HOW TO FUTURE-PROOF YOUR BUSINESS

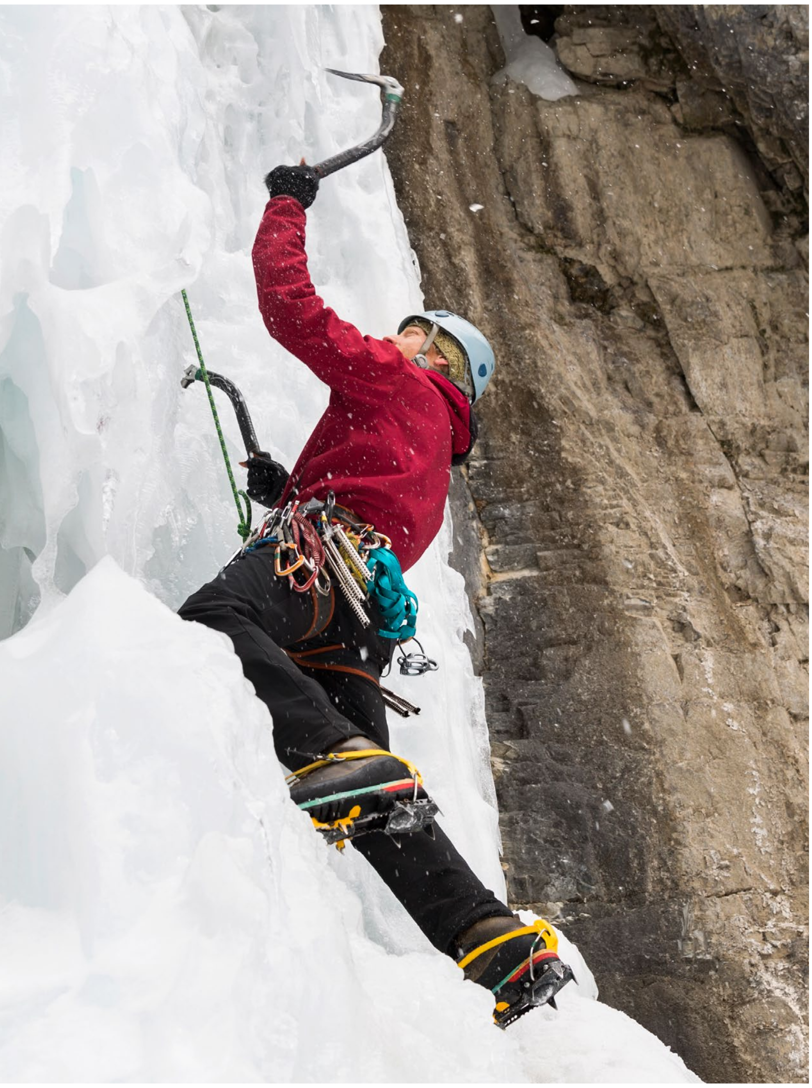
The SME owner's guide to spotting the early warning signs of risk

A company of Allianz

EULER HERMES

INTRODUCTION

Like it or not, dealing with risk is part and parcel of what it takes to grow a business. Many serial entrepreneurs who notch up multiple success stories will describe themselves as risk-takers. One of the UK's most famous examples, Sir Richard Branson, published a book called "Screw It, Let's Do It," reflecting his willingness to take a chance even if the odds were stacked against him.



But even the most maverick of business owners understand the downside of risk and how it impacts every part of a commercial operation. Threats to business exist in all shapes and sizes. They can bubble up within your company, your supply chain or even in changes to world politics and global alliances (think Brexit).

According to Allianz Group's 2018 Risk Barometer, business interruption, cyber-incidents and natural disasters are three of the most common forms of risk facing businesses around the world. Natural catastrophes alone accounted for $135 billion-worth of insured losses during 2017.

Business interruption and cyber-attacks are the top threats for SMEs, while changes in legislation and regulation (such as economic sanctions, protectionism and Brexit) are also high on the agenda. Each risk has its own identity: some are more likely to blow up in your face than others, some will have a bigger impact if they do occur, while some are harder – maybe even impossible – to predict.

