COMMERCIAL BANKING

Building confidence for the future

Through effective risk management

63%

of clients have experienced supply chain disruption.

2/3

of businesses have seen falling demand as a result of Covid-19.
(Source: Lloyds Bank Business Barometer (June 2020), BVA BDRC)

54%

of businesses are using remote working to maintain continuity.

However, less than

1/3

of people in the work force have previously worked from home.
(Source: The Telegraph, April 2020)

Effective risk management strategies will be critical for businesses emerging from the Covid-19 crisis. As the economy begins to re-open, Lloyds Bank explores three important themes to consider:

- Managing financial risk;
- Building a resilient supply chain;
- Risks home-working can bring to your business.

Click here for a 9 minute read

By the side of business

LLOYDS BANK

Building confidence for the future through effective risk management

Key highlights:

- Volatility in financial markets and a fragile global economic outlook means **risk management is key for businesses**;
- Building resilient supply chains will be crucial as companies emerge from Covid-19 and **increase confidence for the future**;
- As the trend in homeworking increases, businesses need to be aware of the risks they potentially face and consider how they can **best protect themselves**.

The UK continues to navigate its way through the Covid-19 crisis. As the transition from lockdown to the recovery phase proceeds, businesses will be required to broaden their planning from implementing emergency considerations to how to adapt to a more uncertain market and economic landscape.

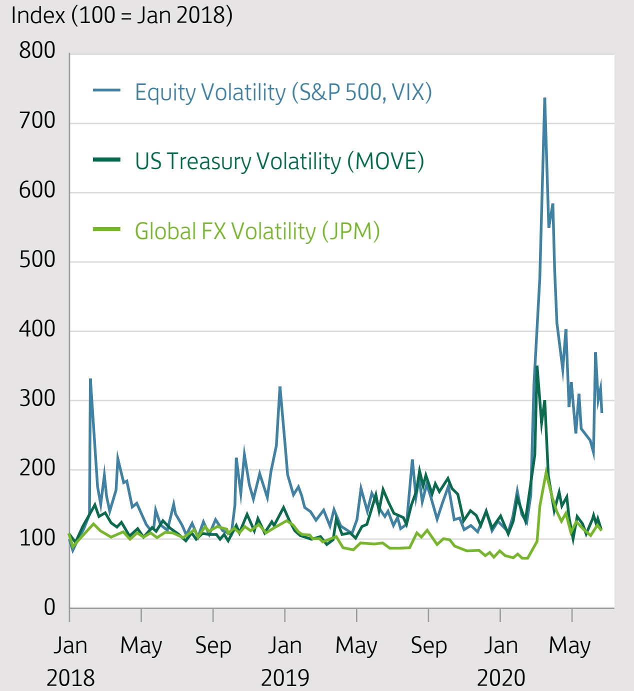
Now is the time to think about how to manage both threats and potential opportunities to build confidence for the future. There are many challenges facing businesses, some of which will require radical changes to adjust to our new environment. **In this note, Lloyds Bank highlights three core areas to consider:**

- Managing financial risk in a changing world;
- Building confidence through a resilient supply chain;
- Addressing the risks that homeworking can bring to your business.

The global pandemic and the measures to contain its spread has led to a very sudden and unprecedented drop in UK and global activity. While the gradual re-opening up of economies and several recent indicators point to a stronger recovery in demand than expected, the outlook for the UK and global economy remains unusually uncertain.

More positively, financial markets have significantly recovered some of their poise in recent months, with risk assets extending gains from their lows in mid-March and key measures of market volatility and liquidity stress showing improvement (**chart 1**). While prevailing financial market conditions are clearly more favourable than in recent months, markets are acutely sensitive to the evolution of the pandemic and the unfolding of the global economic outlook which is why risk management is key.

Chart 1: Global Market Volatility benchmarks for equities, rates and FX



Source: Macrobond (23 June 2020)

Managing financial risk in a changing world

It is important to note that a switch from unstable financial markets to those which have partially normalised is a form of volatility in itself, and this makes risk management decision-making more challenging. In the near and medium term, there could be both scheduled and surprise UK and global macroeconomic events which may require swift operational adaptation of businesses.

