Regional Insight 2019

In an uncertain world – how risk ready are you?

In this Issue

Welcome from Aon

Welcoming delegates to Aon's Regional Insight 2019 conference, Aon's Credit Solutions Bhav Chandegra – Business Development Director, highlighted how today's uncertainty has led to risk managers reporting their lowest level of risk readiness in over a decade.

Referencing Aon's 2019 Global Risk Management Survey, Chandegra explained that economic slowdown is now seen as the number one risk by businesses globally, closely followed by damage to reputation and brand, with accelerated rates of change in market factors in third place. Disruptive technologies are also a growing concern for survey respondents, rising from a ranking of 20 in 2017 to 14 in 2019 globally.

For the UK, the picture is slightly different said Chandegra. "UK businesses see damage to reputation and brand as their biggest risk, with the impact of Brexit – not surprisingly – rising to the second biggest risk, and cyber-attack/data breach completing the top three."

Chandegra added, "In the UK, the continuing uncertainty has weighed heavily upon the economy. Here at Aon, we believe it is imperative to share and discuss the survey findings and other key issues facing our clients."

This volatility is, in turn, leading to a more disciplined credit insurance market, said Steve Hamstead – Head of Business Development for Aon's Credit Solutions. "The more alarming trend we're seeing is the reporting of overdue accounts. Payment behaviours are also deteriorating with requests to rephase debt and breaches of maximum extension periods as businesses increasingly take in excess of 60 days to pay suppliers. It's clear that businesses are using their supplier base to help fund their working capital cycle."

Empower Results®

Tackling the business scourge of late payment

Philip King FCICM – Chief Executive, Chartered Institute of Credit Management – explores how successive governments have tried to alleviate late payment problems for business through legislation and other measures, and how the introduction of public reporting of payment practices is proving to be a real "game changer".

"Late payment has long been an issue for business," Philip King, Chief Executive for the Chartered Institute of Credit Management (CICM), told delegates at Aon's Regional Insight 2019 conference. Over the last 20 years, successive governments have thought they've found solutions, he added, with a series of legislative measures designed to help tackle the problem including the Late Payment of Commercial Debts (Interest) Act 1998, Late Payment of Commercial Debts Regulations 2002, through to the Enterprise Act 2016, which introduced the Small Business Commissioner to help tackle late payment and unfavourable payment practices.

Lead by example

It's not just been a stick approach either; government has also tried other measures such as urging central government departments to commit to paying 80% of their invoices within five days and the balance within 30 days. "Earlier this year the then Chancellor Philip Hammond increased that target to 90% within five days. In July, the Cabinet Office introduced Procurement Policy Note 04/19 which said that if a business wasn't paying its suppliers on time then, if they were looking to bid for a central government contract of more than £5 million per annum, they wouldn't be able to do so."

The CICM has also played a role, explained King, with the launch in 2008 of the Prompt Payment Code. "It was intended to be a voluntary code where businesses would commit to paying their suppliers on time; as well as helping to educate their suppliers to know what to do to get paid." There are now 2,400 businesses signed up to the code, added King and, if a small business feels they are not being paid promptly or treated fairly, they are able to raise a challenge with the CICM. As a result, the CICM has helped businesses collect over £3 million, seen businesses change their payment terms retrospectively – such as reversing a decision to lengthen payment terms – as well as change their payment processes and contractual terms. "We've seen change, but the challenge has been that most small businesses are reluctant to say their best customer isn't paying them properly. Over the last ten years we've seen an average of 20 challenges a year – which is not as many as we would like."

Game changer

A game changer, said King, has been the Small Business Enterprise and Employment Act of 2015, which introduced a duty to report under public reporting of payment practices. "We've moved from the position where a small supplier had to ring us up and say their customer isn't paying on time to a position now where the big customer is telling us what they're doing and how they pay their suppliers. If what they're saying doesn't match the requirements that they have voluntarily signed up to in the Prompt Payment Code, then there is an issue. Since going live in April 2017, we've raised 100 challenges so far this year – in April for example we suspended 17 businesses from the code."