"Natural catastrophes alone accounted for $135 billion-worth of insured losses during 2017."

An ice-cream van owner knows that demand will soar in August and plummet in January, so they have to plan for variations in sales. The 'risk' to income is a given. But what if the van breaks down in the height of summer and repairs take two weeks? This scenario is less easy to plan for but its impact could be serious. The risk profile of any business magnifies as it grows.

One ice-cream van has a pretty simple profile but a national chain of ice-cream cafés has to contend with an interconnected set of challenges that range from complicated logistics to a transitory, temporary workforce.
Certain industries are exposed to greater risks than others. UK financial services could suffer under Brexit, exporters are being hit by a rise in global tariffs, while small businesses in the tech sector say they are having a hard time recruiting skilled staff.

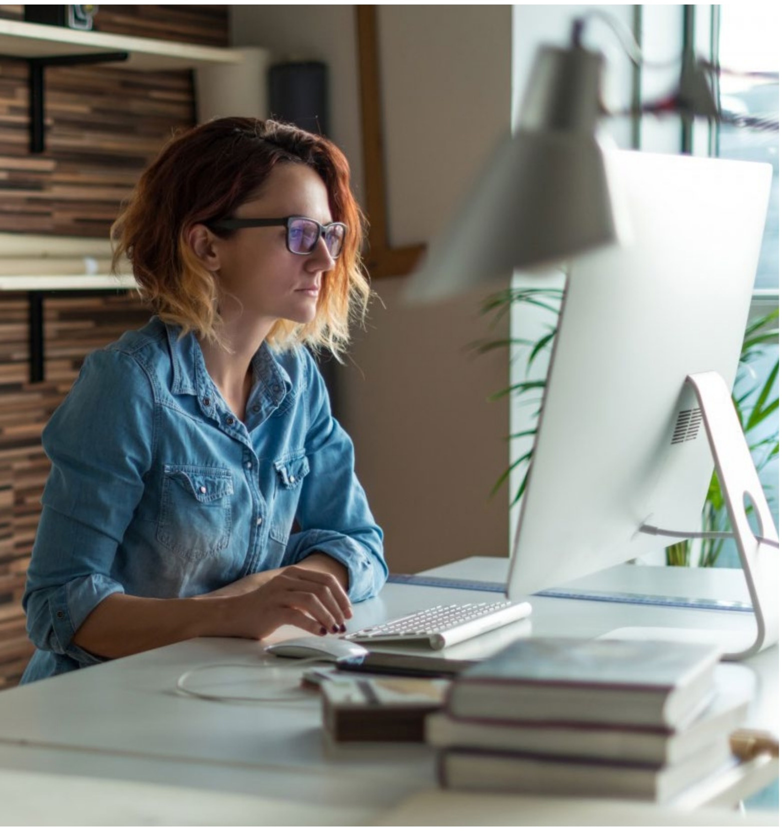
Paul Anderson, assistant head of risk underwriting at Euler Hermes – part of the Allianz Group and the world's leading provider of trade credit insurance – says that management frailties and cashflow are two of the biggest reasons businesses suffer. "You can be a good business in a good sector but poor management causes it to collapse. Small companies aren't always good at delegating so they try to do everything instead of letting other people get on with it and moving into a leadership role."

Paul Anderson refers to one particular growing business that produces steel cylinders in the north of England. Having won a large contract, it focused resources on fulfilling it. The client failed to pay on time and because of the size of the deal (around £1 million), the factory collapsed before the money arrived. "Don't put all your eggs into one basket," he warns.

The challenge increases when business owners move from small, predictable start-ups into larger, more complex organisations. Understandably, when businesses get going owners want to focus on sales but, without due care, risks can build up.

According to Jack Kent, team manager South at Euler Hermes, insuring against bad debts is pivotal in planning your business' growth. "From my experience, the companies who are really serious about their growth options take out trade credit insurance to protect themselves when dealing with companies they haven't supplied before. It protects their growth and limits the fall-out from customers who don't pay or go bust."

It's useful to set aside time to consider ways in which your business could derail – and plan how you will mitigate the fallout if it does. It's impossible to anticipate every spanner in the works, but a considered risk strategy can keep out most of them.



