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MAKE uk
The Manufacturers' Organisation

Trading overseas

Why mitigating the risks will be key to success

Protecting supply chains is vital for UK manufacturers trading overseas.

In the expanding global economy, many manufacturers are looking to trade overseas or in new markets. Whilst international markets present good opportunities for businesses, there are also a number of risks which manufacturers should prepare for.

Trading in overseas markets brings attractive benefits. Most obviously, the potential for growth is higher if you have a wider selection of trading partners and customers. You may also be able to better differentiate your business over competitors as your products or services are more unique in the global marketplace. From a risk management perspective you can diversify the risk of trading by removing the reliance on one sole market – if that collapses your business could still potentially survive through overseas revenue.

The risks associated with overseas trading need to be well defined before the decision is made. There could be a number of points of difference which will cause issues if not planned for in

> Further expansion into overseas markets and the potential for economic volatility is prompting increased action to ensure companies are protected against bad debts. While we see more emphasis on this from 40% of the companies surveyed, a sizable majority of SMEs plan no action on this, which could lead some businesses exposed to additional risks this year.'

Make UK Executive Survey, in partnership with AIG, 2018

advance, for example local legal framework, business etiquette and unstable economies.

Make UK, the manufacturers' organisation, and AIG recently published an executive survey highlighting that one of the major risks of trading internationally is bad debt.[i]

What keeps many business owners awake at night is the fear of trading partners lapsing with payments or becoming insolvent leading to a broken supply chain. Having to chase payments from businesses abroad is daunting, particularly if your relationship with them isn't particularly strong.

However, there are ways to mitigate these risks so manufacturers can continue to trade confidently overseas.

So, what exactly are the biggest threats and most popular solutions?

The threats

1. Brexit

Rather than the political details of Brexit, which at this stage nobody is 100 per cent clear about, it is the uncertainty which concerns businesses most.

Whether it is the volatility of sterling, the nervousness of European partners to invest or supply chain resilience, the biggest issues are familiar ones – but ones which have been exacerbated by the extended Brexit process.

Roberto Simone, a credit analyst at Howden, said: "Brexit is certainly an issue to watch closely. When you look at the UK we've been talking about something big for a long time now.

"We had the collapse in 2008 and recovered – but Brexit affects our main trading partners and you have to factor that in. We are now starting to see the effects. Manufacturers abroad are holding back on exports and, for some, business is on hold. Uncertainty and fear magnifies the problem and will have a stronger bearing the longer the year goes on because the UK is in a transitional phase. It's a risk that businesses need to factor in."

2. The effect of a potential interest rate rise

A rise in interest rates has long been mooted in the UK and it would be little surprise to see rates creep up in the second half of 2018.

"The warning signs to look for are inflation, rising interest rates, the performance in the retail sector and companies going out of business," said Roberto. "All these indicators mean there could be less money in peoples' pockets in the future and that will have an effect on manufacturers trading in the UK."

3. The effect of inflation

The aforementioned Make UK Executive survey identified increased pay pressure as a result of inflation as a real risk for manufacturers, with 54 per cent raising it as an issue – a figure which rose even higher amongst bigger companies. This was further exacerbated by recent rises in the National Living Wage in the UK.

4. The risk of cyber attack

The Make UK survey reported that one in six businesses said that disruptions due to a cyber attack is on their risk radar for the year ahead, especially as technology and data begins to play an ever-larger role in industry.

The theme was taken up by global insurance organisation AIG who said in the report: "At a time when Brexit is dominating concerns about the future, cyber risk stands out as a largely unrelated threat that is rapidly rising up the risk agenda."

The WannaCry ransomware attack of summer 2017 (which targeted computers running the Microsoft Windows operating system) highlighted why.[ii] The high profile attack crippled a range of industry sectors and was followed by a new strain of the Petya ransomware which exploited the same vulnerability.

The solutions

1. Credit insurance

Trade credit insurance is designed to help businesses protect their accounts from loss due to credit risks such as protracted default, insolvency or bankruptcy of trading partners. It can help protect the supply chain prevent cashflow problems and act as a comfort blanket for companies when trading overseas.

In fact, this type of insurance first came to the fore when the UK government was looking to help businesses expand overseas and take advantage of trade opportunities in developing countries. Today credit insurance is offered by private insurance companies, the policy has become increasingly sophisticated and used by many businesses to support business growth.

No matter the business size, credit insurers provide access to financial data about millions of companies across the globe. Therefore, insured businesses can make informed decisions when choosing who to work with. As a result, working with more credit-worthy organisations will bring in higher profitably in the long term. In the event of an overseas customer failing to pay, credit insurers will support in collecting debt locally where there may be a language/cultural barrier.

For larger risks, some insurance companies may be able to provide detailed insight about potential trading partners, even before a deal is agreed, as well a more general analysis of market risk.

A supply chain risk assessment may also be available, along with insurance in order to cover problems in the supply chain or late payments.

The reality is that trading overseas is often crucial to a business' growth plan but does come with extra complications. Working with companies with different cultures, regimes and trading standards is a challenge – and there may be issues with local laws, government stability, bureaucracy and currency fluctuation. So, supply chain management and protecting against risk is vital.