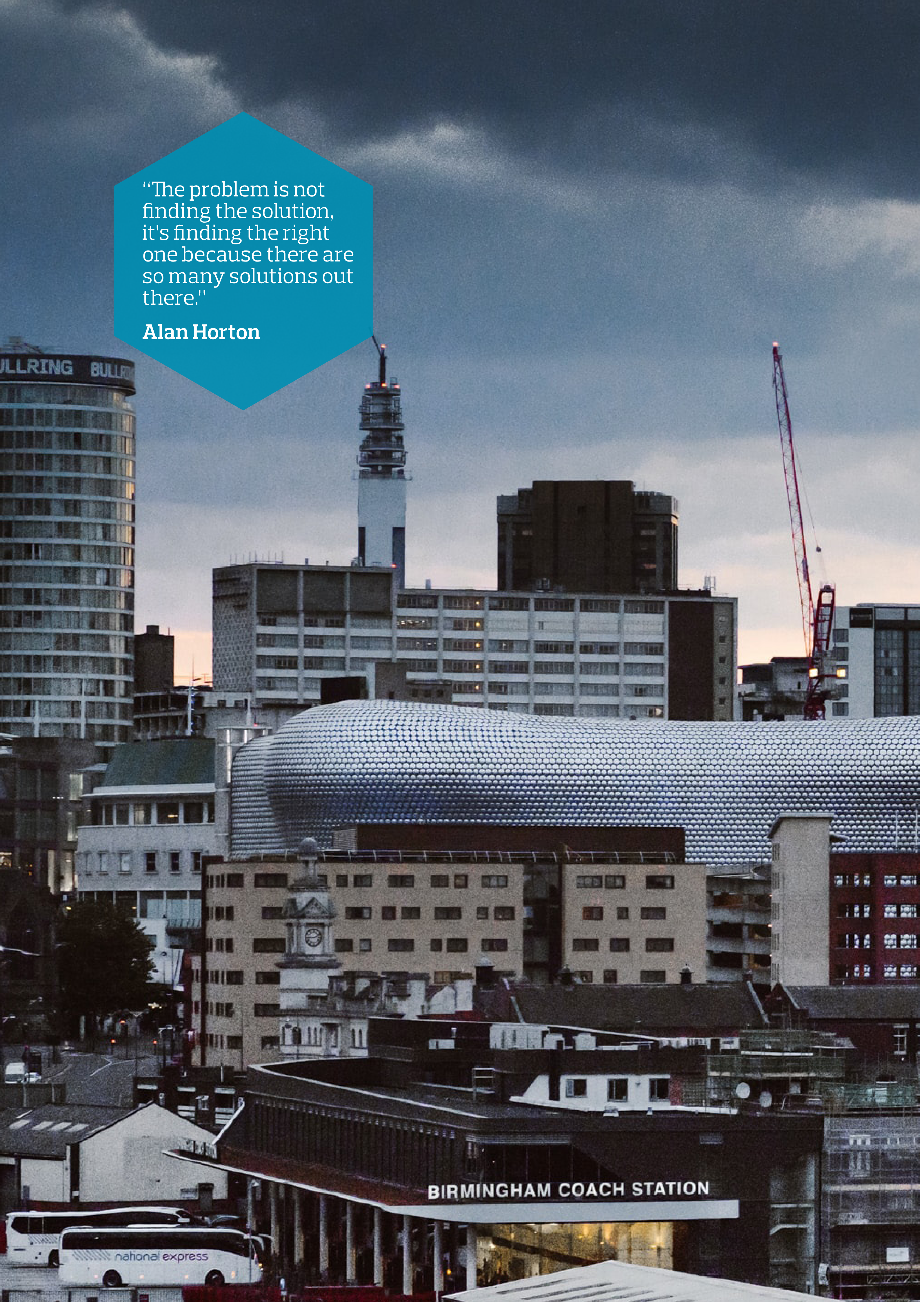
It seems that the threat to brand and reputation from late payment is beginning to hit home said King. "When we say to a business, 'we are going to suspend you from the code and will announce it publicly,' they get very nervous. We now have conversations going on with numerous businesses who are looking to become compliant to their commitment to pay 95% of their invoices within 60 days." As a direct consequence King added, many businesses have put in place actions like removing any terms beyond 60 days, moving payment runs from day 59 to day 53 so payments get through, and improving education both internally with employees, and externally to suppliers to ensure they know what to do to get paid.

"Many businesses are now taking prompt payment seriously with some reporting to their board on a weekly basis on how they're doing," said King, who added that there is an increase in the use of purchasing cards, more streamlining of approval processes so smaller invoices get through quicker, increased awareness and the use of technology – such as the introduction of portals where suppliers can track what's happening with its invoices. "What's key to me is that the businesses who are doing well in this space aren't just making sure they're paying people on time, they're making sure they're recognising the importance of their supply chain," King told delegates.

Culture change is needed

Looking ahead, a consultation is due which will look at increasing powers for the Small Business Commissioner such as the ability to issue fines, said King, while other initiatives may try to force internal audit committees to report on supplier payments and also whether business should have a non-executive director on the board who has a responsibility for reporting on behaviour towards small businesses. "I have sat with successive government ministers who have said we need to fix this late payment problem. But there is no silver bullet – we have to change the culture. We also have to get businesses to understand the importance of good credit management and understand that credit management starts before the order is received and goes on all through the chain," concluded King.