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WHAT RISKS DOES MY BUSINESS FACE?

Risks can come from anywhere. They could be as simple as a key person falling ill or as complex as political instability in a country that is a key link in your supply chain. Here are some of the most common risks to look out for.

1. PROPERTY AND EQUIPMENT

Perhaps the most obvious set of risks are to the physical infrastructure of the business. Buildings and assets like vehicles and equipment can be damaged or break down. An electrical fire, burst water pipe or break-in can cause thousands of pounds to repair, as well as days or weeks of disruption.

1 in 10

SMEs cite fire as a potential business risk

2. CASH FLOW MANAGEMENT

Money is the lifeblood of a business so losing it – or worse, running out of it – presents a significant threat to a company's survival. For small businesses, financial risk usually comes in the form of bad debt, whether it's late or non-payment by clients, but it could come from other sources, such as the bank refusing to extend credit.

Victoria Keeling, direct and bank distribution underwriting manager at Euler Hermes, says small businesses often struggle with finance because they are perceived by lenders to be a higher risk. "Small businesses have to pay more to get capital. If they are new, they are considered higher risk, so they need a good business plan to win backing."

> "Other risk areas include the skills mix. Small business owners have entrepreneurial flair but they can be pigeon-holed instead of being seen as what they need to be, which is almost a jack of all trades."

3. ACTS OF GOD

These are natural events involving weather and geological phenomena. They include floods, hurricanes, earthquakes, snowstorms and even unanticipated volcanic eruptions. Each country has its own blend of potential weather events and so its own risk profile.

