MarshMcLennan

SURVIVING AND THRIVING IN A DEMANDING BUSINESS ENVIRONMENT

The essential survival guide for entities potentially facing difficulties

Marsh Mercer OliverWyman

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EXECUTIVE SUMMARY

In today's volatile and uncertain business landscape, organisations face numerous challenges that can have solvency and liquidity implications with the risk of pushing them towards potential insolvency or restructuring.

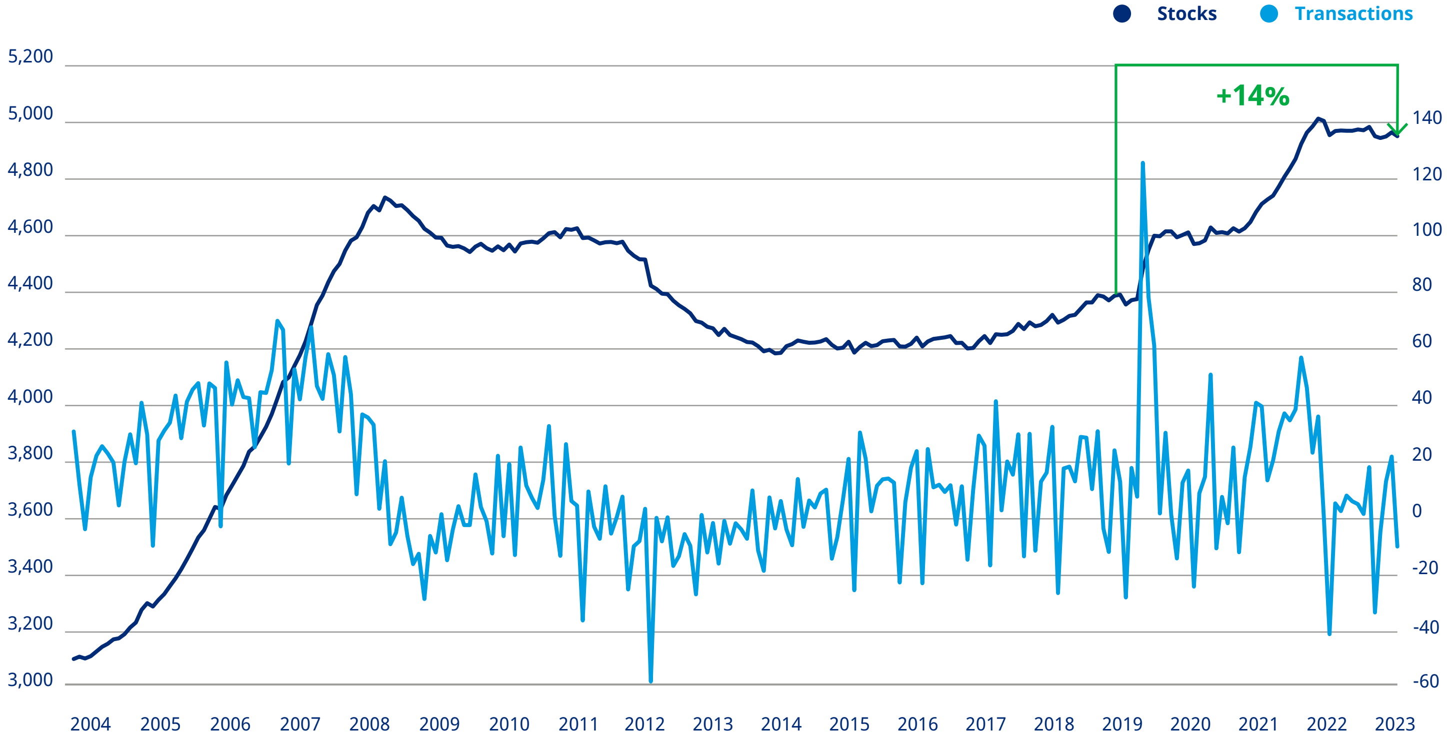
The economic environment was challenging before and during the pandemic but government support helped businesses weather the storm. However, recent inflation, increased interest rates, supply chain issues, client demand in certain sectors, and generally tougher financing conditions have led to increased insolvency rates. Whilst these issues are currently becoming more benign, debt levels remain high and liquidity could become an issue for entities not fully adapted to the current environment.

Macro-economic and geopolitical challenges, the pandemic, as well as investments in future technologies have increased debt by nearly 15% since the outbreak and spread of COVID-19 in 2019-2020.

01 | Volume of debt provided by MFIs

The volume of loans increased significantly since, driven by once favorable lending environments, global disruptions and challenges, as well as investments in future technologies.