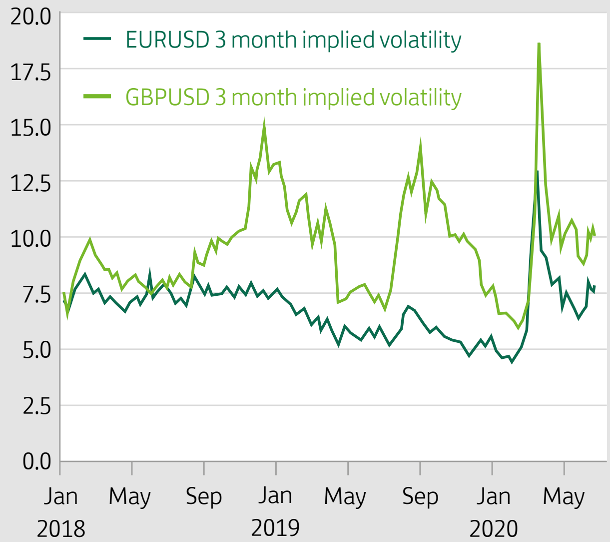
Covid-19 related uncertainty is playing out against the backdrop of Brexit, a topic which has resurfaced in recent weeks. The outcome of Brexit continues to raise questions for clients regarding supply chain efficacy and exports post transition and the associated skittish market movements tied to sterling. There is little reason to expect the effect this has had on GBP over the past 6 months will not continue throughout 2020. **Chart 2** shows that GBPUSD volatility is above EURUSD volatility, evidencing the relevant underlying market concerns.

Sterling volatility heightened at beginning of the lockdown. Global uncertainty remains...

As businesses reopen into an environment vastly different from the pre-Covid-19 position, the blueprint for successfully emerging from lockdown focuses on three immediate priorities.

The first is liquidity, which in any crisis, is paramount. Activities to shore up balance sheets and minimise operational costs and optimise cash positions have been imperative. This work has been a vital first step to enable an assessment of supply chain resilience as well as more difficult projections of future demand.

Chart 2: Current Market Volatility for GBPUSD and EURUSD



Source: Macrobond (23 June 2020)

The second priority, as part of future cash flow forecasting, has been to secure margins and mitigate profit and loss volatility against a backdrop of relatively weak sterling, low (and potentially negative) interest rates and commodity prices, which, at times, have seen negative values. Clearly, this is not an easy task and is made more challenging for both importers and exporters due to differing governments' policies and the speed at which these economies return them to a level of normality.

Finally, understanding the resilience of existing and new commercial partners has been a significant focus. In times of difficulty, buyers and suppliers can become financially stressed with shifts in ability to meet delivery times, quality demands, or payment terms. Where previously, the priority had been the economic terms of contractual negotiations, this crisis has driven the focus to consistency of supply and demand.

There are a range of approaches to mitigate liquidity, financial market, and counterparty credit risk, which by design, can adapt to uncertain future demand levels whilst simultaneously maintaining margins, helping to mitigate profit and loss swings and providing flexibility for when market conditions improve.

Offering flexibility during Covid-19

For many years we have worked with a wholesaler of bathroom supplies to help them risk manage their Foreign Exchange exposures arising from Chinese goods imports funded in USD and sold in the UK. The crisis led to a significant and unpredictable shift in demand of their traditional business lines. To accommodate this, a rebased cash flow and exposure analysis was completed, in partnership, which concluded that a substantial change to the profile of Foreign Exchange transactions that were in place was required. Following an assessment of prevailing market conditions, the portfolio was restructured to match the adjusted requirements.

Whilst assessing the impact of Covid-19 through discussions with Lloyds Bank and supply chain contacts, they identified an opportunity to fulfil the urgent need for personal protective equipment.

However, the dynamics of the PPE contract were different from their usual business activities in terms of suppliers, commercial terms and end users. Lloyds Bank worked with the finance team to understand these terms and design a risk managed approach to accommodate more cash flow flexibility, maintain agreed baseline margins and offer flexibility to benefit from any recovery in sterling during the life of the contract.