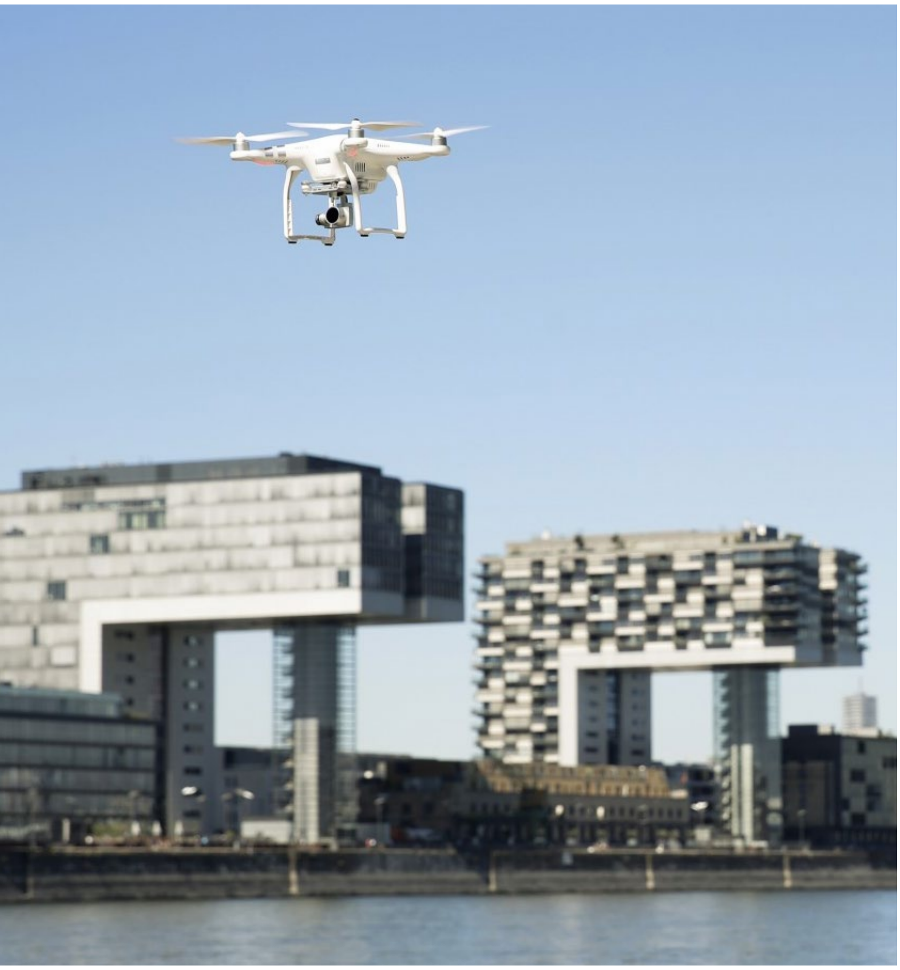
4. PEOPLE

Employees drive your business forward, adding value, generating ideas and doing the legwork that leads to growth. But – whisper it – they are also a common source of risk for organisations. A rogue staff member could decide to run off with your database, leak information to third parties or commit an illegal act on company premises.

In less drastic scenarios, trusted staff can accidentally damage a business by using incompatible technology, approving fake invoices or allowing computer viruses into the network via spam emails.

12%

of SMEs cite people and the threat of theft, fraud or corruption as key business risk



5. CYBERCRIME AND FRAUD

Many problems stem from technology, whether it's the result of an IT breakdown or a malicious attack by cybercriminals. According to UK government statistics, 43% of UK businesses fell victim to a digital security breach in the last year, meaning the threat from criminals is very real. What's more, fraud is now the most commonly experienced crime in England and Wales, and most takes place online.

6 in 10

SMEs say cyber security is a concern

6. SUPPLY CHAIN

Your supply chain is only as strong as its weakest link, yet many businesses are unaware of just how far their supply chains stretch. A product sold in the UK could have travelled through multiple suppliers in a large number of different jurisdictions before it reaches a store shelf.

The more complex the product, the larger the chain of supply. A car manufacturer, for example, relies on timely deliveries from factories all over the world to assemble vehicles for sale. Each business in the supply chain is affected by its own suite of risks, which are multiplied as the chain extends.

33% **of businesses fear they might not be able to continue a smooth operation if business is interrupted by, for example, a supplier going bust**