Loans vis-a-vis euro area NFCs[1] reported by MFIs[2] excl. ESCB[3]
EUR bn, Eurozone



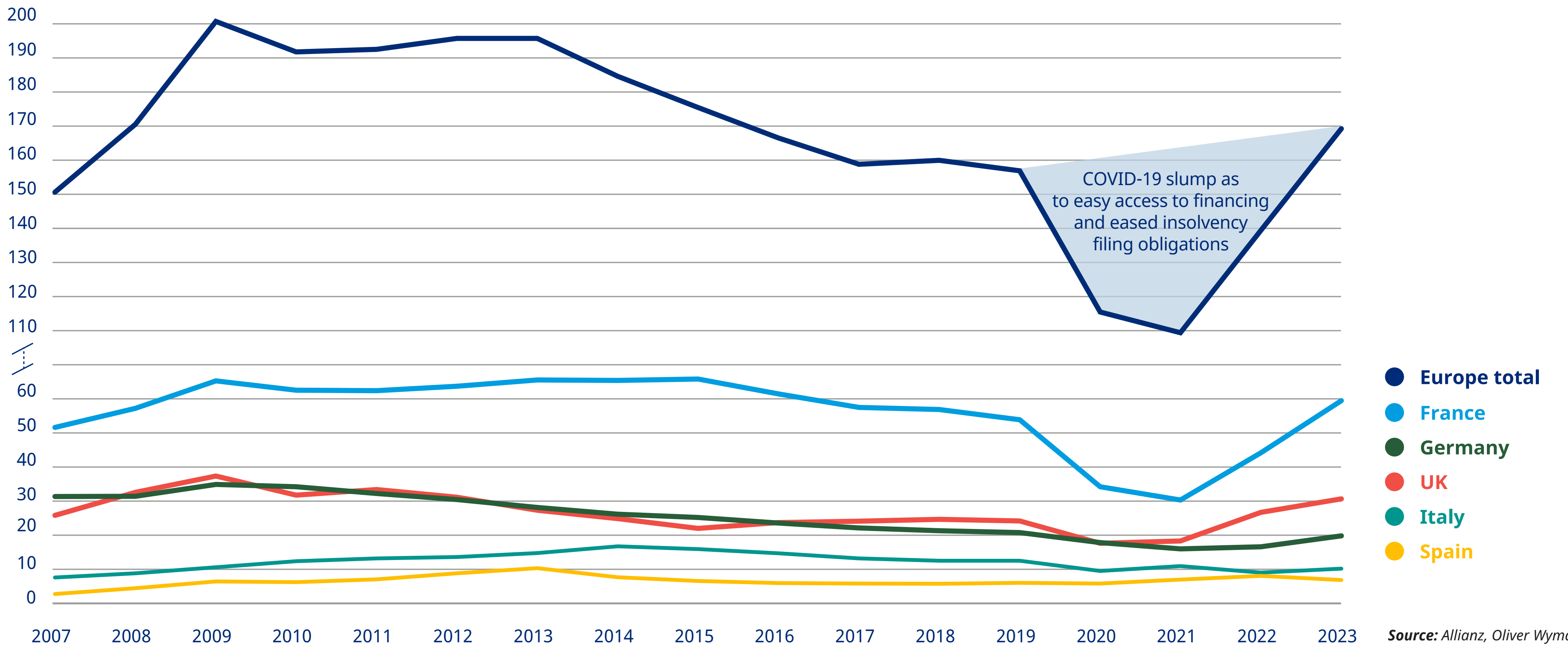
1. NFCs = Non-financial corporations; 2. MFIs = Monetary financial institutions; 3. ESCB = Central banks of the European system.
***Source:** Eurostat, Oliver Wyman*

This coupled with corporate borrowing rates being higher than at any time in the past decade mean that most entities will enter a more financially stressful environment in the coming years. Bankruptcy data across some of Europe's larger economies is already trending significantly upwards.

02 | Insolvencies in Europe

The lower than normal number of insolvencies in 2020-2022 indicates that financing was available for distressed corporates in these years.

