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MARKET INSIGHT: UK Retail

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Xenia’s Market Insight reports are designed to work alongside a credit insurance programme. The purpose of this report is to provide you with objective and practical information that will help to advance your understanding of the issues and how they might impact your business.

We welcome your thoughts and questions on the issues covered. Please email us on info@xeniabroking.com should you require any further advice or have questions about this report.

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Introduction

As a result of the continuing rise of business insolvencies and store closures together with challenges in the labour market and high levels of inflation, the period of 2022 to H1 2023 has been very challenging for UK retail.

The first six months of 2023 brought about a fair share of interesting events including a surprise increase in footfall on the high street at the expense of previously soaring online sales, and an increase in insolvencies and Consumer Prices Index (CPI), which reached 10.4% in February. We can see from the graph below that online sales as a percentage of total retail sales is now on a downward trajectory compared to 2020/21 even though the online environment continues to pick up market share year-on-year.



(<https://www.ons.gov.uk/businessindustryandtrade>)

If we look beyond the dramatic headlines regarding shop closures, it is clear that retail is going through an industry wide transformation, with economic events provoking systematic change, and new channels aiding required growth with technology playing a major role in this re-invention.

As we advance into the second half of the year, the increased stresses caused by uncertain macroeconomic and geopolitical environment continue across several sectors. Inflation has started to decrease however with July's rate at 6.8%, the lowest in 29 months, and will hopefully help the retail sector and the wider economy.

Key observations

Despite the extremely challenging economic environment, the Growth For Knowledge (GFK) UK Consumer Confidence Index improved by a further 3 points in June, a fifth monthly improvement in succession. This was facilitated by the reveal of positive economic news, which helped restore consumers' confidence in their own personal finances and in turn their disposable income. This triggered an increase in footfall on the high street as discussed above.

The other side of the coin suggests that the UK economy is set to flatline at best in the coming months as higher borrowing costs take a bigger toll on consumer spending and business confidence. Retail services saw the weakest rise in new work for six months, and job creation slipped as some firms responded to the market conditions by putting brakes on hiring.

- High inflation is now starting to track towards the 2% target helped by the interest rate increase we have seen in recent months.
- The Consumer Prices Index (CPI) 12-month rate was 6.8% July 2023, down from 7.9% in June.
- However, monthly CPI fell 0.3% in July 2023, whereas it rose by 0.6% in July 2022.
- Retail Price Index (RPI) reading of July 2023 was 9% in July a decrease on the previous month at 10.7% tracking against 1990.
- Cautious spending, increased competition and rising costs have created unprecedented challenges during 2023 and this persists.
- Although we have seen an improvement in some areas, confidence remains close to a record low, which suggests it's likely to take longer to restore confidence to previous levels.
- 2023 has certainly felt the impact of increases in business rates, commodity prices, and wages and pension costs alongside the diminished value of the pound.
- The Bank of England increased the base rate to 5.25% in August 2023, taking borrowing costs to their highest level since 2008.

Retail insolvency analysis

Retail is clearly an industry under pressure. Stores are disappearing from high streets at a rapid pace as consumers' changing behaviour is increasingly shifting from shopping in store to online. Many retailers find themselves in an uncomfortable position as margins are being squeezed between weakening demand and rising costs. This coupled with less money in the consumers' pockets, it is not surprising therefore to hear that even the larger traditional high street shops have struggled with some ceasing to trade. In August it was reported that a net record level of 964 stores either disappeared or were affected, according to new data from ONS.

Analysis carried out by Deloitte's was also alarming as it clearly accentuated that nobody was safe, noting that the figure for failures in the larger retail category had been rising at an alarming rate.

The continued popularity of online shopping, climbing business rates, a hike in minimum wage and inflation at a multi-year high has resulted in a decline in footfall on the high street and led to retailers and food outlets to cut staff numbers and close stores.