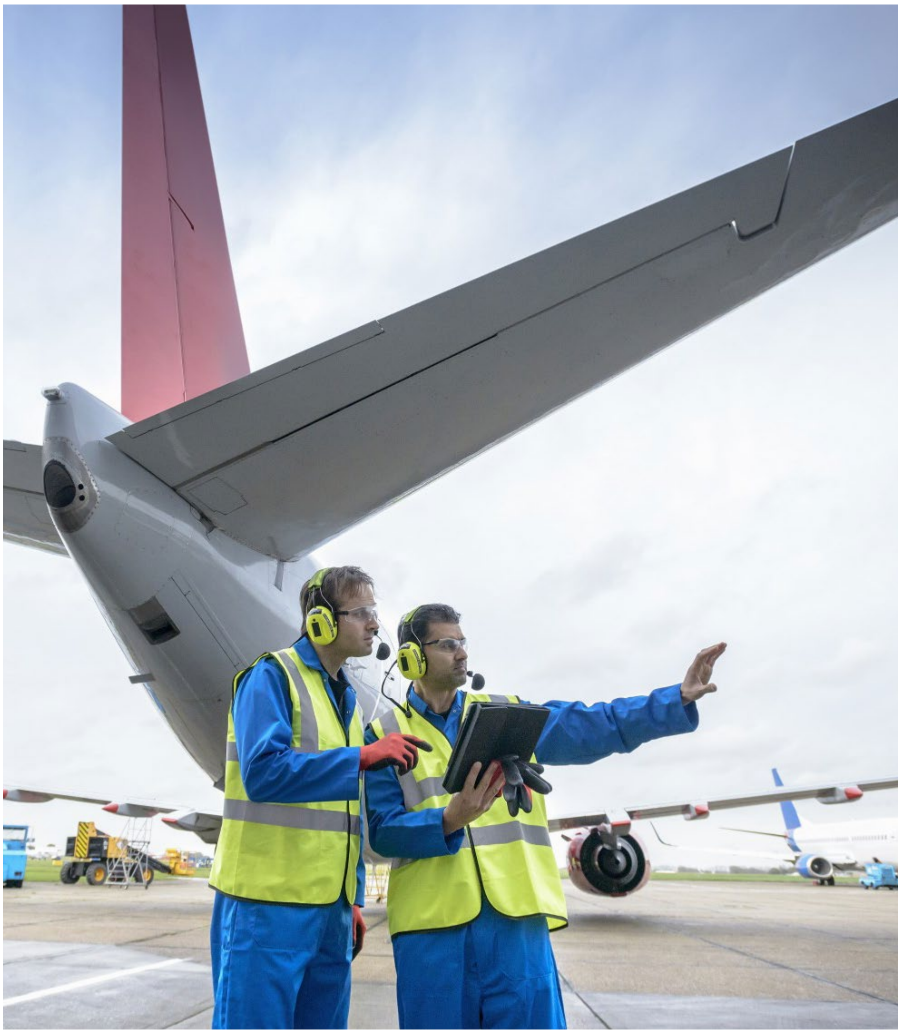
8. STRATEGIC RISK

From the moment someone decides to start a business, they open themselves to strategic risk. Every decision has its pros and cons, some more than others, and ultimately the strategic direction of a company defines whether it succeeds or fails. Major decisions incorporating risk include launching a product line, acquiring a business or moving premises to accommodate growth. On a smaller scale, individual hiring and firing comes with the potential to disrupt smooth operations.

7. GEOPOLITICAL

Political and socio-economic changes influence both the supply side and the retail market and their effects are often dramatic. The UK's decision to exit the European Union (EU) caused a fall in the value of sterling, making imports more expensive, while its final impact on trade is still unknown.

Meanwhile, the election of Donald Trump in the US has seen the country's economy grow, but also sparked trade tensions and a tariff war with powerful trading blocs like China and the EU.



"With all the uncertainty, Brexit is a huge problem for small businesses," says Victoria Keeling. "Depending on the outcome, there could be extra expenses and pressure to expand outside the EU to cover the shortfall, pushing companies into unknown territory."

HOW TO IDENTIFY RISK?

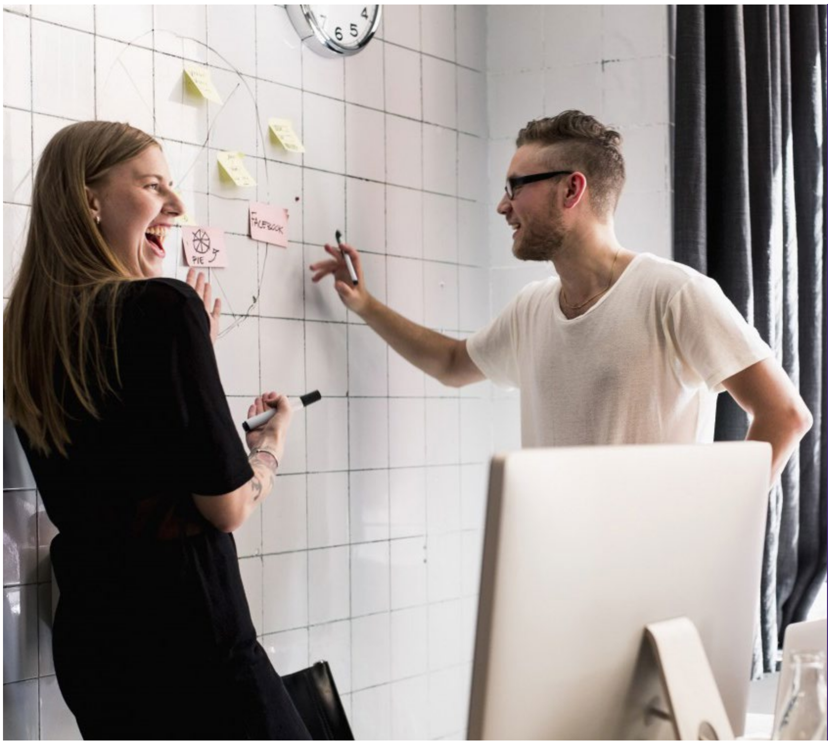
A business' risk profile is unique. The threats it faces are dictated by location, the market, where it sources materials and services, scale, operations and technology, as well as its workforce and the skills required to keep it growing.

