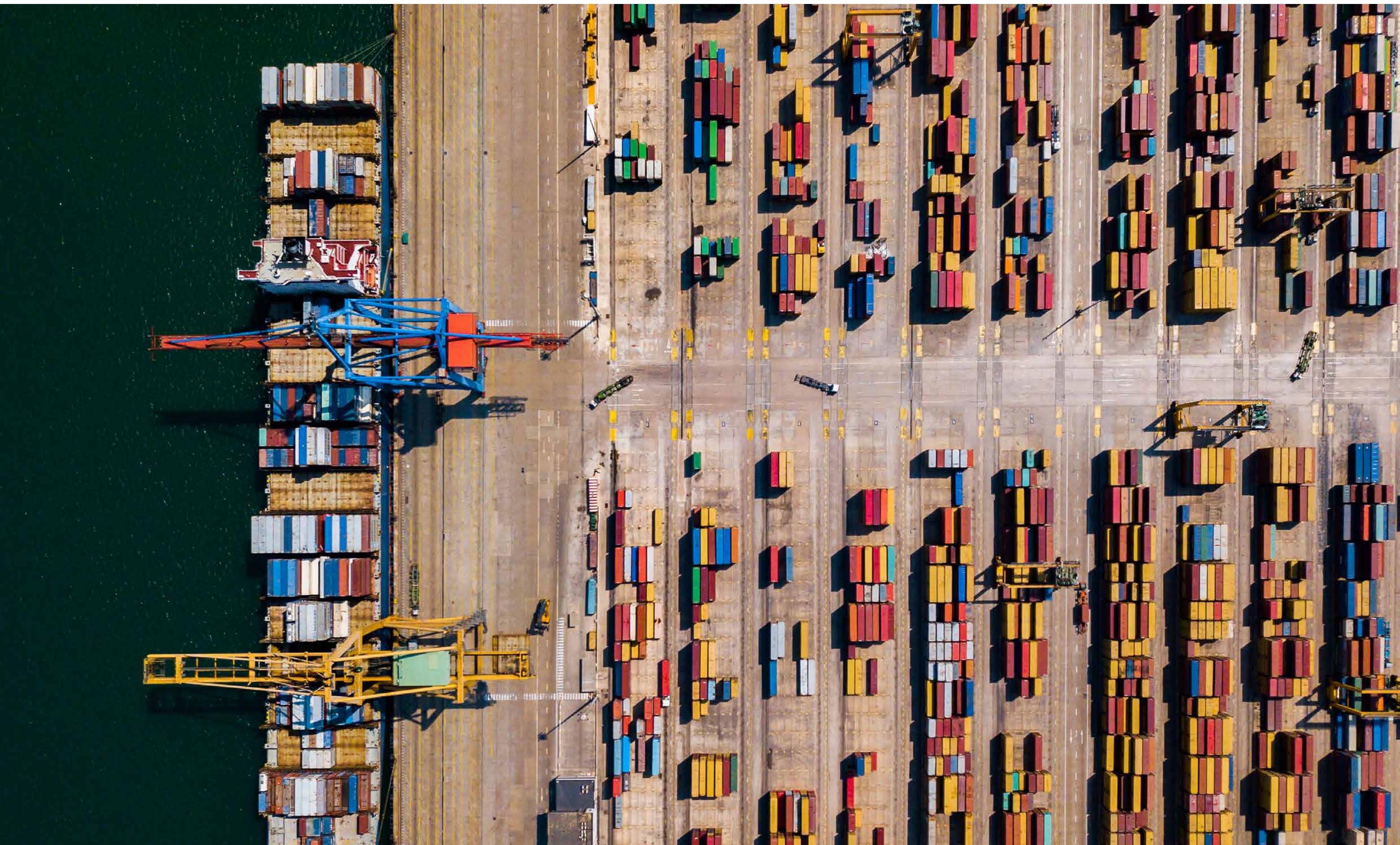
Trade

2024 Client Trends Report

Better Decisions in Trade, Technology, Weather and Workforce



Wide-Ranging Trade Issues Confront Global Businesses on Multiple Fronts

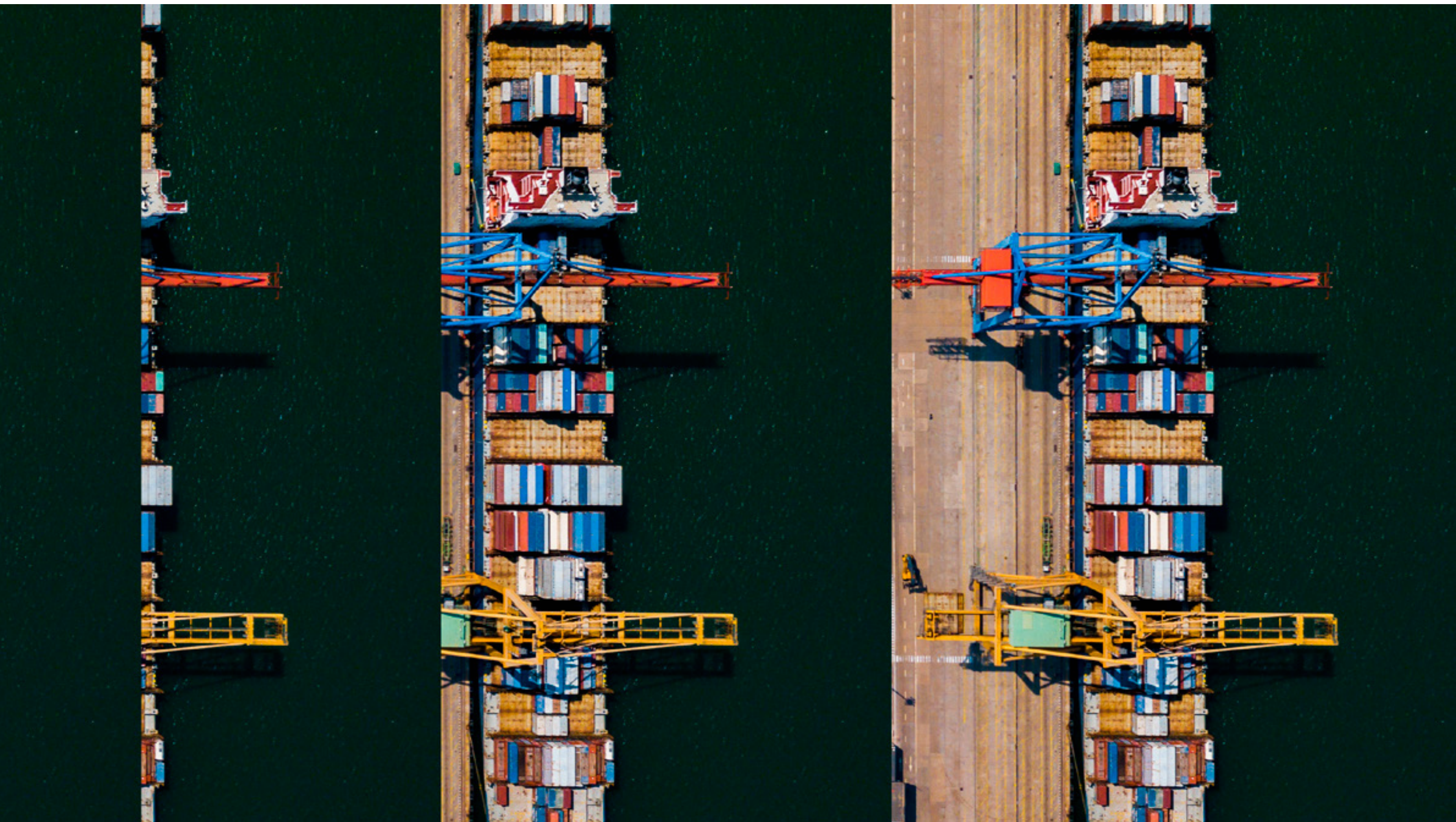
Global business leaders highlight risks linked to trade as some of their top concerns — both physical and financial. While the topic is complex and broad, there are opportunities that business leaders can pursue to stay ahead of emerging trade dynamics.