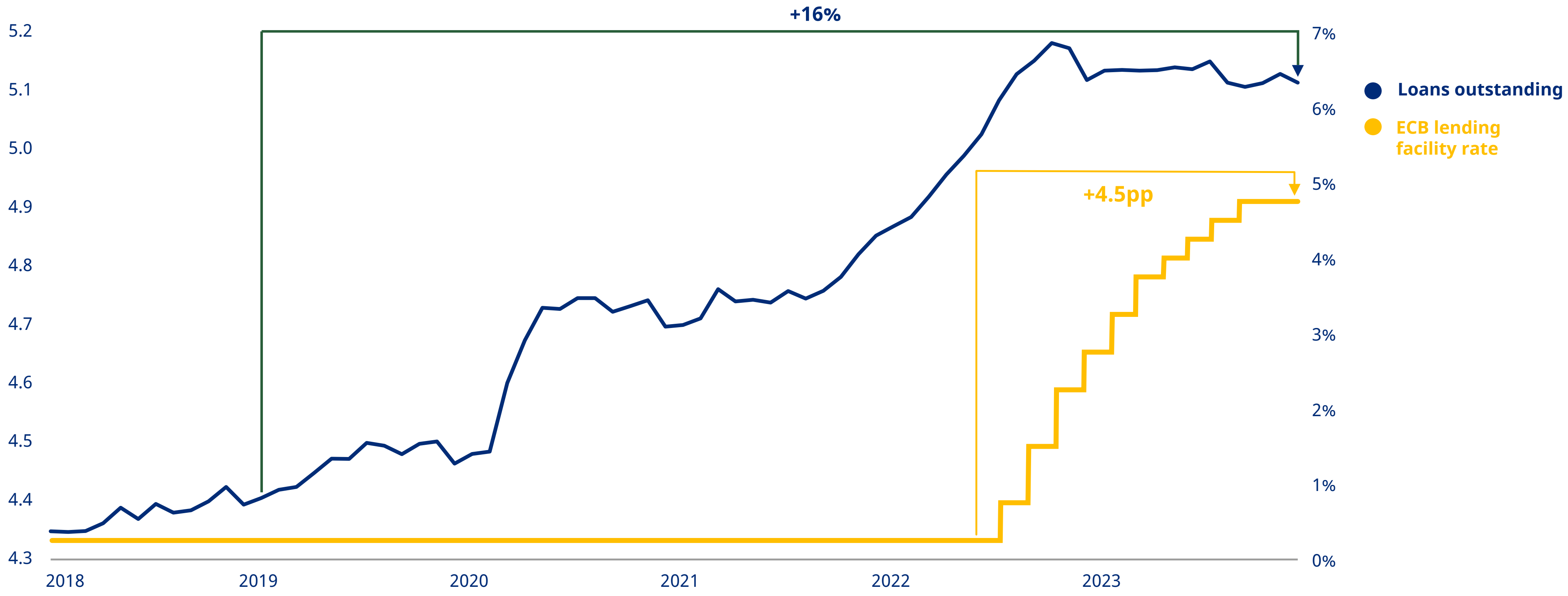
Business insolvencies in Europe
In thousand cases, absolute, annual, end of period



Source: *Allianz, Oliver Wyman*

03 | Debt volume and interest rates increased significantly in parallel

Loans[1] outstanding and ECB lending facility rate
In € trillion and in percent, Eurozone



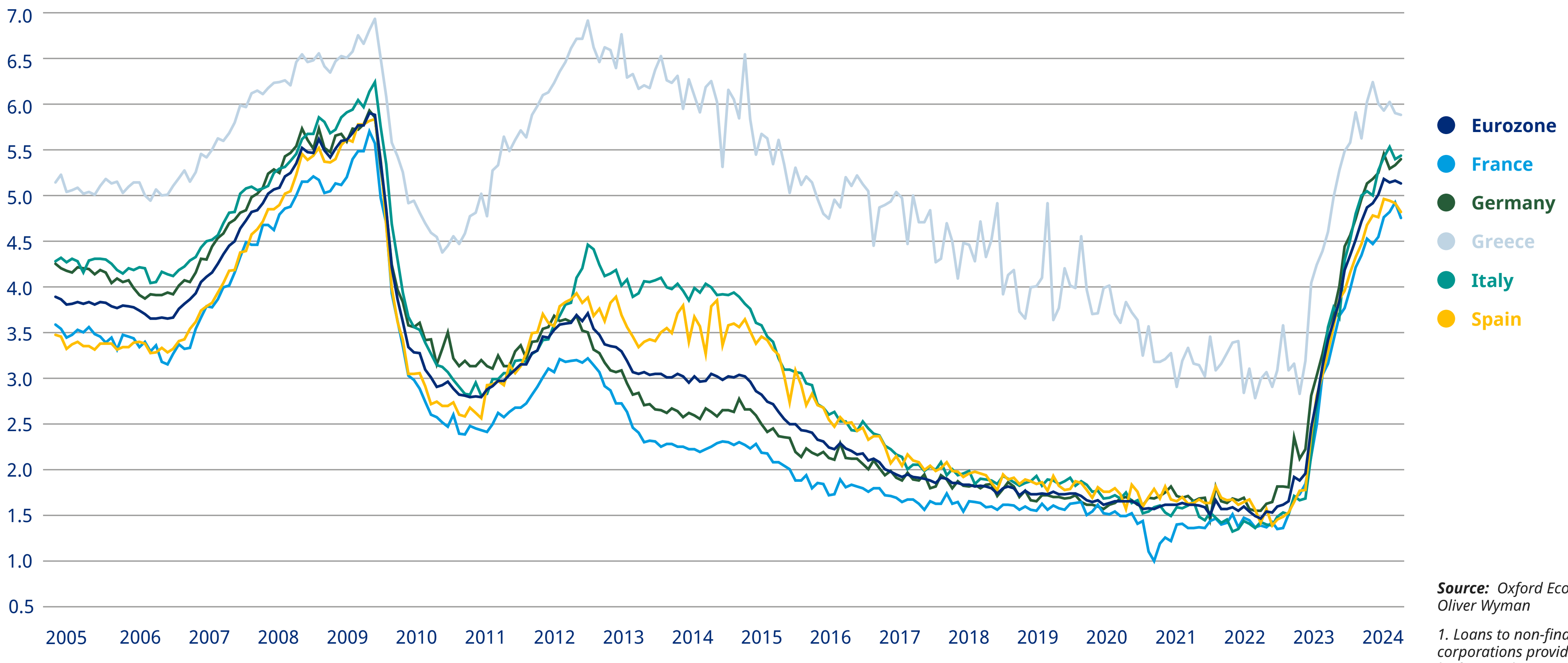
1. Loans to non-financial corporations provided by financial institutions