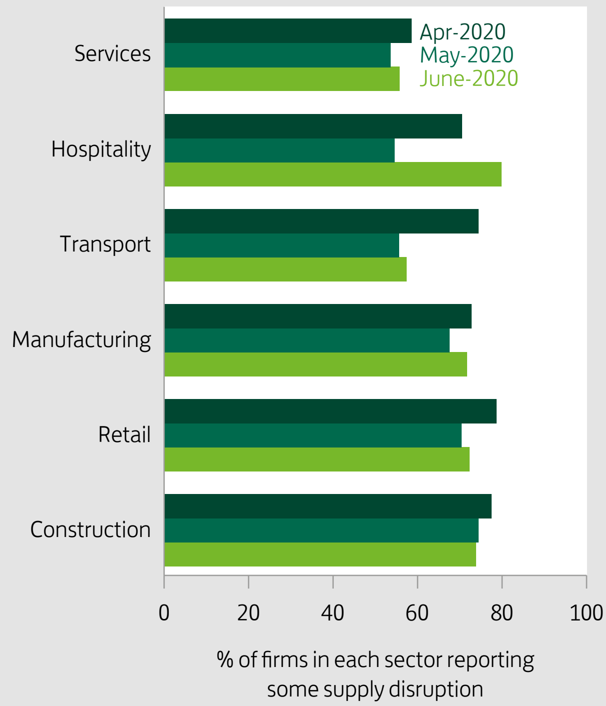
Building confidence through a resilient supply chain

For many years businesses have been focussing on supply chain optimisation to minimise costs and reduce inventories. In so doing, many companies have removed buffers and flexibility to absorb disruptions. For example, Covid-19 has turned these previously perceived strengths of 'just in time' inventory levels to potential weaknesses.

The situation is perhaps made worse by the lack of end-to-end visibility and linear supply chain models. For many companies Covid-19 was the first time that they were faced with having to think about supply chain viability which was dramatically impacted and disrupted business continuity.

The **Lloyds Bank Business Barometer** shows that whilst supply chain disruption has marginally improved since April, the picture remains extremely challenging across most key sectors. 63% percent of firms in June reported some disruption to their supply chains - similar to May (62%) albeit lower than 66% in April. Dislocations have been higher in manufacturing, hospitality and retail than in services – with signs that the average duration of supply chain disruptions may be declining, with a greater proportion of businesses expecting normalisation to take place within 3 months.

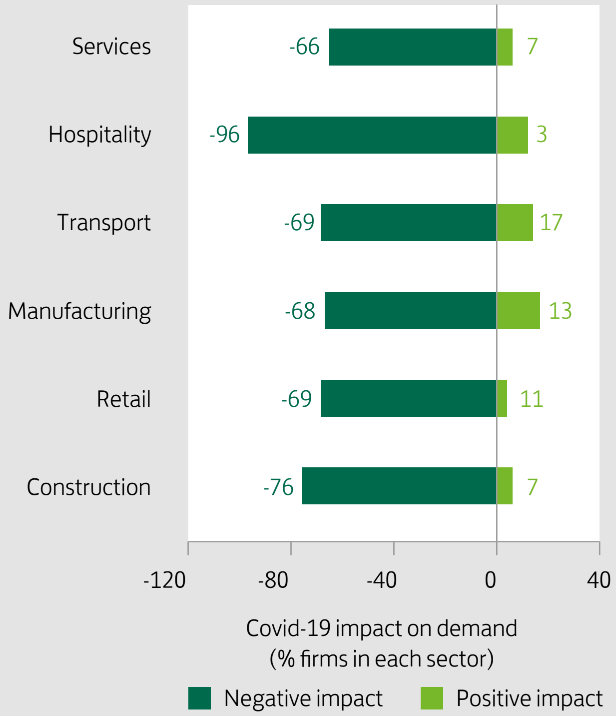
Chart 3: Supply chain disruptions remain significant



Source: Lloyds Bank Business Barometer (June 2020), BVA BDRC

The June Lloyds Business Barometer shows the **majority of UK firms (68%) reported a negative demand impact from Covid-19**, although it was slightly less severe than in April (74%). There were indications that the average demand impact had become slightly less severe in June, with only 28% (compared with 34% in May) of businesses reporting demand had fallen by more than half.