Key Takeaways

01 Trade is under attack on a variety of interconnected fronts, with geopolitical concerns a top focus area for businesses in 2024 — and likely to remain a pressing issue in the years ahead.

02 M&A activity has experienced recent headwinds, but there is a sense of change and optimism in 2024.

03 Businesses can prepare for future volatility by using a variety of risk transfer solutions to mitigate trade risks.



3.1%

Global growth is projected to be 3.1 percent in 2024, up from its 2023 projection by 2.9 percent.

Source: The World Trade Organization

Trade is the lifeblood of the global economy. But due to its breadth and scope, it unsurprisingly faces several significant challenges — often interconnected and mutually reinforcing — including geopolitical instability, inflation, climate change, currency fluctuations and people availability. Together, these create a complex and volatile global trade landscape for business leaders to navigate.

Movement of Goods and Commodities

Geopolitical instability is a top concern for businesses. We have seen its impact in recent months in the Middle East and — over a longer period — in Ukraine. Trade between geopolitically distant economies accounts for nearly 20 percent of global goods trade, but close to 40 percent of trade in globally concentrated products.[1]

The Suez Canal — at the neck of the Red Sea — is used by roughly a third of global cargo vessels. But following attacks by Yemen's Houthis, linked to the war in Gaza, average worldwide costs to ship a 40-foot container have doubled[2] as ships, which traditionally took the Red Sea-Suez Canal route, have opted to traverse around Africa. This detour adds an additional two weeks to the journey, resulting in higher fuel and labor costs — which are ultimately passed on to the business and consumers.[3] It is clear that the rerouting of shipping lanes has the potential for far-reaching consequences beyond the immediate locations affected.

Trade Trends: Today and Tomorrow

All of the top 10 risks identified by business leaders in Aon's latest Global Risk Management Survey have implications for global trade, with six directly linked:

01 Business Interruption

02 Economic slowdown/slow recovery

03 Supply chain or distribution failure

04 Commodity price risk/scarcity of materials

05 Damage to reputation/brand

06 Increasing competition

> "Geopolitical issues remain the primary issue in our global supply chain. They're reshaping trade channels, resulting in less availability of certain products and commodities. This causes price increases and is central to significant global tension.
>
> Richard Waterer, Global Risk Consulting Leader

[1] "Geopolitics and the geometry of global trade" — McKinsey

[2] "Importers Face Surging Shipping Costs, Delays as Red Sea Diversions Pile Up" — Wall Street Journal

[3] "Shipping Costs Soar in Wake of Red Sea Attacks" — The New York Times

Case Study

Launching a Special Facility for Smaller Cargo War Risks in the Red Sea

As issues in the Red Sea continue to impact global shipping, many insurers have canceled war and strikes coverage under their marine cargo policies. The loss of this cover has created a significant protection gap for traders and intensifies concerns about maritime travel through the Red Sea trade route.

In response, Aon worked closely with Lloyd's to create a special risk facility for smaller cargo war risks in the Red Sea. The cargo risk facility is written with Lloyd's capacity and enables small and mid-size traders in the Dutch market to quickly access war coverage for shipments through the Red Sea. Risks are bundled into one facility, which enables traders to pay premiums as much as 50 percent lower than what they would have paid individually.

Beyond geopolitical activity, the number of new global trade restrictions has steadily increased year-on-year. There were more than 3,000 new restrictions in 2023, up from about 650 restrictions introduced in 2017.[4]

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> Currency exchange fluctuations, inflation, near-shoring, climate issues and the availability of qualified people are all interconnected and impacting trade right now.
>
> Lee Meyrick, Co-Lead Global Specialties, Chief Executive Officer Global Marine

Meanwhile, climate obligations are an increasing focus for businesses moving goods and commodities globally. Maritime regulation introduced in 2020 requires ship owners and operators to decrease sulfur emissions by 85 percent. New cleaner fuel can be over 25 percent more expensive, representing a direct financial impact on businesses' bottom lines.[5] The combination of new regulations and heightened stakeholder scrutiny have the potential to create new reputational exposures and financial impacts — issues that are expected to deepen as businesses look to tackle the climate crisis.