***Source:** ECB, Oliver Wyman*

04 | Corporate borrowing rate

As central bank interest rates have risen, corporate borrowing rates too increased from 2022 onwards

In corporate borrowing rate 2004 – 2024, Eurozone, in %



Source: *Oxford Economics, Oliver Wyman*

1. Loans to non-financial corporations provided by financial institutions

In the World Economic Forum's Global Risks Report 2024, published in partnership with Marsh McLennan, economic downturn and inflation are among the top ten risks in the short to medium term. These are likely to have an impact for organisations across the globe.

05 | Global risks ranked by severity over the short term (2 years)

1st Misinformation and disinformation

2nd Extreme weather events

3rd Societal polarization

4th Cyber insecurity

5th Interstate armed conflict

6th Lack of economic opportunity

7th Inflation

8th Involuntary migration

9th Economic downturn

10th Pollution

Risk categories

- Technological
- Economic
- Geopolitical
- Environmental
- Societal

Source: *World Economic Forum Global RisksPerception Survey 2023-2024.*

To help organisations navigate these difficult times, Marsh McLennan has developed a comprehensive survival guide to assist owners, management, and external stakeholders during challenging periods.

This guide incorporates valuable insights from industry experts and thought leaders, offering practical strategies and solutions for various scenarios, such as insolvency, restructuring, and navigating difficult times.

It covers a wide range of areas, including strategy, mergers and acquisitions (M&A) involving carve-outs or divestitures, insurance, and labour cost management, including compensation and benefits.

Whether facing headwinds or undergoing restructuring, this survival guide provides the necessary guidance and support to overcome obstacles and achieve success.