Chart 4: Clear majority of firms still report negative Covid-19 impact on demand



Source: Lloyds Bank Business Barometer (June 2020), BVA BDRC

Demand has been negatively affected across all sectors with some, such as hospitality and construction, experiencing greater impact than others. When demand falls in this way, companies are faced with the need to balance the daily running of their business, evaluating inventory levels, maintaining fixed costs, and mitigating new risks in anticipation of changes in demand, supply or production which in turn impacts revenue generation. Equally, when demand increases, it can lead to rapid cash burn – due to the need to source inventory and produce prior to sales – which is not helpful when liquidity is scarce.

10% of firms have seen an increase in demands for their product or service.

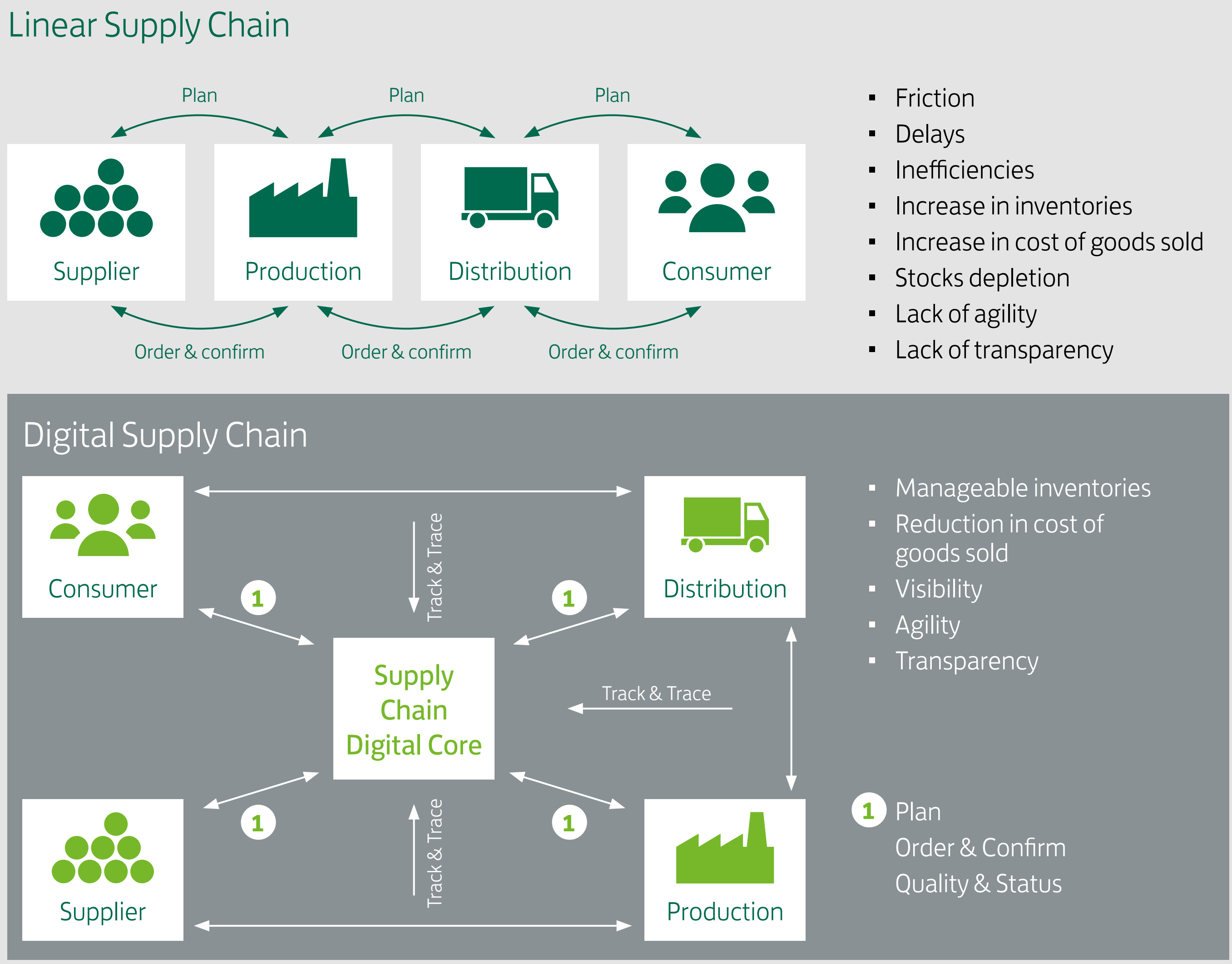
In addition to supply disruption, both inventory uncertainty and supplier demand for earlier payment adds to the complexity of managing customers who may seek payment extensions to address their own risks and potential delivery delays. It is now taking longer for invoices to be settled, reversing a previous trend of faster payments. Businesses took, on average, 36.7 days to settle an invoice in 2019, compared to 36.8 days in 2018. In the first quarter of 2020, average payment terms rose 1.7% to 39.2 days and likely rose further in the second quarter. Extending payment terms has increased pressure to UK suppliers' Cashflow (Tradeshift).