"The intersection of supply chain and reputational risks has created a perfect storm that poses a potential threat to both an organization's profitability and brand equity," says Ladd Muzzy, Global Reputation Risk Practice Leader. "Quantifying the reputation exposure has been a keystone to better business decisions."

An Outlook on Movement of Goods and Commodities

Supply chain risk is complex, multi-faceted and costly, with disruptions significantly impacting both business and financial performance.

Looking ahead, organizations need to consider enterprise risks associated with their supplier location strategy, including political risk and terrorism, corruption and bribery, and risks associated with weak legal and regulatory controls.

Geopolitical risks will remain a significant concern for international business, especially where they are reliant on supply chains with exposures to volatile regions and sea lanes.

"Geopolitical tensions linked to issues, such as the busiest election year on record, are pressing concerns for business leaders and the insurance market," says John Minor, Director of Crisis Management and Political Risk. "They have the potential to complicate supply chains for many clients. Navigating capacity challenges will drive risk managers to be more strategic as we approach the insurance markets from a supply chain perspective."

M&A Dynamics

In addition to the movement of goods and commodities, the role of mergers and acquisitions (M&A) is significant in shaping the landscape for global trade. M&A dealmakers see potential in the global economy in the coming years, but maintain a close eye on an increasingly interconnected risk landscape.

According to Aon's Global Risk Management Survey, dealmakers and risk managers consider the top five financial risks to be:

01 Cash flow or liquidity risk

02 Capital availability

03 Interest rate fluctuations

04 Asset price volatility

05 Business Interruption

[4] "Geopolitics and the geometry of global trade" — McKinsey

[5] https://www.aon.com/getmedia/c307576d-68cf-485b-b31f-52c68b044678/how-can-fuel-insurance-support-companies-transition-to-cleaner-fuels.aspx

Each risk intersects, amplifying the threats financiers face.

Macroeconomic volatility and increasingly complex regulatory regimes have affected M&A market dynamics over the past two years. Access to capital has become increasingly challenging, with elevated interest rates making the cost of borrowing more expensive.

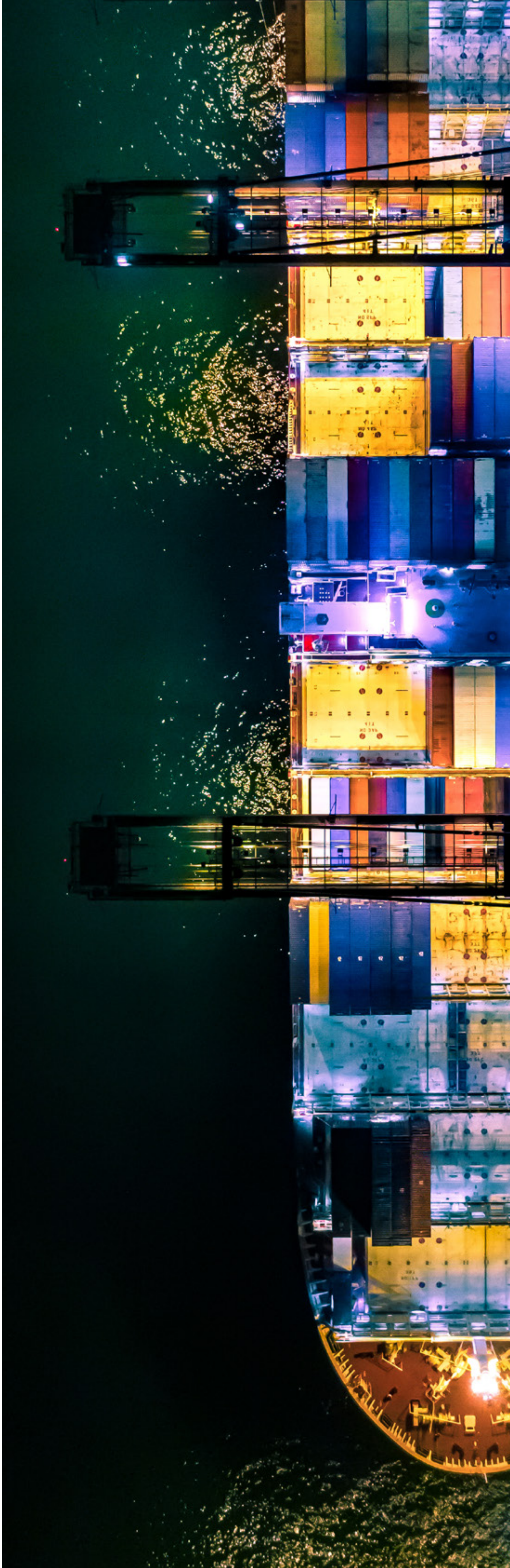
In response, some dealmakers explored alternative sources of capital, while others paused transactional activity until economic volatility begins to smooth. This led to a deal volume decline of 11 percent in the first half of 2023, 35 percent down against 2021 highs, according to Aon's M&A 2023 Risk in Review.