> "We've seen change, but the challenge has been that most small businesses are reluctant to say their best customer isn't paying them properly."
>
> **Philip King FCICM**



"The problem is not finding the solution, it's finding the right one because there are so many solutions out there."

Alan Horton

Working capital, credit and technology – moving with the times

Alan Horton, International Working Capital Director, Santander Corporate & Commercial Bank, argues that while we are living through unprecedented times, amongst all the uncertainty there is still lots of opportunity for business.

The combination of Brexit, an increasingly global economy, trade wars, and another possible general election on the way is creating uncertainty, said Alan Horton International Working Capital Director at Santander when business owners and leaders want certainty. But despite the pressure on margins, returns and growth there are, he added, still opportunities for business.

Focusing first on the UK, Horton questioned whether the country is making the most of its global reach. "In the UK, we are in a unique position with our Commonwealth attachment and we are still perceived as a global brand. In terms of an opportunity, growing overseas must be an imperative. Of course, that will come with its own challenges; the further you travel for business, the further goods have to go and the less control you have. But, access to information has never been as good and the ability for a business to make a credit decision on a customer's credit worthiness in another territory, has never been so achievable," said Horton.

Choice is extensive

Turning to the banking/finance sector, Horton added that the level of competition, new entrants and new technology is unprecedented, which again is good news for business. "Within the market, the access to working capital has never been so great. The problem is not finding the solution, it's finding the right one because there are so many solutions out there. We're not just reliant on the big banks to provide facilities, the choice is extensive."

At the heart of this new competition is the impact of technology. Referencing a report from ING, Horton said that nearly a third of consumers in the UK think their bank is being over ambitious in their introduction of new technology on different devices. That said, the majority (69%) expect the latest technology to be available. "People expect access to technology to empower their business, to draw money, to make payments and manage their business," Horton told Regional Insight delegates.

The future for finance

Turning to the Bank of England's The Future for Finance report, Horton explained how finance will continue to undergo a fundamental change over the next ten years with new entrants, consolidation, and a growing shift from banks to market-based finance. "There will still be the big banks offering core services such as bank accounts and overdrafts; the new entrants want banks to do that because the reality is, it is the least profitable area. What they want to be able to do is provide the working capital and funding which, in turn, is encouraging greater competitiveness within the banking sector," said Horton. "For business owners and leaders, the message is that there is working capital solutions out there, it's trying to find the right one which is going to be the challenge."

What do the Bank of England see as the next steps? "The payment system will continue to evolve," said Horton, "and there will be more innovation through modern financial infrastructure; support for the data and the economy through standards and processes; as well as a transition to a low carbon economy. There are competitors coming into the market who can do a credit evaluation in 24 hours and make money available – it's all digitally based. There are credit analysis tools available to credit control and financial teams that are probably more extensive than they have ever been. We're seeing more automation in decision making."

Becoming more competitive

From Santander's perspective, said Horton, the bank is facing the same issues as its competitors. "We have to keep capital aside for stress tests, so how do we become more efficient and more competitive? We're looking at areas like enhanced prospecting, document management, auto credit scoring, and better loan application flow. Reciprocation of information is also a big thing we're moving to. Banks have always been good at gathering information off businesses to make evaluations. We're going to look to share that information with our clients. It's your information you're giving us, so why wouldn't we discuss that openly with you and try and work with you?"

Trade credit insurance 2020 outlook

Tom Hunt, Underwriting Manager for QBE European Operations, looks at an underwriter's view of risk and what the economic indicators mean for trade credit insurance and why.

When it comes to assessing the warning signs and triggers that credit insurers pay attention to when looking at risk, Tom Hunt – Underwriting Manager for QBE European Operations, delivered a macro view of the global economy and the indicators that could foretell trouble ahead.

With global GDP growth forecast to slow from 3.2% in 2018, to 2.7% in 2019 and 2.6% in 2020/21, it's clear said Hunt, that the decelerations in international trade and manufacturing, amplified by an inventory correction in industrial economies and trade wars are having an adverse impact.

How does all this fit into a trade credit underwriter's view of risk in the UK?

"At a macro level we look at what's happening globally, then we try and bring it down to Europe and look at who are the trading partners of the businesses we are underwriting, and then we bring it into UK risk and output," said Hunt. And for the UK, the economic picture is one of falling GDP and a currency that dipped to its lowest level in 34 years in September, while a hard Brexit could spell even bigger trouble, added Hunt. "Some Economists are estimating a peak contraction in real GDP of -3% year on year, versus the -6% year on year contraction seen in 2009 post the global financial crisis." UK plc profit warnings are also sitting at a 10-year high said Hunt. "A profit warning on its own is not necessarily a huge red flag but it does prompt us to start looking at the fundamentals of that business. Why is it happening and can they cope?"

