



Business Risk Report.

A survey on Financial Market risks for UK businesses.

Contents.

- 01 Introduction
- 02 The overall picture
- 03 Businesses' perception of risks
- 04 Analysis by sector, region and firm size
- 05 About us



“ Four in five British businesses say they have no hedging strategies in place despite concerns about financial market risks and their potentially negative impact on businesses. ”

Introduction.



Welcome to the first edition of our Business Risk Report, which gauges both the attitudes and hedging approaches of UK businesses to financial market risks.

We are clearly living in volatile times and we feel it is important to provide clients with an insight into UK companies' approaches to risk management. This first edition focuses on the impact of key asset classes – interest rates, commodities, inflation and FX – on UK businesses. We have also broken our results down regionally, by sector and by company size to provide an extra dimension of insight.

Interestingly, despite the FX volatility and interest rate reduction over the past six months our current report shows that UK business owners are also preparing for the negative impact of both commodities and inflation in the coming months. However, this concern is still not reflected in companies' increased hedging activity.

The report highlights the gap between companies' fear of market risk and their level of hedging protection against that risk. It is here that our role as trusted risk adviser can really come to the fore as we provide expert advice and tailored risk management solutions against the risk that may threaten the financial performance of our clients businesses. With this in mind, I hope the Business Risk Report becomes a regular reminder about the importance of pro-active risk management.

Clare Francis

Managing Director and Head of Sales and Derivatives Structuring, Lloyds TSB Corporate Markets

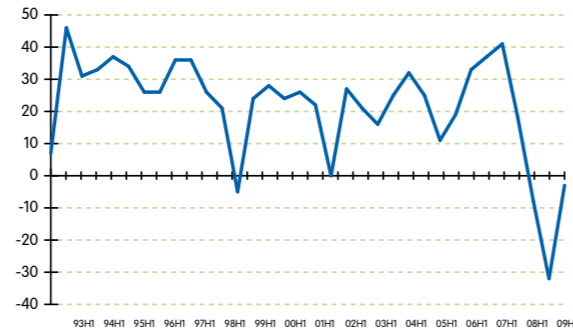
The overall picture.

Business confidence improves from record lows.

Business confidence index.

Our business confidence index, which takes into account order book levels, sales and profit expectations in the next six months, rose to **-3** from a record low of **-32** in the previous survey.

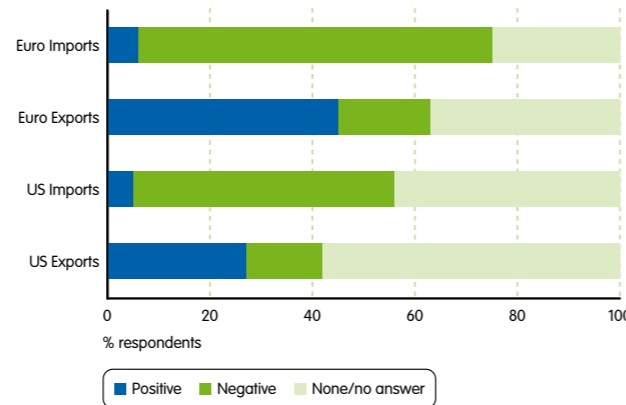
The rise in business confidence suggests economic activity is expected to stabilise in the second half of the year, but sustained growth is not yet assured. Although businesses are hopeful of higher orders and sales, most firms expect profits to remain under pressure, thus capital spending and staff numbers are expected to be reduced further.



FX market movements.

Although the pound has moved moderately higher on a trade-weighted basis since the start of the year, it remains significantly lower than a year ago. The survey shows that the value of the pound is having a positive impact on exports, especially to the euro zone, but it is having a significant negative impact for imports.

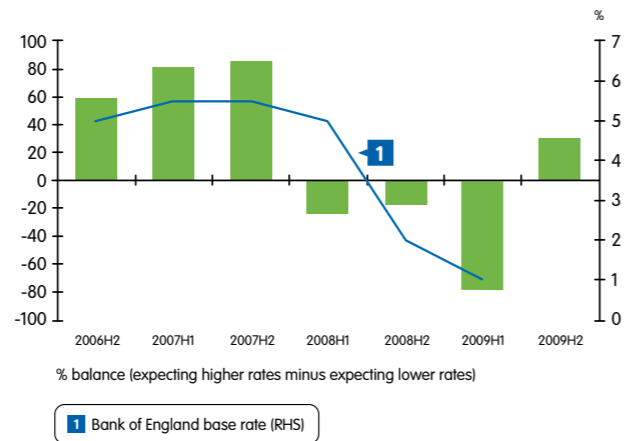
Nearly half (**45%**) of exporters to the euro zone said the exchange rate is having a positive impact, but only about a quarter (**27%**) of exporters to the US said the same. Imports were particularly affected by the current value of the pound, with **51%** and **69%** indicating that it is adversely affecting US and euro zone imports, respectively.