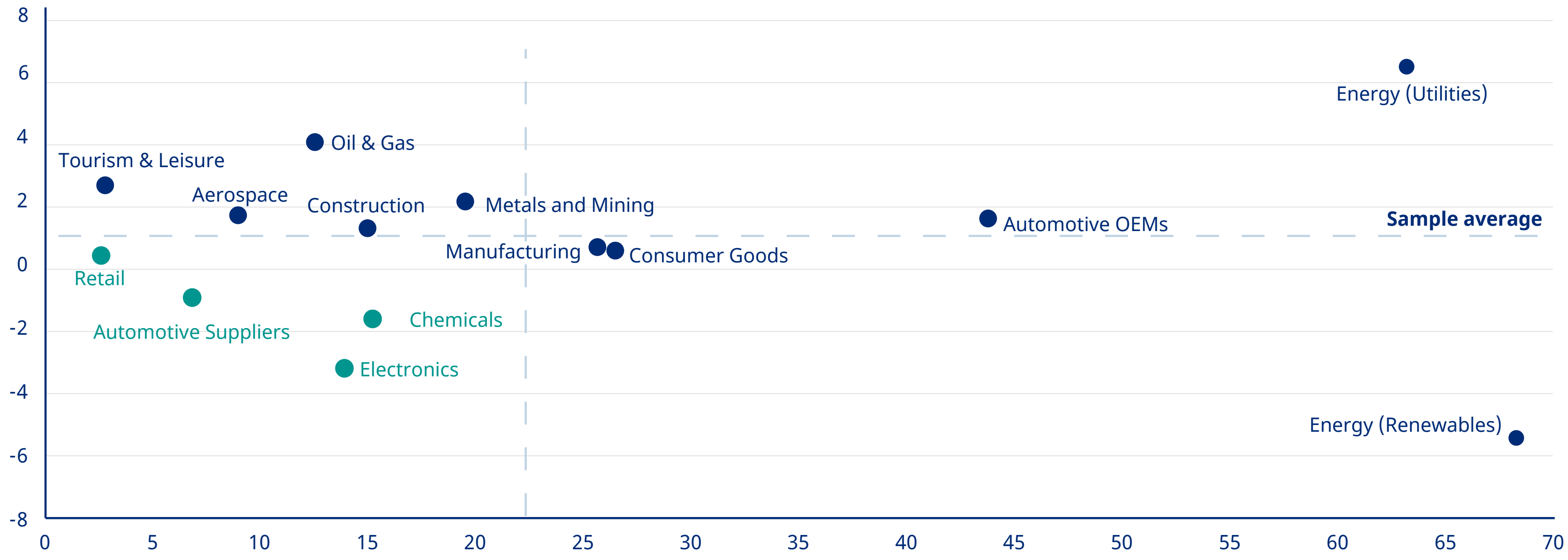
1

STRATEGIC IMPLICATIONS FOR COMPANIES FACING DISTRESS

In recent times, several organisations have faced immense pressure to maintain cost-effectiveness, agility, and profitability. So, the lingering sense of uncertainty persists. This is reflected in our Restructuring Report 2024 of restructuring experts where around 95% of respondents state that a challenging and more complex future market environment is to be expected. The reasons for the negative outlook are, on the one hand, familiar challenges from previous years, such as geopolitical risks, high raw material and energy costs, and disruptive market changes. While on the other hand, companies are faced with new challenges, primarily increased financing costs resulting from the higher interest rates.

06 | Comparison of financial performance. H1 2023 compared to H1 2019

Change of EBITDA-margin In percentage points, aggregated by sector



Change of revenues
In %

Based on a sample of 3,409 corporations (without financial institutions)

Source: *S&P Capital IQ, Oliver Wyman analysis*

1.1 Navigating complexity in a challenging market

As businesses face these ongoing challenges and strive to regain value, they may find themselves in situations where the viability of the business as a whole is under pressure — either due to persistent negative cash flow, or the need to refinance maturing debt while the business is loss-making.

To turn around the business and secure the sustained support of its capital providers, management needs to develop a restructuring concept. The basis for such a plan needs to be a holistic and honest assessment of the status quo including thorough analysis of:

- The market, industry, and competitive landscape the organisation is active in
- The organisation's current strategic positioning and competitiveness within the market
- The organisation's operational performance and financial health

Based on this analysis the organisation specific turnaround plan and strategy can be put in place, including short-term measures to ensure short-term survival, long-term measures to reposition the organisation on a profitable path and a clear vision of the future business model.

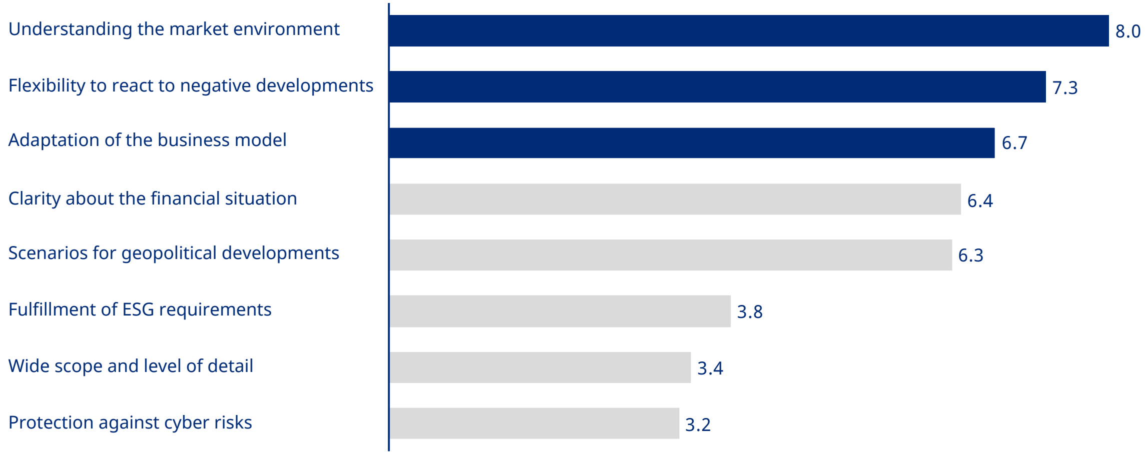
In addition, the management needs to develop an integrated financial plan that projects the profit and loss and the balance sheet to determine the liquidity needed to fund the restructuring. This will create a clearer view of the organisation's ability to serve its debt and refinance at the end of the restructuring period.