Although trade credit analysts are most often used for larger businesses, it is not only corporations which benefit from the insurance. For SMEs, this type of insurance can be even more important. For a business with a £2m turnover, a trade partner defaulting or going out of business can have a major impact on business continuity.

Key benefits of credit insurance

- **Expand into new markets and launch new products**
- **Work with new clients you know nothing about**
- **Retain good working relationships with customers**
- **Gain a competitive edge through ongoing access to customer insight**
- **Improve your cash flow**
- **Make quicker business decisions**
- **Become more profitable**

2. Preparation for all eventualities

The Make UK Executive survey suggests businesses are becoming more forward-looking in their planning by spotting potential problems early on and putting a strategy in place to deal with it.

Many businesses, for instance, are already undertaking preparatory work in case of a 'no deal' outcome for Brexit.

3. Managing cash flow

Manufacturers of all sizes mentioned better management of cashflow – and more mitigation strategies to cope with it – as important. As Lloyds Bank's Working Capital Index noted: "Businesses that are actively growing tend to focus more on revenue and margins than working capital and balance sheet efficiency. However, many firms are likely to be left exposed if economic conditions deteriorate which would require them to free up cash quickly."[iii]

The Make UK Executive survey showed many businesses are already putting measures in place to better manage cash flow in a post-Brexit era in which the market may look very different.

4. Automation

Manufacturers hoping to scale-up in 2018, and especially those embracing the global market, have concerns about the challenges arising from capacity constraints. So 72 per cent say they are looking at automation in their production processes as part of the answer – as well as communicating better with those in the supply chain to improve flexibility and responsiveness.

5. Improving productivity

Meeting increased demand was cited as a major issue for 2018 in the Make UK survey, with 86 per cent of companies increasing efforts on process innovation and efficiency improvements to counteract it. Embracing technology was also seen as important.

6. Cyber insurance and updated data protection policies

As technology grows ever more important in global business, the threat of cybercrime and of a company suffering a data breach grows with it. Cyber insurance can protect businesses from losses arising from a breach and is becoming increasingly popular. However, it doesn't in itself protect a business from a breach.

Many businesses have recently updated their data protection policies and undertaken in depth data audits due to the EU General Data Protection Regulation which commenced in May. Huge fines of up to 4 per cent of global turnover or 20m Euros, whichever is greater, are now applicable.

Conclusion

There may be complications in the home economy but it is by no means doom and gloom for businesses, which have a global outlook and prepare appropriately for the challenges ahead.

With Brexit ahead, trading partners in Asia, South America and North America could become even more important in future, especially as currency devaluation is currently helping UK exports to grow.

Those businesses which prepare properly for those markets, evaluating and mitigating all the possible risks, will be best placed to take advantage of the opportunities ahead.

Sources: i. Make UK Executive Survey in partnership with AIG, 2018 ii. BBC News iii. Lloyds Bank Working Capital Index

Q&A: The role of a credit risk analyst

with Roberto Simone of specialist insurance broker, Howden

Tell us about your role. How does it work?

My job is to look at the businesses and markets a client is looking to trade with and to dig deep to find out the risks, which might not be obvious on the surface. It's a bit like being an investigative journalist, analysing inherent risk in businesses.

So where are you finding this information?

It comes from a wide variety of sources, some of it in the public domain – open source information which could be anything from reports and published accounts to social media. But you also use your contacts and your experience. You're looking for anything which could increase risk when trading with them.

Can you give us an example?

Well, take a business whose trade is heavily weighted to just one client. That's a bigger risk because it will be disproportionately affected if something goes wrong with that relationship. But from the outside it looks perfectly healthy. Having all your eggs in one basket can be a risk. The loss of a big contract can have detrimental effect on their ability to pay and on cash flow too and in some cases its viability.

What else do you look at?

There are a lot of things. Their profile in the press, who they trade with, their trading position, where their problems lie. What is the likelihood of them defaulting? Sometimes businesses look solid and all the media about them is positive – but high-profile businesses have gone bust so it doesn't mean there isn't any real risk that is latent.

What would a client expect to receive from you?

An in-depth, unbiased and balanced report on a potential trading partner in which we stress test the supply chain and analyse the bigger picture. An intricate detailed report into a particular company and its latest financial performance evaluating trends, key performance indicators and its financial health.

Do you only analyse individual businesses?

No, we can also look at entire markets, for instance analysing the issues when doing business in China and taking into account the cultural problems as well any local laws and business barriers. With extensive credit experience on a number of International territories can assist with a businesses strategy when considering to trade with less familiar regions.

So, is it only about mitigating risk?

No, it can also be about identifying opportunities. I have vast experience as an underwriter and that can be valuable. Many companies may be apprehensive about doing business in a particular country but we can help because trade credit insurance gives them reassurance by mitigating all the risks.

Different sizes of company have different needs, too. For bigger companies it may be possible train up their own risk analysts, helping them to understand what's needed through credit risk training. You give them the key facts to look out for. Sometimes a business looks strong but there's something hidden there – I've seen that so many times over the last 15-20 years.

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About Howden

Howden is the world's largest independent international retail broker. We have been the insurance partner to Make UK, the manufacturing association, for over ten years. We have helped numerous manufacturers to achieve their commercial objectives, from reducing business risk with improvement contributions from insurers to stabilising premiums to enable more accurate long-term budgeting.

Speak to a member of the team today.

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