FOOD FOR THOUGHT

A PERIODIC EXAMINATION OF KEY ISSUES AND TRENDS FROM MARSH'S FOOD & BEVERAGE PRACTICE

PROTECTING YOUR BOTTOM LINE FROM COSTLY CUSTOMER DEFAULTS

Despite recent profitable performance by many food and beverage companies and a strong outlook for the remainder of 2015 and beyond, financial risks remain. This includes the possibility that retailers and other customers will default on payments because of bankruptcy, insolvency, or other factors. No food and beverage company is immune, but your organization can protect itself and its bottom line through the purchase of trade credit insurance.

THE THREAT OF CUSTOMER DEFAULT

Thin margins and bankruptcies have always been common among food and beverage companies. But smaller and midsize food sellers — including organic grocers and other specialty retailers — now face greater competition from "big box" retailers that are gaining market share. Not only are these larger retailers pushing smaller competitors out of the market through lower prices, but they could also drive consolidation among grocers and supermarket chains — applying pressure on smaller companies. Of course, larger retailers are not immune to insolvency, as evidenced by the recent bankruptcy by the Canadian arm of a leading US big box retailer.

Competitive pressures are also being felt among restaurants, significant customers of food and beverage companies. Changing expectations — including a push for higher-quality ingredients — and volatile agricultural commodity pricing are squeezing margins and could lead to more bankruptcies. That same volatility in commodity pricing and higher feed prices has led to bankruptcies in the meat and protein supply chain, increasing pressure on margins.

Another event that could affect a customer's ability to pay its food and beverage suppliers involves product contamination or a public health crisis involving a retailer. Fueled by negative publicity and social media conversations, a single event could force a company out of business or cause it to default on its payments.

For a small or midsize food and beverage company, the impact of one or more customers defaulting could be devastating. A larger company might be able to survive, but the cost from even a single default could severely damage its top and bottom lines.

HOW TRADE CREDIT INSURANCE CAN HELP

A trade credit insurance policy is designed to protect organizations against a customer's default on certain eligible accounts receivable. In most cases, default as a result of insolvency, slow pay, and other credit and political risks are covered by trade credit insurance.

Although the vast majority of American companies do not purchase trade credit insurance as protection — purchase rates

are much higher in Europe — the coverage can yield significant benefits for food and beverage companies. For example:

- Transferring credit risk to an insurer can allow companies to increase sales by extending additional credit, sell into new markets and to new customers, and offer more competitive payment terms.
- Credit insurance programs can often be given to suppliers in lieu of letters of credit, allowing companies to free up additional working capital and reinvest in their businesses.
- Trade credit insurers collect and maintain information on balance sheet strength, sales histories, payment records, and financial ratios of millions of companies worldwide. Policyholders can often access this data and use it to make smarter decisions to avoid losses and safely support sales growth.
- Banks may be able to provide more flexible financing and more favorable terms for companies whose receivables are insured.

BUILDING THE RIGHT TRADE CREDIT INSURANCE PROGRAM

Despite the challenges, trade credit insurers remain eager to insure the accounts receivables of food and beverage companies. But not all trade credit insurance policies are structured the same. If you're considering a trade credit insurance policy, you should talk to your broker about how to best structure your program to meet your organization's specific requirements.

Trade credit insurance policies can be highly customized to provide the right coverage for a company based on its operating model, industry, and geographic footprint. For example, a policy can be structured to provide coverage for:

- All of a company's receivables (whole turnover).
- A select list of accounts for which a company perceives the greatest risk (key account structure) — for example, its largest customers.
- Receivables from one particular customer (single debtor).

Which policy is right for you? That depends on how much risk you have concentrated in any single customer. If your risk is spread across several customers, a whole turnover program may be best. But if an individual customer represents 15% or more of your revenues, you may wish to consider a single debtor program.

Meanwhile, it's important to consider the bigger picture, including geopolitical and other external factors. Policies can be tailored to provide coverage for domestic sales and/or export sales, and to cover individual countries. For example, a significant amount of trade credit capacity has been deployed in recent years to cover exposures in Greece and other southern European countries amid the European sovereign debt crisis. And insurance programs that were placed before sanctions were imposed against Russia have allowed policyholders to collect on claims related to those sanctions. That said, certain countries may be difficult or impossible to insure right now, including Afghanistan, Argentina, Egypt, Iran, Iraq, Russia, Turkey, and Venezuela.

The risk that a customer may default on its payments can never be fully eliminated. But trade credit insurance can help food and beverage companies protect their accounts receivables, free up valuable capital, and remain competitive.

For more information on this topic, contact your Marsh representative.

This briefing was prepared by Marsh's Food & Beverage Practice, in conjunction with Marsh's Trade Credit Practice and AIG.

Marsh is one of the Marsh & McLennan Companies, together with Guy Carpenter, Mercer, and Oliver Wyman.

This document and any recommendations, analysis, or advice provided by Marsh (collectively, the "Marsh Analysis") are not intended to be taken as advice regarding any individual situation and should not be relied upon as such. This document contains proprietary, confidential information of Marsh and may not be shared with any third party, including other insurance producers, without Marsh's prior written consent. Any statements concerning actuarial, tax, accounting, or legal matters are based solely on our experience as insurance brokers and risk consultants and are not to be relied upon as actuarial, accounting, tax, or legal advice, for which you should consult your own professional advisors. Any modeling, analytics, or projections are subject to inherent uncertainty, and the Marsh Analysis could be materially affected if any underlying assumptions, conditions, information, or factors are inaccurate or incomplete or should change. The information contained herein is based on sources we believe reliable, but we make no representation or warranty as to its accuracy. Except as may be set forth in an agreement between you and Marsh, Marsh shall have no obligation to update the Marsh Analysis and shall have no liability to you or any other party with regard to the Marsh Analysis or to any services provided by a third party to you or Marsh. Marsh makes no representation or warranty concerning the application of policy wordings or the financial condition or solvency of insurers or re-insurers. Marsh makes no assurances regarding the availability, cost, or terms of insurance coverage.

Copyright 2015 Marsh LLC. All rights reserved. MA15-13527 USDG 18440