1.2 Restructuring plans need to reflect the rising complexity

As highlighted, the market and industry complexity is recognised by industry leaders as more complex and challenging than in the past. Consequently, the "standard" turnaround measures of the past are not sufficient anymore. In times of increasing complexity, tailormade and scenario-based restructuring concepts are required. What the respondents in our study (Restructuring Report 2024) all call for is a deeper understanding of the organisation's market environment during the crisis and a careful examination of the right business model to overcome the challenges (see figure 7).

07 | The most important restructuring elements

What are the most important elements in a restructuring concept?
From1 = least important to 10 = most important



Source: *Oliver Wyman Restructuring Survey 2024*

1.3 Clear vision, stakeholder engagement and communication are key

A successful turnaround programme is a team effort — not only involving the internal stakeholders, such as the leadership team or workers' councils but also the external stakeholders, such as financiers, suppliers, and customers. It is crucial that business leaders have a clear understanding of this guiding target picture and the ability to effectively communicate it, together with the underlying restructuring concept to external stakeholders.

Only then all stakeholders can be aligned on the same mission and be willing to make their contribution towards it. By actively involving the stakeholders in the decision-making process from an early stage and seeking their input, leaders can deepen trust and foster a sense of ownership and commitment. Addressing concerns and providing regular updates on the progress of the turnaround will help to build collaborative relationships with stakeholders. This ensures their support and alignment with the organisation's goals and helps to navigate the restructuring process more effectively.

2

INSURANCE MANAGEMENT AND RISK MITIGATION: TRANSFER RELEVANT RISKS AND CONTAIN COSTS

2.1 Insurance portfolio optimisation

During a crisis, existing insurance structures can provide cost-saving opportunities for companies, helping them manage liquidity. It is crucial to carefully handle the organisation's insurance needs and understand how the ongoing crisis affects coverage, including identifying situational exclusions.

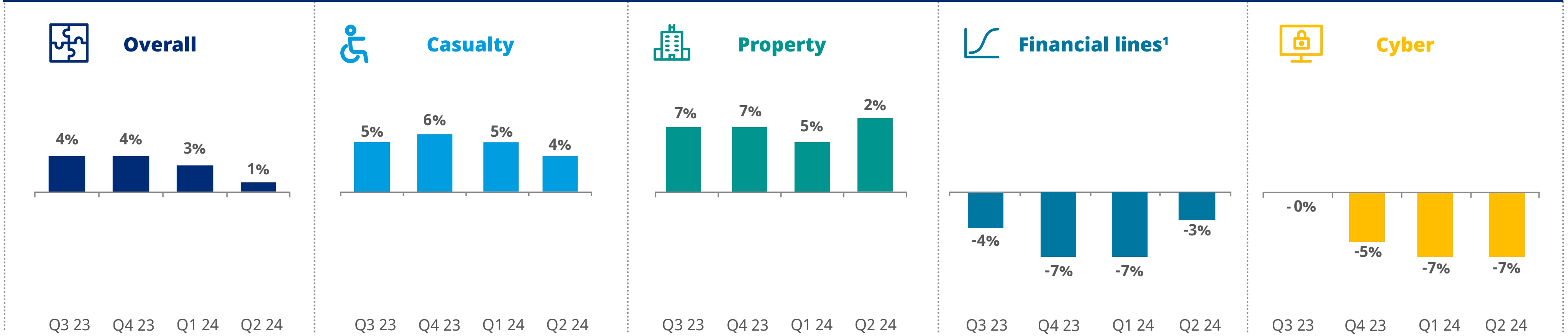
As presented in Marsh's quarterly Global Insurance Market Index report, premium levels have increased drastically over the past five years, however, in late 2023 and early 2024, the insurance market stabilised and softened in parts. Insurance rates in Europe increased 1% in the second quarter of 2024, thus, proactively managing your organisation's insurance structure can provide meaningful cost savings in this market.

Developing a risk management strategy that aligns with your organisation's unique requirements is crucial. This includes considering alternative risk transfer mechanisms like captives, risk pools, and specialised insurance facilities. Leveraging data analytics can help identify cost-effective insurance solutions, while proactive claims management practices can optimise recovery. These elements form the foundation of a comprehensive risk management approach.

08 | Q2 2024 Global Insurance Market Index — Europe

Commercial insurance rate increased 1%, down from an increase of 3% in Q1 2024

Composite insurance rate change by line of business



Market overview

The market index showed **increases** in casualty and property and **decreases** in financial lines and cyber.