As companies prepare to navigate their business beyond Covid-19, banks have an important role to play in that recovery process. At Lloyds Bank we have tailored solutions and helpful online tools that can help you manage your payment and performance risks with your buyers and sellers, better manage the volatility and help companies rebuild more sustainable and agile supply chains that can stand the test of time.

Additionally, some other helpful business strategies may include reviewing:

- product portfolios and potential diversification;
- counterparties – building relationships;
- channel shifts (online vs. physical presence);
- looking beyond Tier 1 suppliers for assessing supply chain vulnerabilities;
- moving from a linear supply chain model to digital supplier network;
- logistics risks of getting products to end customers.

Shift from a linear supply chain to a digital supply chain



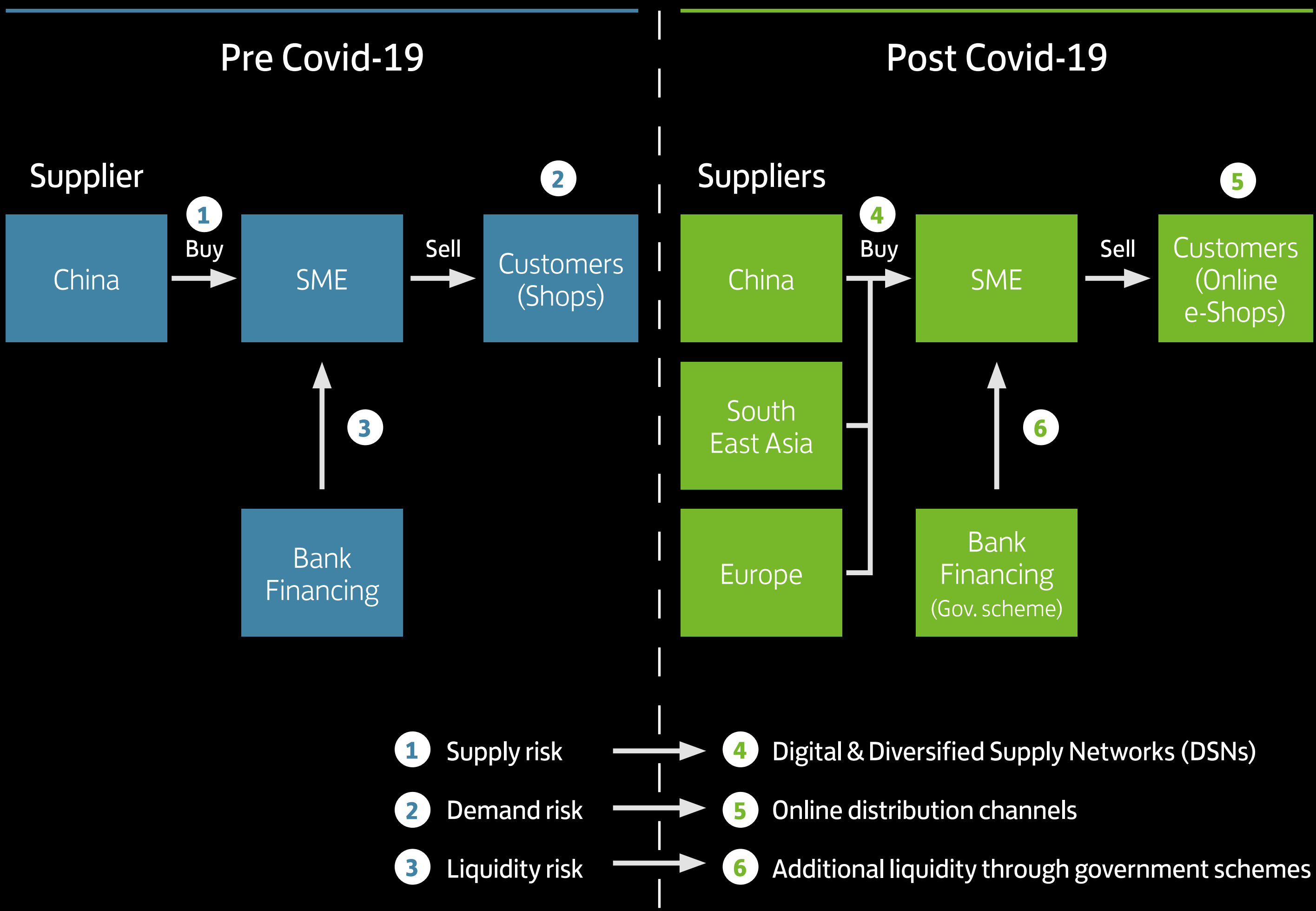
Pricing strategies will also be an important consideration as business gradually transition back to normal - both to address normal supply-demand considerations, as well as being able to maintain profitability.