A manufacturer in Glasgow faces a different set of risks than a microbrewery in Dublin, yet both must identify their exposure to avoid damage. Understanding threats is a vital step towards drawing up a procedure for crisis management. Here is a three-step guide to drawing up a risk profile…

1. BRAINSTORM WITH THE TEAM

Assess the primary threats and request input from people involved in the various functions of the business, including finance, marketing, IT and HR. Create a longlist of potential pitfalls. This should focus on threats that are either imminent and/or potentially damaging.

Draw inspiration from other companies in your market – particularly those involved in high-profile events reported in the press – that have experienced problems and consider whether your business could suffer the same fate.

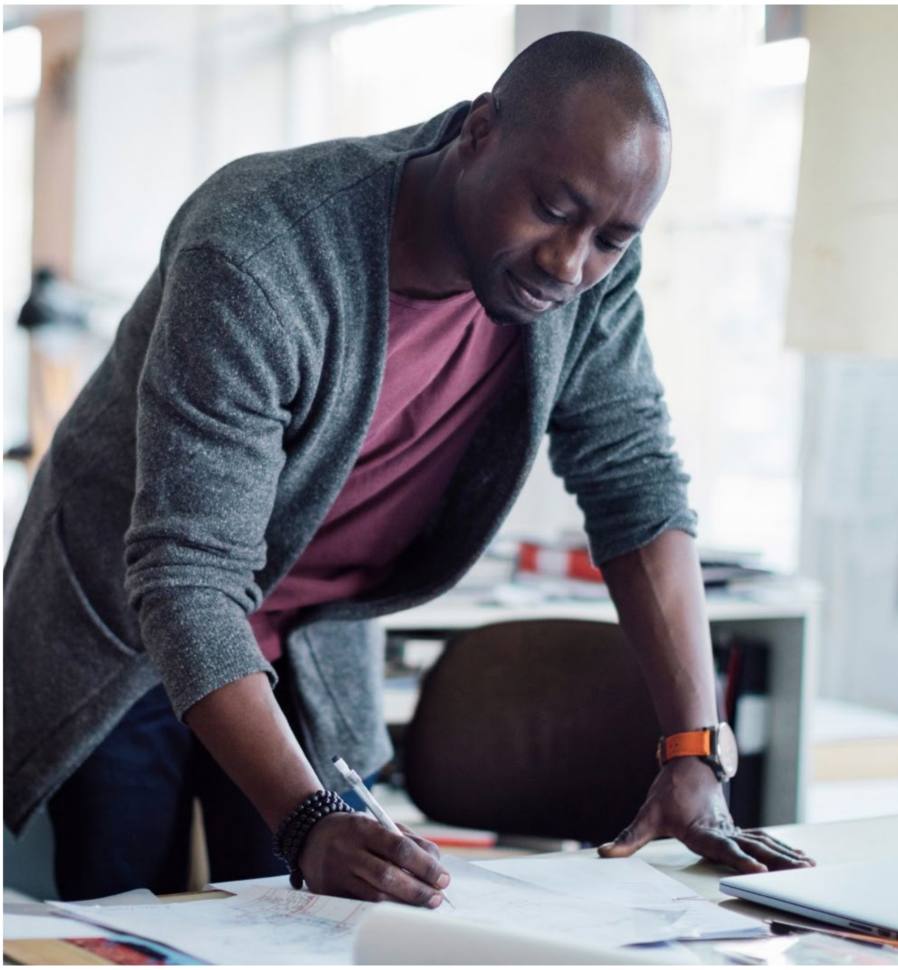


IF YOU NEED A KICK-START, START WITH THE FOLLOWING QUESTIONS:

- Do we source or supply companies overseas? If so, to which countries and how stable are they?
- Which companies are we selling to and are there warning signs in their communication or payment times?
- What kind of access do staff have to key areas like finance and IT; are there any weak spots?
- What does the sales pipeline look like and are there any new or unknown clients?
- Is the market strong generally? If not, could diversification help secure new revenues?

2. LIST AND CATEGORISE

Group these cases into categories of risk (there will likely be some overlap between departments) and order them into a scale of severity. Discuss 'what-if' scenarios with your team to paint a picture of situations you want to avoid. If the business has experienced disruption in the past, ask yourself whether the threat has passed or if it could happen again.