Casualty	Property	Financial lines[1]	Cyber
4%	2%	-3%	-7%

Europe insurance composite rate increase of 1%
(a decrease of 2% compared to prior quarter)

Source: *Global Insurance Market Index Q2 2024*

[1]Financial Lines reporting is not inclusive of cyber.
All rates presented are averages unless otherwise noted

2.2 Emerging risks mitigation: Staying ahead of the curve

Organisations should focus on identifying and addressing existing and emerging risks that are relevant to their industry and operations as part of their risk management efforts. This involves staying informed about the evolving regulatory and legal landscapes to ensure compliance. Additionally, the organisation should engage with insurance brokers and carriers to understand emerging risk solutions and incorporate them into their risk management framework. By actively considering emerging risks, the organisation will be able to proactively mitigate potential threats and enhance its overall risk management strategy.

During challenging times, the personal exposure of the organisation's directors and officers becomes a significant concern. Safeguarding their personal assets becomes crucial, particularly in situations of insolvency or bankruptcy where the organisation may be unable to provide indemnification. This is where a directors and officers (D&O) policy becomes especially valuable. However, it is important to note that this period also poses increased risk for D&O insurers. Therefore, companies must ensure they effectively present their risk to secure appropriate coverage and protection for their senior leaders.

2.3 Additional liquidity creation

In difficult times, maintaining liquidity is crucial for an organisation's survival. It is important for organisations to consider insurance solutions as a means to create additional liquidity. Seeking advice on utilising insurance policies as collateral for financing arrangements or leveraging insurance assets to access alternative sources of capital can be beneficial.

Engaging with insurance brokers and carriers is also recommended to explore innovative liquidity solutions that can support the organisation's financial needs like factoring (both recourse and non-recourse), optimising credit insurance to increase the basis for purchasing receivables and accelerating cash flow, procuring additional coverage capacity such as top-up coverage and single buyer solutions, replacing escrow accounts with surety bonds to unlock liquidity, and freeing up bank lines by replacing bank guarantees with surety solutions from the insurance market.

2.4 Realising savings through risk finance optimisation

Insurance can be a valuable source of capital to manage and mitigate volatility. It should be considered alongside other sources of capital, such as debt and equity, to finance insurable losses. To determine the best balance between risk retention and risk transfer, it is important to understand your risk appetite, risk tolerance, weighted average cost of capital, volatility of key insurance risks, and insurance market pricing. This analysis, known as risk finance optimisation helps inform the design and placement of your insurance programme, optimising the allocation of capital to manage your risks.

Transactional risk insurance can be a helpful tool when dealing with post-close contractual liabilities in carve-outs or distressed divestitures. In situations where an organisation is separating a specific part of its business or selling a troubled asset, it is important to limit liabilities that may arise after the deal is closed.

Alternatively, the new owner may require warranties and indemnities to protect themselves. Transactional risk insurance can provide this protection through a third-party insurer.

In distressed M&A scenarios, it is crucial to recognise the significance of transferring transactional risks. One way to mitigate these risks is by exploring insurance solutions, such as warranty and indemnity insurance. To structure insurance-backed solutions for distressed M&A transactions, it is advisable to engage with insurance brokers and legal advisers. Thorough due diligence and risk assessments should be conducted to identify potential transactional risks and liabilities, ensuring that appropriate measures are taken to manage and mitigate them.

2.5 Environmental, social, and governance improvement in preparation for divestment

In the past, many business executives saw sustainability efforts as a mere compliance burden or a way to potentially save costs. However, the mindset has shifted significantly. Today, these very same executives are allocating substantial resources to sustainability initiatives, recognising the immense value they can bring. By improving both the top and bottom lines, these initiatives offer tangible opportunities to create value. Consequently, when evaluating potential acquisition targets, thorough assessments are conducted in terms of sustainability, if certain criteria are not met, investors, banks, and funds may choose to withdraw their support.

Active stakeholder engagement and developing an environmental, social, and governance (ESG) framework is essential for companies seeking to understand their ESG priorities. Conducting ESG risk assessments to quantify the operational and financial impacts of sustainability initiatives is also crucial. Materiality analysis and the resulting materiality matrix help companies determine which sustainability issues to prioritise. Effective reporting and stakeholder communication is also vital to consistently communicate the organisation's sustainability commitments.

3 LONG-TERM SUSTAINABLE LABOUR COST MANAGEMENT

3.1 Workforce optimisation

As companies across Europe face economic downturn and inflation they need to implement cost-cutting measures to safeguard their workforce and talent. In fact, "inflation and capital concerns" was the top concern in our recent Global Talent Trends 2024 Study (GTT), with over half of CEOs in Europe who responded saying it was influencing their 3-year business plan.

In this period, it's important to conduct a thorough workforce analysis and review governance processes. Improper rewards and benefits decision making, was highlighted by just over 20% of CEOs as posing the biggest short-term threat to their business in the GTT.

