

MARSH



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Executive Briefing

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Risk management techniques to build business resilience



Meeting the challenge

Most businesses are only too aware of the challenges caused by the current economic climate. In the current environment many historic assumptions about business stability are being questioned and many risk factors such as labour unrest (across the world), supplier liquidity, customer default, fraud and directors' liabilities are changing rapidly.

How can your business react?

Marsh believes that by applying risk management techniques businesses can build resilience to help them trade through the downturn. This paper sets out our thoughts in the key areas of:

- Updating your risk profile
- Insurance and risk financing
- Boosting your access to credit
- Examining your supplier management
- Redesigning products
- Managing fuel costs
- Managing the risks in business restructuring

Marsh and our sister companies in the MMC group can assist you with all the issues raised in this document. For more information or assistance please contact your usual Marsh representative or E-mail: national.enquiries@marsh.com

Update your risk profile

In the current volatile economic conditions, key stakeholders in your business, including those who provide funding, are likely to become even more interested in your approach to corporate governance and the management of risk. Volatility can change areas and levels of risk rapidly and you may now be exposed to risks that were previously not of concern.

For these reasons we strongly recommend you review the range of risks to which you are exposed, their potential impact and your control and mitigation strategies.

Pay particular attention to political and labour unrest that may be exacerbated by rising food and energy prices around the world. This may threaten your supply chain or contract manufacturing.

Revisit your contingency planning. At a time when margins are being squeezed, it is essential to have robust plans to respond to any adverse incidents that occur.

Ensure your plans reflect scenarios such as loss of a key supplier or customer, or intervention by a foreign government that restricts exports and thus prevents you from receiving product or key ingredients.



Re-examine your insurance and risk financing

Consider whether you should transfer more risk to the insurance market and therefore reduce volatility in your costs. This might involve reducing levels of retained risk ('deductibles') or buying cover in areas you have not considered before, to enhance the level of protection for your business.

Challenge your broker to demonstrate how they are differentiating your business in the insurance market. They should be collecting detailed information from you about your management of risk, to aid negotiation of the best possible insurance terms for you.

Review your sums insured. With changing conditions, you may need to amend your sums insured. For example, with low demand for building construction the rebuilding costs of premises may be lower, thereby meaning your sums insured and premiums can be reduced. Consider a professional valuation of your buildings and contents sums insured for insurance purposes.

Consider your premium financing options. Attractive premium credit options are available to help you spread payment and Marsh can provide access for you.

Consider other risk transfer options. There are some types of risk that cannot easily be transferred to the conventional insurance market. Alternative Risk Transfer mechanisms are available and may form part of your overall approach to protection.

Protect directors

As the fall-out from the sub-prime mortgage crisis is demonstrating, directors are in the firing line when stakeholders see company values reducing. Review the level of protection you are purchasing in the Directors' and Officers' liability insurance market, especially if you have exposures in the US.

Check your business interruption cover. Ensure you are purchasing cover for any key supplier dependencies.

In the present economic environment it is critical to maintain your credit rating and access to funds. Standard and Poor's have recently indicated that they will begin incorporating consideration of the strength of Enterprise Risk Management (ERM) practices within rated entities as a component of their credit ratings methodology. This is yet another driver for ensuring your approach to risk management is robust and will stand up to scrutiny.

Boost your access to credit

Evaluate your trade credit exposures. Whether you currently insure your risk or are financing it on the balance sheet, now is a good time to review the insurance products that are available to protect against the increased risk of customer default or late payment.

Focus on maintaining a good profile with the trade credit market – if your suppliers cannot obtain insurance on you, they may not be prepared to give you credit.

As banks tighten their lending policies, credit insurance may provide lenders with the security to advance greater amounts or reduce the cost of borrowing.



Manage your fuel costs

Ensure that fuel cost sensitivity analysis is part of your decision process. Although fuel costs are now less than their peak, they are still much higher than two years ago. Fuel costs have now risen to such a degree that they can change where companies should locate their network of manufacturing plants, distribution centres, depots and other facilities.

Protect your business from rising transportation costs. Consider renegotiating service delivery frequencies to your customers or passing through fuel surcharges to them, to protect yourself from rising transportation costs.

Consider forward buying. If you use commodities or materials that are anticipated to continue increasing in price, consider forward buying. Weigh the inventory holding and obsolescence costs, warehouse space requirements etc against the value of stockpiling goods bought in at lower cost.

Redesign products

Mitigate loss of margin by creating smaller product sizes, lighter-weight or slimmer packaging to lower per-unit transportation costs. Use alternative formulations to reduce material or ingredient costs.

Some companies are changing production from luxury to value lines, in response to changes in consumer demand and buying preferences. Also consider value-added bolt-ons to products to increase their attractiveness – such as easy to access insurance cover for the product.

Examine your suppliers

Watch for early warning signs that your suppliers are becoming financially stretched, manifesting, for example, as delayed or partial shipments or product quality issues. Use credit management reports on suppliers in the same way you would for customers. Reduce your supplier dependencies as far as possible – aim to have diversity not just among multiple suppliers, but also geographic locations.

Control the risks in business restructuring

The credit crunch has shaken up the dynamics of the mergers and acquisitions (M&A) market. While transactions are being done, there has been a shift in power back to corporate buyers, who in recent years have been sidelined by the M&A activity fuelled by private equity firms. Transaction sizes are smaller and valuations are arguably more reasonable, fostering an environment that could prove to be attractive for both cash-rich corporates and private equity firms holding on to unallocated funds.

With the days of covenant-lite financing over, we are seeing a renewed focus around the due diligence process and in particular the analysis and transfer of the risks and liabilities between the buyer and seller. Never before has the innovation and adaptability of the M&A insurance market been so valuable.

If things go wrong

In today's evolving marketplace even the best-managed business can at times face difficulties. When this happens, early and constructive action may reduce the adverse impact. Corporate recovery experts can often help businesses to improve working capital management and cash-flow, or to achieve solvent closure.

The information contained in this publication provides only a general overview of subjects covered, is not intended to be taken as advice regarding any individual situation and should not be relied upon as such. Insureds should consult their insurance and legal advisors with respect to individual coverage issues.

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