33%

of SMEs fear business interruption (including supply chain disruption) making it the the top risk for SMEs.

3. ROLEPLAY SCENARIOS

Taking the most serious threats to your business, roleplay how the business would respond if one of these events actually happened. Would the response be robust and clinical, or haphazard and ineffective – or somewhere in between?

Running this test will reveal holes in the system and show you where action is needed. Draw up a list of priorities: you might want to grade risks by their levels of urgency.

EVENTS COULD INCLUDE:

- A major customer cancelling a contract or going out of business
- A flood knocking out your IT capacity
- An attempted hack into your invoicing processes
- A supplier letting you down
- A new product or service failing to drum up demand.

It's important to conduct regular reviews to ensure your business is running well.

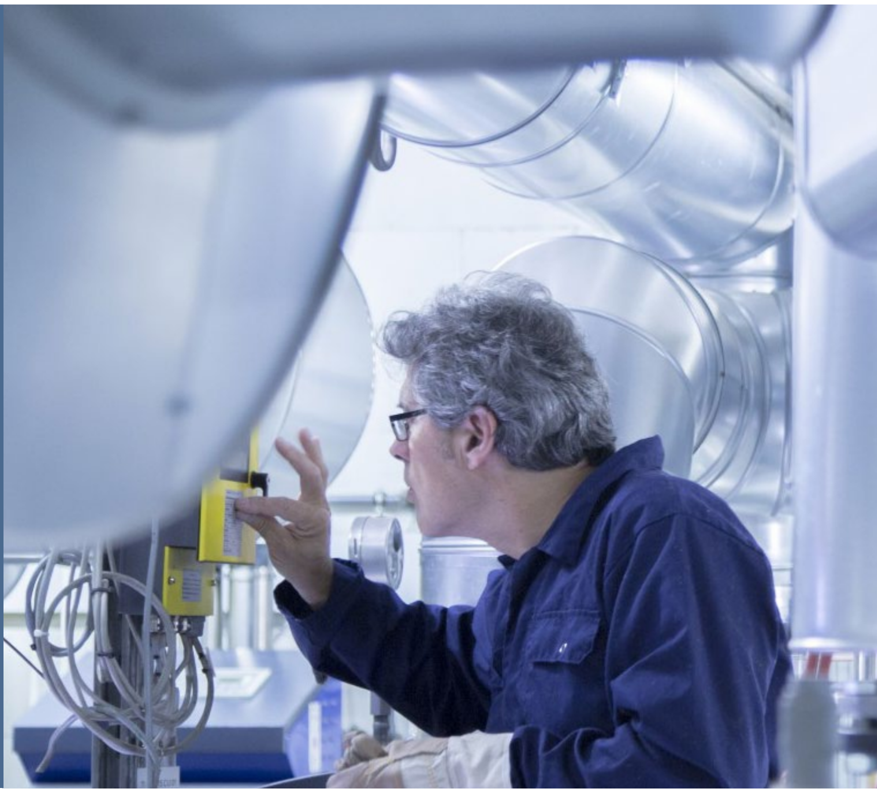
"Businesses should always review procedures, suppliers, systems and prices," says Jack Kent. "They should consider the whole business, looking at what works, what doesn't and whether they are paying the right money for the things they buy.

"Trends change, as do people and technology, so it's important to keep evaluating. For example, department store BHS, didn't have a plan B, it didn't diversify and it didn't invest properly in online services, so it fell behind the competition."