3.2 Skills strategy and framework

Having the right skillsets for the right positions is essential for optimising talent and therefore managing cost, which is a major concern for companies facing difficulties. Labour costs was listed by 52% of HR respondents to the GTT as one of the workforce challenges that will impact their business the most in 2024. At the same time 45% of companies, froma our recent survey of 1,400 HR leaders, said they have now needed to put in place a form of skills library or taxonomy they use in their organisation and almost two-thirds (64%) actively monitor market demand or availability of skills.

It's important to lay a strong foundation for skills-based decisions and a career framework defines the organisation's job architecture mapped directly to a skills taxonomy for workforce planning, capability development, performance management, and cost optimisation.

3.3 Health and benefits management

Increasing health and benefits costs is cited as the top risk in Europe and globally in our latest People Risk 2024 study. This is a manageable risk if organisations focus on active plan management.

Conducting proactive and thorough plan reviews can help control costs without the need for extensive benefit reduction. A formalised global benefits programme can provide important structure for long-term management.

There are several levers companies can consider in this process including:

- Alternative financing options including captives and self-insurance.
- Communicate changes with stakeholders in the organisation early and often.
- Focus on tracking plan performance over time. Today, only one in three employers have an effective way to actively monitor benefits costs (People Risk 2024 Study).
- Keep your employees healthy. Costs can be managed well by first mitigating underlying health risks including general health check-ups, early screening programmes for cancer, and offering employees the support they need for managing chronic health conditions.

Overall, the lack of a strong governance structure for benefits and insurance programmes is a significant issue with 70% of companies saying they don't have an effective approach, and this can lead to more financing issues down the road.

This can be managed by:

- Being proactive in plan design and cost review in order to budget for future costs increases.
- Conducting regular and structured benefit reviews with key stakeholders in the organisation.
- Keeping ahead of changes to benefits legislation in different markets.
- Building a robust governance framework for benefits and considering outsourcing some aspects including pension and investment management and global benefits coordination.

CONCLUSION

While there might not be much an organisation can do to prevent itself from falling into difficulty during trying economic times, there are several proactive measures it can take to not only survive the crisis but also thrive in the face of adversity. By implementing strategic initiatives and adopting a forward-thinking approach, organisations can position themselves for long-term success.

It is crucial for organisations to have a clear vision and strategic direction during a turnaround programme. This involves setting achievable goals, aligning stakeholders around a common purpose, and fostering a culture of innovation and adaptability. Open communication channels and regular engagement with employees, customers, suppliers, and other key stakeholders are also essential to build trust and maintain support throughout the recovery process.

Another key area that organisations can focus on is insurance management. By carefully assessing their insurance coverage and identifying gaps or areas of improvement, organisations can ensure they have adequate protection in place to mitigate potential risks. This includes reviewing policies, negotiating terms with insurers, and exploring alternative risk transfer mechanisms such as captives or parametric insurance.

Labour cost management is a third critical area that organisations should address during challenging economic times.

By carefully evaluating their workforce needs, organisations can identify opportunities for cost optimisation without compromising productivity or employee wellbeing. This may involve implementing flexible work arrangements, exploring outsourcing or automation options, and optimising staffing levels to align with business demands.

While navigating through challenging times can be complex, seeking guidance from expert advisers can greatly enhance an organisation’s chances of success. If your organisation is currently at risk or experiencing problems, we strongly encourage you to take proactive steps towards recovery. By embracing change, implementing strategic measures, and seeking expert advice, you can position your organisation for long-term success and emerge stronger from the crisis.

Contact us today to embark on the path to recovery and unlock new opportunities for growth and resilience.

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ABOUT MARSH McLENNAN

Marsh McLennan (NYSE: MMC) is the world's leading professional services firm in the areas of risk, strategy and people. The Company's more than 85,000 colleagues advise clients in over 130 countries. With annual revenue of $23 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses. Marsh provides data-driven risk advisory services and insurance solutions to commercial and consumer clients. Guy Carpenter develops advanced risk, reinsurance and capital strategies that help clients grow profitably and pursue emerging opportunities. Mercer delivers advice and technology-driven solutions that help organizations redefine the world of work, reshape retirement and investment outcomes, and unlock health and well being for a changing workforce. Oliver Wyman serves as a critical strategic, economic and brand advisor to private sector and governmental clients. For more information, visit marshmclennan.com, or follow us on LinkedIn and X.

AUTHORS

Alexander Qvennerstedt
Private Equity and M&A,
Practice Leader,
Marsh Europe
alexander.qvennerstedt@marsh.com

Lutz Jaede,
Partner, Head of Turnaround
& Restructuring,
Oliver Wyman Europe
lutz.jaede@oliverwyman.com

Yannick Egnongo
Senior Associate,
M&A advisory services,
Mercer Europe
yannick.egnongo@mercer.com

Marsh Mercer OliverWyman