CREDIT INSURANCE

Risky business

Andy Jamieson, a director at insurance broker Peter Hill Credit, outlines one way to reduce your exposure to bad debt and customer insolvency

No one needs to be reminded that we live in difficult times. We are now into a double-dip recession with no end in sight. Running a haulage business at the moment is about as hard as it gets and there are more than enough daily worries to occupy the most stoic of operators. Diesel prices, the regulatory burden, taxation, security, congestion, utilisation and squeezed margins aside, slow-paying customers have become a way of life. They are time-consuming, have to be managed carefully and are often larger companies with a 'take it or leave it' attitude. It is a worrying fact that many hauliers don't really know how well their customers are doing – or even how their customers' customers are fairing. In fact, many haulage businesses are probably exposing themselves to horrendous financial risk.

Managing credit risk can be tricky at the best of times. An unexpected bad debt in any business is difficult, but bad debt in this industry where margins of only 5% or less are common can have a catastrophic effect on cashflow. In the worst, but not uncommon, scenario the failure of a major customer does mean the end of the road.

Using a margin of 5%, a typical bad debt of only £10,000 requires a haulage business to generate additional turnover of £200,000 just to stand still. Take a similar example with a larger loss of £75,000 and that amount of additional turnover required to absorb this financial hit increases to an almost unachievable £1.5 million.

Credit insurance

For the most part it can seem that bad debts are impossible to avoid and to a certain extent that it true, because there will always be companies that go bust without any warning. However, there is an option available to companies and this is Trade Credit Insurance. This is simply an insurance policy which covers the policyholder against the risk of loss resulting from customer insolvency or non-payment of invoices.

Traditionally, most credit insurance policies are written on what is called a 'whole turnover' basis. This means it covers the entire business as long as business is invoiced on credit terms and this accounts for the vast majority of credit insurance policies sold. In these more commercially sensitive times it is now possible to be more selective, choosing to insure a specific customer or a selection of key accounts.

Road haulage is actually considered to be a lower risk than some industries due to the diverse nature of customers' businesses. A haulier with a spread of clients may deliver packaging, chemicals, food, engineering parts, steel, timber and construction materials during the course of the year. This spread of risk across various sectors translates into lower credit insurance premiums of around 10-20% compared with, for example, a building materials merchant supplying only the construction industry.

Business turnover

A typical policy will cost somewhere between 0.1% and 1% of a businesses turnover depending on the size of the business and past history. A typical road haulier turning over £3m with no losses to speak of would be expected to pay around £10,000 to protect their business. Policies cover on average around 90% of the debt with a small excess of between £500 – £,1000.

One criticism laid at credit insurers is they will only cover the 'blue chip' companies while refusing cover on more risky firms. That criticism may have been valid in the first couple of years of the recession as insurers battened down the hatches but, in fact, claims are still increasing and underwriters are more likely to write cover now than in previous years as better and more recent information on companies presents itself.

Cost is another point. Premiums became very expensive and certain industries, like construction and retail, were placed off limits by some underwriters. Again, things have changed and now all underwriters are actively competing for your business, which makes premiums virtually the same as pre-recession levels.

Apart from credit insurers themselves there are other organisations which keep a close eye on the how companies are doing.

Credit information supplier Graydon finds that 69% of businesses are above normal and high risk. New research from Graydon, based on 2.5million incorporated businesses, has found that 69% of UK business can be regarded as high risk or above normal risk. A comparative figure in June 2009 found that 60% of UK business fell into this category. Just 5% of the companies reviewed were awarded low-risk ratings by Graydon UK, compared with 13% three years ago. The research also found that attitudes towards sharing financial information are making the situation worse than it needs to be.

The total sums owed to Britain's small and medium-sized enterprises have reached a record high of £35.3billion, according to research to be published. Bacs Payment Schemes, the organisation which runs the clearing and settlement of automated payments including direct debits, says that the total outstanding to SMEs has risen by £2billion during the past six months.

Ongoing recession

The ongoing recession has seen many hauliers hit hard or even forced out of business in the wake of high-profile retail sector insolvencies such as MFI, Woolworths, Zavvi, Allied Carpets, Habitat, Oddbins, Borders, Focus DIY, Clinton Cards and recently Peacock Stores whose creditors are likely to receive only two pence in the pound when a dividend is finally declared.

There have been some equally large insolvencies in other trade sectors which may not be well known to the general public

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"We couldn't afford any more bad luck to come our way" Paul Johnson

Case study: Johnson Haulage

Paul Johnson, joint partner of East Yorkshire-based haulage firm Johnson Haulage, says: "After two of our customers went into receivership within 18 months we were struggling with cashflow problems. Because of this we couldn't afford any more bad luck to come our way.

"With the national credit crisis taking a firm grip on our economy we began to look into ways to overcome what was an increasingly difficult time for everyone.

"When a colleague of ours suggested credit insurance we felt it might be something worth looking into. After much research and time spent reading and understanding how the procedure would work, we contacted a credit insurance broker. They explained the whole process clearly and concisely, and explained to us how to get the most out of our cover as well as what levels of cover were available to us.

"After this we felt that what had started out to be quite a complex procedure had ultimately turned out to be a very easy decision to make for our haulage business as this cover protects us from the kind of bad situations we had experienced previously.

"This has enabled us to concentrate on the day-to-day running of the business where in the past we may have had other factors to take into consideration. Thanks to the peace of mind our credit insurance policy gave us, we have regained confidence in our industry and our business has expanded."

but have had the same devastating effect on their creditors. The food industry was hit hard with the failure of DBC Foodservices and construction giant Rok plc.

According to the Insolvency Service on company insolvencies, the hard statistics are that 45 companies are currently failing every day. That's almost 17,000 a year. The construction sector alone provided 20% of all insolvencies. The Insolvency Service says the number of businesses going into liquidation rose to 4,303 in the first quarter of 2012 – a 4.3% increase compared with the same period last year and a rise of 0.2% on the previous three months.

The harsh reality is that corporate failures remain at historically high levels, similar in fact to those seen at the height of the recession in late 2008 and 2009. Furthermore, the cumulative total of insolvencies over the past four quarters has actually risen by more than 3%. This is primarily due to a significant increase in the number of CVAs (Corporate Voluntary Arrangements) and other types of corporate insolvency.

There is anecdotal evidence to suggest that a proportion of failures go unreported with the owners of small companies choosing to simply walk away from their companies. The best that can be said is that UK insolvencies remain at a high but fairly static level. Given the lack of business and consumer confidence at home and the continuing crisis in the Eurozone, it seems unlikely that this picture will improve in the near future, and many UK businesses remain highly vulnerable.

An increase in interest rates, a worsening of the UK or Eurozone economic situation or the continued slowdown of work in the public sector could set the business dominoes falling across the board or, at the very least, in the more vulnerable trade sectors. The message is clear. There has never been a better time to reduce your exposure to financial risk.

Information at:

- **www.rha.uk.net/creditinsurance**
- **www.baddebtinsurance.net**
- **www.peterhillcredit.co.uk**