Despite these numbers, change and optimism are in the air in 2024. "Macro factors are indeed squeezing clients and creating headwinds for M&A," says Gary Blitz, Co-CEO for M&A Transaction Services. "But over the last three to six months, we've been seeing the market rebound as the volatility coming from those factors subsides." This should bode well for broader trade dynamics.

Alongside the financial and operational impacts of macroeconomic volatility, environmental social and governance (ESG) pressures are a focus for dealmakers globally. It is not just a responsible choice, but a strategic imperative. From attracting investors and consumers, to fostering employee engagement and securing regulatory compliance, embracing ESG principles has become integral for forward-thinking businesses.

ESG obligations and robust governance reporting directly impact company valuations and deal appetite, but dealmakers are reporting the quality of ESG information is not always up to the desired standard currently.

As multinational M&A deals and supply chains extend across multiple regions, assessing social risks, such as a country's human rights record, is now a business imperative from both an ethical and regulatory standpoint.



"Because ESG means different things to different stakeholders, and because regional and industry nuances matter, there is not a one-size-fits-all approach to ESG-related categories. This is especially true in the impact of ESG on valuations or risk assessments by financial stakeholders," says Kelsey Owen, Partner of Talent Solutions, North America.

An Outlook on Financial Trade, M&A and ESG

Global growth is projected at 3.1 percent in 2024, up 0.2 percent from October 2023, according to the World Economic Outlook.[6] Inflation is also falling faster than expected in most regions — down to 5.8 percent in 2024 and predicted to reach 4.4 percent in 2025. The likelihood of a hard economic landing is receding, and risks to global growth are broadly balanced.

As such, the key word in M&A — and trade more broadly — is stability, which the global economy appears to be delivering to dealmakers as we move deeper into 2024.

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> The world is returning to one where dealmakers are more confident in pursuing deals, knowing that the ground under them will not turn to quicksand the following day.
>
> Gary Blitz, Co-CEO, M&A Transaction Services

To prepare, executives should embrace deeper due diligence efforts across key risk areas, including cyber security and workforce resilience. They should also develop a robust risk transfer strategy that leverages transaction insurance capital to de-risk transactions.

[6] World Economic Outlook Update January 2024, International Monetary Fund

“Peculiarly, the general view that inflation has peaked and is only going to go one way may increase volatility as people wait to do deals to see if they get a cheaper cost of money,” says Alistair Lester, Co-CEO, M&A Transaction Services.

Despite evolving risks, deals are providing opportunities to invest in digital and ESG-friendly capabilities, which are helping to bolster dealmaking prospects in several sectors, including telecommunications and digital technologies, industrials and chemicals and renewable energies.