Interest rate expectations.

Although a slight majority of companies expect interest rates to rise rather than fall in the next six months, as shown in the chart, the overwhelming majority expect rates to remain unchanged. This compares with an overwhelming majority, last December, expecting interest rates to fall.

The latest survey shows that **66%** of respondents expect no change in interest rates in the second half of this year. However, about one-third (**31%**) anticipate a rise in interest rates, while only **2%** expect rates to fall further.

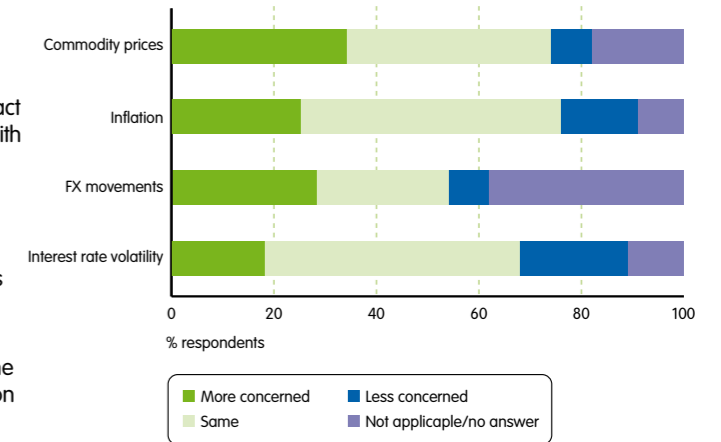


Businesses' perception of risks.

Companies remain concerned about financial market risks, but most have no hedging strategy in place.

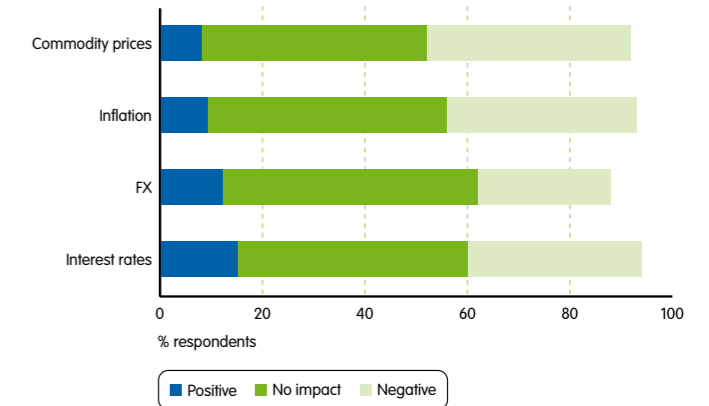
Businesses' perception of risks.

- Our latest survey shows that one-third (**34%**) of companies said they were more concerned than six months ago about the impact of commodity prices, while **8%** said they were less concerned, with **40%** saying the risks had remained the same.
- The proportion of businesses more concerned about FX movements (**28%**) outweighed those less concerned (**8%**) by more than three-to-one. A quarter (**26%**) said the FX risks had remained the same and the remainder indicated that such risks were not applicable to their business.
- Inflation risks were applicable to nearly all businesses in the past six months, but a half (**51%**) said that the risks had not changed in the past six months, while **25%** were more concerned about inflation and **18%** were less concerned.
- With interest rates at record lows, the proportion of companies more concerned about interest rate volatility (**18%**) was slightly outweighed by those less concerned (**21%**), while **50%** said the risks were the same as six months ago.



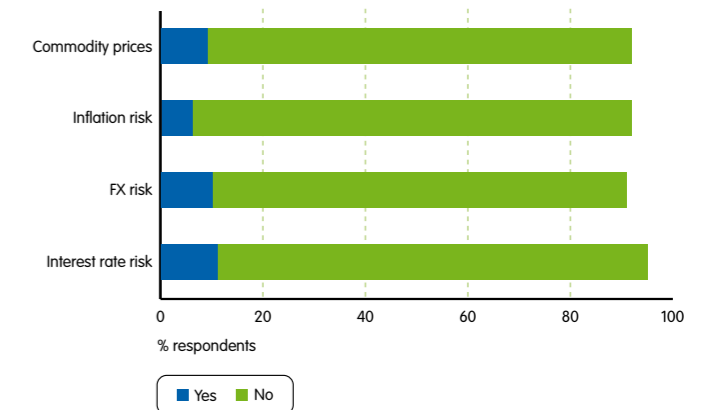
Developments in financial markets.

- 40%** of companies expect commodity prices to have a negative impact on their business in the next six months, compared with only **8%** which expect a positive impact.
- A clear majority of respondents to the survey also said inflation is expected to have a negative impact on their business (**37%**), compared with **9%** which anticipate a positive impact.
- A quarter of companies (**26%**) expect FX to have a negative impact on their business in the next six months, compared with **12%** which anticipate a positive impact.
- More than twice as many respondents said they expect interest rates to have a negative impact (**34%**) rather than positive impact (**15%**) on their business in the next six months.