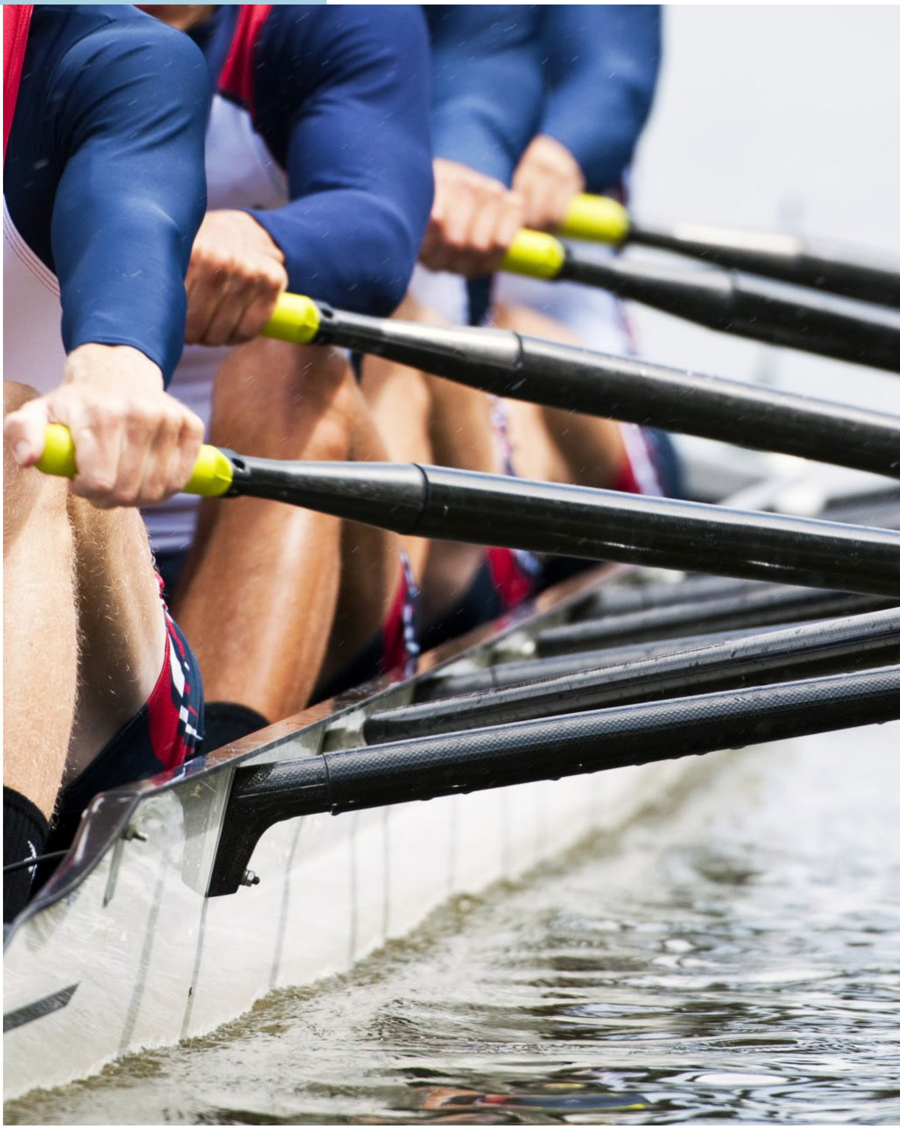
IS TRADE CREDIT INSURANCE FOR ME?

Small businesses face many risks. Some you may feel are unlikely to affect you, others you may have the resources to cope with. But some will take you by surprise. Here are five reasons why trade credit insurance could be just what you need.

1. You can maintain your cash flow and profitability by mitigating your risk of bad debt.
2. You can obtain more working capital (often at more favourable rates) since insured receivables translate to secure collateral.
3. You can enhance your customer relationships and be more competitive by safely raising credit limits or offering better terms.
4. You'll access better knowledge about your customers and prospects to help avoid losses before they occur.
5. You'll sleep better at night knowing your risks are covered and your payments are guaranteed.



CONCLUSION



Business risk is a tricky subject. At first it will feel too nebulous and diverse a topic to digest, let alone plan for. But by taking a methodical approach, it is possible to identify the threats that are unique to your business as well as develop a plan to reduce their effects.

By involving your top team you'll uncover areas of risk you hadn't considered. By writing these down and ordering them into an action plan you'll clear a path to a less risky future, and by communicating your strategy with employees you'll reduce the chances of coming unstuck.

If you have any questions on how you can better manage risk, get in touch or visit our website to discover our solutions.

Contact us
info.uk@eulerhermes.com
0800 056 5452

eulerhermes.co.uk