Dealmakers will need to navigate higher expectations from regulators, who are demanding greater transparency regarding how ESG factors are considered in the investment process. Investors, too, are raising the bar and demanding disclosure of more granular ESG information than ever before. 96 percent of dealmakers surveyed in Aon’s recent M&A Risk in Review expect ESG scrutiny in deals to increase over the next three years. While 24 percent now say environmental litigation is their most pressing ESG concern. Prudent investors who capitalize on current conditions and stay ahead of developing trends will find pathways to success.

“The Inflation Reduction Act (IRA) is creating a lot of M&A deal flow in the U.S., tax investing and opportunities in renewable energy and infrastructure projects,” adds Blitz. 68 percent of dealmakers expect the expanded tax incentives under the IRA to drive global investment in U.S. disproportionately to the rest of the world to a high or moderate degree. “We’re actively helping investors and the buyers protect themselves in those deals. An ESG mindset is driving a lot of appetite, in addition to the beneficial tax credits.”

The climate imperative will continue to guide leaders’ trade decisions. ESG obligations, increasing stakeholder scrutiny and evolving regulations will create focus and impetus for the global M&A market.

How Businesses Can Prepare for Change

There are three opportunities businesses need to consider when navigating the risk to global trade.

Opportunity 1

Build a Singular Supply Change Strategy

Building visibility into the supply chain is the cornerstone of mitigating risk. A single strategy for supply chain risk is about a single version of the truth — a taxonomy of supply chain issues that the firm agrees they face consistently and, most importantly, a singular understanding of possible outcomes.

Harnessing data and analytics to build transparency around your most important suppliers, their geographic location and their dependency on third parties will be critical as risks evolve. Awareness of the costs of supply chain failures will help leaders take proactive steps to invest in mitigating existing risks and their potential impact.

“From a risk strategy point of view, it starts with an understanding of where the risk is in the supply chain and quantifying it,” says Waterer. “If you have a picture of your top risks and an understanding of your level of exposure, that will frame the decisions that you want to make as an organization, informing an appropriate balance of risk and reward.”

Opportunity 2

Leverage Data and Analytics

While the economic outlook can impact when and how businesses exercise their capital, whether through internal investments — such as risk management — or external transactions — such as M&A activities — data and analytics will remain the bedrock of better decisions. We have seen this help in three scenarios:

01

The company already has information on its supply chain. It hopes to revisit its insurance program to see what kind of coverage is in place and if it can cover the losses the company may incur due to an interruption from a third-party supplier.

02

The company is uncomfortable accepting its current level of risk and wants to enhance risk management. Data and analytics can support the assessment of supplier risk and the auditing of supplier risk management. This includes understanding levels of supplier utilization and determining fallback positions in the event of an interruption. This type of analysis helps companies decide whether they need to make adjustments to their supply chain risk management, like identifying a dual source supplier.

03

The company has recognized that the risk exposure is significant. Therefore, they address it in the supply chain strategy by bringing production closer, changing suppliers, assessing deal sourcing, inventory management or holding more stock.

Opportunity 3

Use Insurance Risk Transfer

Specialist solutions are critical in helping organizations navigate volatility and mitigate the risks inherent in trade through supply chain risk management. They can also help facilitate the pursuit of complex M&A transactions. Data-driven insights allow leaders to make informed decisions about material risks and how to address potential exposures.

"The thesis in our world now is that we can solve for identified risks through insurance transfer," adds Lester. "A question I am hearing from clients is: how insurance solutions can help box away a risk we are concerned about in a way that allows us to get a deal done."

In response, supply chains may shorten as more businesses consider the use of nearshoring as an operational strategy to overcome evolving supply chain risks. Data will be central to decision-making. Improved insights around where, and how, risk impacts the supply chain can help inform business leaders as they prepare for unplanned events and volatile supplier performance.

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> Supply chain risk management should be truly enterprise-wide, connecting risk and insurance professionals with senior directors in supply chain, procurement, treasury, strategy and operations, around a common set of data and decision making.
>
> Derrick Oracki, Managing Director and Actuary in Aon's Global Risk Consulting practice

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