The need for open communication with customers when faced with uncertainty is crucial. This will help instigate the exploration of alternate supply arrangements helping to minimise losses and customer attrition.

As businesses look to build a resilient supply chain, they might consider 3 key areas to focus on:

- **Mitigate supply shock**: Work closely with existing suppliers while diversifying the supply base;
- **Manage demand volatility**: Preserve inventory and find a cost-effective way to finance it or simply find alternative channels of distribution;
- **Make work safe**: Invest in enabling a safe infrastructure for staff to work, using online channels, and app-based technology wherever possible.

Case Study



The power of APIs

One of our clients runs a clothing and sportswear business. Before Covid-19, their main supplies were sourced from China due to competitive prices. As factories shut down production in China during Covid-19 lockdown, orders were re-directed to an alternative supplier base in other South East Asia and Europe. Lloyds Bank was able to increase their Letter of Credit limits to enable increased value of merchandise; as the alternatives sourced had an increased cost.

As the pandemic spread globally, and the UK announced their own lockdown, Covid-19 cut off the distribution channel for the company which primarily used physical shops for sales.

The company pivoted to the use of online channels to maintain sales and cashflow generation. The Lloyds Bank facility was complimented with Government schemes and loan extensions to address liquidity shortages for the company.

The rise in home-working can open up new risks to your business

Whilst managing the risks driven by the market and addressing issues with challenges in both supply and demand, more standard operating risks are also an issue.

UK businesses have had to quickly change the way they operate to adapt to the *new normal* of the coronavirus pandemic. Organisations have been encouraged by the government as part of the lockdown process to ask their staff to work from home where possible. Whilst working from home is quite usual for many businesses, for others this has been a significant step.

Companies switching to a home working model may not have the technology, policies and training in place to support it securely and may be relying on employee's personal IT equipment. Without appropriate security measures, this could place your customers, company, and employees at risk. For further information, click here.

Home working best practices:

- Develop a home working policy appropriate to your business and technology capability;
- Set an automatic lock on computers and laptops using a strong password;
- Enable device encryption to protect stored data;
- Make offline backups of your data regularly;
- Update software on your device frequently together with your antivirus software;
- Disable or limit the use of removable media to protect your company's data and reduce the risk of malware;
- Consider using a reputable VPN (Virtual Private Network) to connect to your company network (beware of malicious VPN software that may contain malware);
- Avoid using open Public Wi-Fi Networks, use a VPN to secure your connection;
- Educate employees to spot suspicious phishing emails and how to safely use collaboration tools such as: Zoom, Microsoft Teams, WebEx.

