Common misconceptions about trade credit insurance debunked

Dispelling the myths and misunderstandings about trade credit insurance and explains how it could protect your business.

Bad debts and cashflow interruptions have always represented an existential threat to businesses. Yet uptake of insurance to cover bad debts remains curiously low in the UK.

Despite the increasing threat of non-payments, many businesses still have not investigated the benefits of credit insurance or feel that it is not suitable for them.

Below are some of the most commonly held misconceptions.

Misconception 1: All my customers are strong, and I know them well

Time and again, the economic cycle reminds us that even the most undoubted business is not impervious to toppling in times of economic turmoil. The recent bankruptcies are reminders that no company is too big to fail.

Looking at the last filed accounts for these businesses, it's probable that most companies would have been very happy to give generous credit lines to them. Indeed, both companies were extensively credit insured, and thanks to **credit insurance** programs placed and managed many of our clients have had their claims paid and cash returned to the business already.

Misconception 2: Insurers only want to cover the good risks

Recent figures show claim payments rose by 23% in the first half of 2023 to their highest first half yearly figure since 2018, reflecting the continued challenging trading environment faced by many firms.

Misconception 3: We've never had a bad debt

Many companies say "we've never had a bad debt, so we're not going to buy credit insurance". But you wouldn't say: "we've never had a fire, so we're not going to get buildings cover".

Suffering an unexpected bad debt can seriously dent, or even wipe out, an entire year's profitability and in some cases cause the failure of the business. Past experience is no guarantee it will not happen in the future and credit insurance allows you to sleep easy at night in the knowledge that if the worst does happen, your business is protected.

No matter how good your credit management is, there is no guarantee you will be paid, and certainly not in the current environment. Company accounts are usually at least 9 months old and can be up to 21 months old – and that's assuming an extension has not been taken and they are filed on time! Relying on information that arguably pre-dates the current economic crisis is - one might say - 'risky'.

When large players fail, the impact ripples outwards severing payment lines to huge numbers of suppliers and affiliated businesses. In the case of some of these debtors, their debts to creditors exceeded millions of dollars, causing chaos in the whole supply chain - what we call the domino effect. While you may think you know your customers and they have never given you any payment issues, if they were to suffer a large bad debt themselves, will they be able to weather the storm and have sufficient funds to be able to pay you?

Misconception 4: It's too expensive

Credit insurance is very affordable for most businesses. As well as bad debt protection, it also provides customer intelligence, which is a huge added value. Several insurers also provide collection services and contribute towards collection costs.

A specialist credit insurance broker will bring a wealth of broking and market expertise, ensuring you secure the best terms and coverage.

In turbulent economic times, responsible business leaders must ask themselves how they can justify the risk of not having insurance to protect against bad debts.

Interesting fact: Just a $50,000 bad debt for a company operating at a 10% margin would have to produce an additional $500,000 turnover just to stand still.

Misconception 5: You have to insure everything

Another misconception about trade credit insurance is that “you have to insure everything”. While wraparound cover is usually the best way of mitigating risk, whole turnover insurance is not the only option and is not for everyone. There are many structures available allowing companies to target particular aspects of how they trade, which can be a more efficient policy option than full cover.

Misconception 6: Insurers cancel cover or reduce limits when the going gets tough

Where cover is cancelled, it is usually due to adverse or up-to-date information being received by the insurer and is often based on information not in the public domain. Businesses often see this not as an inconvenience but as a valuable insight into changes in their risk exposure, or an ‘early warning system’ allowing them to potentially avoid a bad debt or at least not increase their exposure just at the wrong moment.

Any change to cover is not retrospective of course and only affects cover for future deliveries/services provided. Additionally, 30 to 60 days’ notice of any cover change is commonplace, giving time to fully explore the reasons behind the decision.

For businesses seeking certainty of cover, in some cases, non-cancellable credit limits may be available therefore removing the risk of insurers cancelling cover.

Even insurers – with all the information available to them – can’t predict every failing business and of course that is what ultimately credit insurance is all about - *protection against the unforeseen.*

Misconception 7: Credit insurance creates an admin burden

Of course, drawing up a made-to-measure insurance policy requires spending some time to gather and provide details to a broker. But a good one will aid and let you know exactly what is needed in the easiest format. Once this initial onboarding is done, the policy should sit comfortably alongside existing credit control practices and would rarely add any significant burden to your existing processes.

Misconception 8: Credit insurance restricts sales

Actually, the opposite is often true. Used properly, credit insurance is a great tool to promote growth securely, expand with new and existing customers or into new markets.

Concentrating sales efforts with creditworthy customers means time and effort is saved increasing productivity within the sales cycle.

Using the insurance policy as security can often lead to improved funding which can be used to enable expansion of the business.

Misconception 9: I don't need credit insurance

Without cover to protect against the possibility of payment breakdowns, the repercussions on businesses can be swift and brutal, especially for smaller businesses.

Few successful businesses operate in a vacuum, and their success can be heavily impacted by the failure of companies they rely on and trade with. This is particularly notable given the rising levels of insolvencies across the country. Companies are still facing treacherous economic conditions with inflation, increased interest rates, high energy bills, demand restrictions due to the cost of living crisis and in many cases higher wage bills too.

Insolvencies have risen dramatically since the record low of the Covid-19 pandemic. This follows the end of the government's support for businesses and temporary insolvency measures introduced to assist businesses during the pandemic.

In the third quarter of 2023 insolvencies hit their highest level since the global financial crisis, rising 10 percent from a year ago. Meanwhile, firms in "critical financial distress" jumped 25 per cent in the last three months.

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