses review their health and profitability.

Audited accounts

Are you making a profit?

How do your sales and profit compare to previous years?

Is the profit growing in line with sales or not?

When was the last time you reviewed your overheads?

Are you in control of them?

Management accounts

Do you produce regular management accounts?

How do the figures compare with annual accounts?

Are your sales increasing or decreasing?

Have you noticed any unusual trends?

Sales ledger and debtor book

Look at your debtors – do your customers pay on time?

How many bad debts have you had in the past year?

Stock and forward order book

How quickly is your stock turning over?

Are there any obsolete lines?

How full is your forward order book?

How does it compare with previous years?

Customers

What is your relationship with your customers?

What makes your product stand out from your competitors and how loyal are your customers?

How easily could they go elsewhere?

What is their financial position?

Suppliers

How good is your relationship with your suppliers?

Could you negotiate a better deal elsewhere?

What would happen if your main supplier suddenly hiked prices?

Staff

How is staff morale?

Are they committed to the survival of the business?

Forward planning

What is the worst thing that could happen to your business and are you prepared for it?

What is the condition of your premises and machinery?

Do you have the funds to cope with future demands?

Do you keep tabs on your competitors?

Do you know what's happening outside the business?



Insurance – be prepared for changing conditions

As outlined earlier in this publication, in the trade credit insurance market we are experiencing a cautious approach by insurers, rising premium rates and a need to demonstrate the effective management of risk and exposures. The jury is out as to whether this will expand into other types of insurance. Although some commentators are warning of tougher conditions, Marsh is still experiencing an environment where rates can be held or reduced in many instances, a situation we expect to be able to support where good risk information is provided. Underwriters are naturally cautious and in the absence of evidence to the contrary, they will assume the worst.

Nevertheless, with insurers balance sheets deteriorating, it makes sense to prepare for the possibility of a harder insurance market during 2009. (By this we mean a market that is characterised by rising premium levels, less availability of cover and insurers taking a tougher stance on levels of risk control, compliance with policy terms and conditions and payment of claims.)

Action points

We recommend that all businesses put plans in place to manage a changing insurance market place. These include:

- Make sure your broker has operated in a hard market before – their techniques need to change in order to negotiate the best deal for you.
- Investigate whether you can enter into a multi-year deal with your insurer, which locks premium rates at current levels.
- Review your risk control mechanisms – will they stand up to increased scrutiny from underwriters?
- Have property and health and safety risk surveys carried out, to provide detailed information to underwriters.
- Budget cautiously for your 2009 insurance renewal. Whilst there is a lot that can be done to mitigate price increases, we recommend you are prepared.
- Understand your insurer selection – a hardening market can be accompanied by weaker carriers.
- Review the design of your programme and the level of risk you retain – what was a good deal previously may not prove to be the optimum option going forward.

As the world's leading insurance broker and risk advisor, with over 130 years experience, we are here to help you. Please contact your dedicated Client Relationship Manager for assistance.

The information contained in this publication provides only a general overview of the subjects covered, is not intended to be taken regarding any individual situation and should not be relied upon as such. Insureds should consult their insurance and legal advisors regarding specific coverage issues. Statements concerning legal matters should be understood to be general observations based solely on our experience as insurance brokers and risk consultants and should not be relied upon as legal advice, which we are not authorised to provide. All such matters should be reviewed with the client's own qualified legal advisors in these areas.

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