More details on home-working guidance can be found at NCSC.

> 54% of businesses are using remote working to maintain business continuity... Less than 30 percent of the workforce had ever worked from home, according to the annual population survey, with those in higher paid jobs living in London and the south east most able to avoid the office.

The Telegraph – April 2020

Case Study

Covid-19 phishing scams

Home working increases reliance on email for communication, thus creating perfect conditions for email fraud schemes. Cyber criminals are taking advantage of the pandemic to trick users into revealing their personal information or clicking on malicious links or attachments. Fraudsters may even impersonate government organisations, such as HMRC and World Health Organisation among others, in order to disguise themselves as reliable sources.

The Chartered Trading Standards Institute (CTSI) has reported that scammers are sending text messages with malicious links to trick people into believing they have been in contact with someone who has tested positive for coronavirus.

Phishing emails have spiked 600% from Feb 2020, ('Barracuda Networks' 2020). Since lockdown, 'Action Fraud' reports that fraudsters have stolen more than £7m (source: actionfraud.police.uk/covid19).

Conclusion

The UK is facing one of its most significant economic shocks during peace time. The pace and shape of the hoped-for recovery is unclear, business confidence remains low and the economy is fragile. However, welcome signs of stabilisation are increasingly emerging.

The risk landscape has changed dramatically, where issues seen as a low priority before the pandemic are now seen as critical to business prospects and resilience.

Businesses are reflecting on what has become a very different operating environment. Applying the right resources to both assessing the risks and developing a clear strategy to mitigate them is of great importance.

Taking the right steps to implement effective risk management strategies could help provide the resilience to build a successful long-term future.

Key actions will be:

- Consider how financial market movements may affect your business and what risk management solutions are available to support you;
- Rebuild a sustainable and robust supply chain for the future through effectively managing payment and performance risk with buyers and sellers;
- Explore alternative arrangements with suppliers and diversify the supply base;
- Review homeworking best practices and ensure appropriate security measures are in place to protect your business.

Our risk management solutions

Lloyds Bank has solutions that can help you identify, quantify, and manage the potential impact that movements in the financial markets can have on your business.

Typical solutions, depending on requirements, include:

- **Forward Contracts** which offer complete certainty and protection from exchange rate fluctuations, on a fixed date or agreed window of dates;
- **FX Orders** – which protect against an agreed worst case FX rate and/or a desired rate should the market move favourably.

These are available from our team of experts. For more information and points of contact, please click here or access our digital channel Arena for support.

In addition, our team can help with **Interest Rate**, **Commodity** and **FX Management** Solutions designed to protect against ongoing uncertainty, which include:

- Protection against unfavourable FX, Interest Rates and Commodity Prices whilst offering flexibility during periods of uncertain future cash flows;
- Adaptability to respond should prevailing market conditions be favourable to an established base case.

Lloyds Bank also has a variety of solutions that can help companies trading both in the UK and globally, including:

- Supply Chain Finance
- Receivable Purchase
- Letters of Credit
- Trade Loans
- Guarantees

These products can help address payment, counterparty and country risks. For more information, please click here.

International Trade Portal

Provides analysis of supply chains, ensuring you're well informed to source new partners.

UK International Trade Index

A quarterly measure of demand for UK exports and international supply chain conditions.

Lloyds Bank Business Barometer

Our monthly survey gauging the opinions of businesses in the UK since 2002

Cyber Risk Resource Centre

A useful information hub to help businesses stay one step ahead of cyber crime.

Our service promise

If you experience a problem, we will always try to resolve it as quickly as possible. Please bring it to the attention of any member of staff. Our complaints procedures for businesses with an annual turnover of up to £25m are published at **lloydsbank.com/business/contactus** and for businesses with an annual turnover of £25m or more they can found at **commercialbanking.lloydsbanking.com/contact-us/**

Go to:
lloydsbank.com/help-guidance/coronavirus

If you would like to know more, please speak to your Relationship Manager

Please contact us if you would like this information in an alternative format such as Braille, large print or audio.

Important information

LLOYDS BANK

(06/20)