Dealing with the debt

Another concerning factor, said Hunt, is the level of corporate debt. Global company borrowing at the end of December 2018 was around $13 trillion, more than double the level before the 2008 global financial crisis, while companies around the world need to repay/refinance as much as $4 trillion in the next three years. Much of this debt has also been packaged up as collateralised loan obligations by the banks in a similar way to mortgage debt, which was packaged up and sold, triggering the last financial crisis. "If companies start to struggle to repay debts, this is a possible trigger for doubling down on any recessionary impact that we could see over the next few years," said Hunt.

An additional marker to reference is the level of corporate insolvencies. The underlying number of company insolvencies increased in 2018 to 16,090, the highest level since 2014. "We are seeing things start to accelerate. It's a concern. The sphere of risk that has been written by the credit insurance market is much bigger than it was in 2008. When you're seeing this level of insolvencies and you're writing a bigger sphere of risk, you start to pick up more of these failures," said Hunt.

The three sectors hit hardest in 2018, added Hunt, were construction, wholesale and retail trade, and accommodation and food service (including casual dining). Despite the number of claims however, QBE can and will back businesses even if they are operating in a troubled sector and have a company voluntary arrangement (CVA) in place said Hunt. "We will underwrite when there is a CVA providing the conditions are right and the information is good. We will still back difficult situations as an underwriter."

Impact on credit risk insurance

As a consequence of the changing economic picture, there has already been a noticeable contraction in risk appetite from the insurance market over the past 12 months, said Hunt. "But we're seeing more opportunities from Lloyd's of London and the financial markets, and 'opportunities' will exist for those insurers who are willing to write risk based on the stand-alone fundamentals of a business." Pricing has also gone up over the past 12 months from a six/seven year low, he added, with pricing expected to increase considerably through 2020, especially in the event of a no-deal Brexit."

"The sphere of risk that has been written by the credit insurance market is much bigger than it was in 2008."

Tom Hunt

Panel session: Lessons learnt?

Alan Horton (AH) – International Working Capital Director, Santander Corporate & Commercial Bank

Tom Hunt (TH) – Underwriting Manager, QBE European Operations

Philip King (PK) – Chief Executive, Chartered Institute of Credit Management

Q: What lessons have been learned from the Carillion insolvency?

TH – "When you get a failure like Carillion, that's the time when credit insurers need to hold steady. The way you do that is by accelerating your knowledge of the companies in the supply chain that you think will be most impacted. Additionally, Carillion was such a big percentage of many of our clients' trade that if we'd pulled the cover when we first had concerns, we would potentially be helping our clients to go bust. We had to take a position for longer than was comfortable and the way you do that is by getting better information."

PK – "For me, the key lesson is around knowing your customer and their customer, and their customer. I talked to lots of small businesses who failed or suffered because of the Carillion failure and didn't even know they were working for Carillion. It's incumbent on anyone working in credit to know the supply chain ahead of their customer."

Q: Given the increase in insolvencies and debt, how do we come out of this problem?

TH – "We haven't hit a global recession yet. There is still growth out there. It's about where you steer your business – if you are in a market that is in decline, and a business model that no longer works, then management needs to recognise that. Take an objective view of your business and where it will be in a few years and ask can it weather a storm? If you're working with your credit insurers and we're trying to exit a risk, we should be trying to help you replace that lost revenue as well."

AH – "It's about embracing new markets, new opportunities and looking at things you haven't looked at before. The other fundamental issue is that during the last recession, a number of businesses started to shrink and reduce their finance and risk management teams. In terms of cost and budget for effective credit control and risk management, have those teams been brought back up to pre-credit crunch levels?"

PK – "We are seeing increased use of technology, and the smart businesses are the ones who will use technology to be more efficient and that they use the resource that they free up, to be more effective in terms of knowing the customer better and doing all the things we need to do in order to manage the economy and the business better."

Q: As the economy slows, is it your expectation that companies will seek to conserve cash by taking longer to pay?

PK – "I think businesses will seek to conserve cash by taking longer to pay but I think they are under huge pressure from a whole variety of different areas not to do that. There are solutions that are out there which enables them to take longer to pay without necessarily acting to the detriment of their suppliers."

AH – "For smaller companies particularly, if there is an opportunity to extend payment terms, they will do so because it is an acceptable form – regardless of whether we like it or not – of extending working capital."

TH – "We're on the cusp of technological solutions that could bridge some of the gaps in areas like payables finance."

Key Contacts

Bhav Chandegra
Business Development Director
Aon's Credit Solutions
bhav.chandegra@aon.co.uk

Steve Hamstead
Head of Business Development
Aon's Credit Solutions
steve.g.hamstead@aon.co.uk

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

Aon is authorised and regulated by the Financial Conduct Authority.

aon.co.uk