Hedging strategies.

- Despite the concerns about financial market risks and their potentially negative impact on businesses, more than **80%** of companies in our survey indicated that they have no hedging strategy in place.
- Only **6%** of companies said they had a hedging strategy in place to protect against inflation risks, rising slightly to **9%** for commodity prices, **10%** for FX risks and **11%** for interest rate risks.



Analysis by sector, region and firm size.

A quick summary on the results of the survey from a sector, regional and firm-size perspective.

The sector picture.

- Concerns about interest rate volatility had fallen in aggregate compared with six months ago, but were above average in the transport & communications and retail sectors. However, in all sectors, more companies expect interest rate movements to have a negative rather than positive impact on their businesses in the next six months. About **10%** of companies in all sectors had a hedging strategy in place for this risk.
- Firms in the retail, wholesale & distribution and manufacturing sectors expressed the greatest concern about the impact of FX movements on their business in the next six months. The survey reported a quarter (**26%**) of companies in wholesale & distribution and **18%** of manufacturers had a hedging strategy in place, but the proportions were significantly lower in other sectors, including in retail (**6%**).
- Concerns about the impact of commodity prices in the next six months were the highest in retail, wholesale & distribution, manufacturing and transport & communications. However, only **9%** of all companies said they had a hedging strategy in place, with the manufacturing sector having the highest proportion at **14%**.
- Companies in the transport & communications, hotels, catering & leisure, construction and retail sectors expressed the greatest concern about the impact of inflation on their businesses in the next six months. However, no sector reported more than **10%** of companies with a hedging strategy in place.

The regional picture.

- At the national level, companies have indicated a notable rise in concerns about commodity prices compared with six months ago. Such concerns were the highest in South Wales & Welsh Borders and the Eastern region, but notably lower in London. This also reflected the proportion of companies with a hedging strategy in place.
- Companies in London and the Eastern region reported the greatest concerns about the impact of inflation on their businesses. The lowest was in Scotland and the South East. Yet only **5%** of London firms had a hedging strategy in place, compared with **11%** in Scotland.
- Risks from FX movements registered the highest concerns among firms in London and South Wales & Welsh Borders, but were significantly lower in North & North Wales. The proportion of companies with a hedging strategy in place varied from **7%** in the Midlands to **15%** in London.
- Companies in South Wales & Welsh Borders appeared to be the most concerned about interest rate volatility, while Eastern and Thames Valley firms were least concerned. **18%** of firms in Scotland said they had a hedging strategy in place compared with **8%** in the South East.

Analysis by firm size.

- Smaller companies in our survey tended to be more concerned about the impact on their businesses from interest rate volatility, inflation and commodity prices, while larger companies tended to be more concerned about FX movements.
- Nearly a quarter (**22%**) of companies with turnover below £1m said they were more concerned about interest rate volatility than six months ago. This compares with **17%** of companies with turnover of £1m-25m and **9%** of firms with turnover of over £25m.
- Larger companies were more concerned about FX risks on their businesses than smaller firms. A third (**34%**) of companies with turnover of £50m or over indicated that they were more concerned than six months ago, compared with **28%** of firms with turnover below £50m. Moreover, **34%** of firms with turnover below £50m said FX risks were not applicable to their businesses, compared with **19%** of companies with a turnover of over £50m.
- Concerns about inflation were the highest in firms with turnover of less than £5m. Just over a quarter (**27%**) of such respondents indicated greater inflation concerns than six months ago, compared with **18%** of companies with a turnover of over £5m. The proportion of companies with a hedging strategy in place for this risk was low across all firm sizes.
- Firms with turnover below £5m appeared more concerned about commodity price risks than other companies. Less than **10%** of firms with turnover below £10m had a hedging strategy in place, compared with **15-20%** of companies with turnover above £50m.

About us.

Lloyds TSB Corporate Markets' Economics team works in tandem with relationship and financial markets teams to provide analysis of the issues impacting the economy and business areas its customers operate in. The mission of the team is to add value to customers, through superior economic analysis and insightful research into financial markets and industrial sectors.

Our Financial Markets team provides solutions to businesses of varying size – from commercial through to global corporations and financial institutions. The complexities of today's volatile financial markets mean that businesses have an even greater need for a risk management partner. Our Financial Markets experts take a consultative approach and can provide you with a risk strategy that includes FX, Inflation, Interest Rates and Commodity solutions.



Contact us.

Economics.

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lloydstsb.com/corporatemarkets

Business Risk Report is based on the responses of 2,564 companies surveyed via Lloyds TSB Commercial Business in Britain May 2009 questionnaire.