Retail Casualties Data

	Businesses Failing	No. Stores Affected	No. Employees Affected
2023 (to mid-August)	39	962	19,046
2022	49	2,318	34,907
2021	19	1,758	26,274
2020	54	5,214	109,407
2019	43	2,051	46,506
2018	43	2,594	46,014
2017	44	1,383	12,225
2016	30	1,504	26,110
2015	29	728	6,845
2014	43	1,314	12,335
2013	49	2,500	25,140
2012	54	3,951	48,142

<https://www.retailresearch.org/whos-gone-bust-retail.html>

Notable Insolvencies

Some of the most recognised failures so far this year are listed below:

Wilko Ltd - (Turnover £1.3 billion) The well-established and renowned large hardware-&-general merchandise retailer, went into administration on 10 August 2023, having filed a notice of 'Intention to Appoint Administrators' on 3rd August. Although they made numerous attempts to preserve the business and its going concern status they had to unfortunately concede into administration. The firm made a profit of only £3.2m in 2021 and traded at a loss of £36m in 2022. They owe about £70m to suppliers and required this level of working capital to continue trading. Wilko had been badly impeded by covid and, as a major high-street player, the fact that shoppers have not returned to high streets in the numbers they once did. As well as the changes in consumer behaviour has come renewed competition from other low-cost sellers such as B&M, Poundland and Home Bargains has made things even more difficult.

Cath Kidston Group - (Turnover £130m) The well-known apparel retailer, was put into administration in late March 2023 by its private equity owners Hilco Capital. Hilco had only bought the loss-making business in 2022. Cath Kidston failed back 2020 with 60 UK stores (200 globally), most of which were closed. The IP, brand and domain names of Cath Kidston were acquired by Next via a pre-pack for £8.5m.

Kettle Interiors - (Turnover £25m) Furniture supplier and B2C retailer, went into administration in March 2023. Although the firm had a large elevation in sales during the pandemic, the post-covid world hit business profits

through high shipping costs and uncertain deliveries creating additional financial problems. The firm was unable to raise additional capital or turnaround the business.

Connect Distribution Services - (Turnover £97m) The online distributor of spare parts, accessories, and consumables mainly for DIY appliances, went into administration in March 2023. Originally set up as a wholesaler approximately 50 years ago, they traded B2C and B2B through eSpares, BuySpares, 4OurHouse, and the Connect Trade Portal. The stock, IP, contracts, and fixed assets were acquired out of administration by Screwfix for a cash consideration of £3m.

Moore Large & Co Ltd - (Turnover £40m) Cycle distributor established back in 1947 went into administration in March. Moore Large was a major importer and wholesaler of bikes, accessories, cycle clothing and parts, selling to retailers including Go Outdoors Amazon and Costco. During the covid period, sales of big-ticket bikes and equipment were high, but in 2022 and early 2023 the Company suffered a steep fall in sales (around 20%-25%) and even the concerted efforts of an MBO early 2022 wasn't enough to ensure its viability. A combination of rising interest rates, sterling devaluation and massive oversupply leading to discounts was a recipe that couldn't be managed leading to increased debt burden and diminishing margins.

Lavish Alice - (Turnover £50m) The trading style of Fast Fashions Collection International was placed into administration in February after being threatened by HMRC with a winding-up order few months prior. This led to the Lavish Alice wholesale arm being put into administration with debts of up to £4m. Going forward the company will trade online B2C only. The wholesale arm used to supply Harvey Nichols, Bloomingdales, Selfridges, and Saks Fifth Avenue. The company suffered significant losses during the pandemic and, despite a subsequent large increase in sales, the business was unable to pay its creditors on time.

Thomson Hayes Retail Display - (Turnover £28m) The well-established retail display company, went into administration and ceased trading at the end of February 2023. Its focus was department stores and cosmetics and during the pandemic demand for retail displays of course fell. The company's attempts after Covid to fulfil its existing contracts were beset by supply issues and the onset of inflation in 2022.

Paperchase - (Turnover £130m) The upmarket stationery and gifts retailer went into administration at the end of January 2023. Paperchase appointed the administrators to stand by, as a contingency, in case they were needed, which was good foresight. The company had successfully expanded across the UK and many other countries, but following accumulated increased losses accentuated by Coronavirus pandemic lockdowns and the subsequent reduction in shopper footfall in town centres compared to 2019 it could no longer withstand.

Shaws The Drapers - (Turnover £20m) The well-known firm selling soft furnishings, craft equipment and wool (28 branches in England and Wales) went into voluntary liquidation at the beginning of 2023. They had been selling off stock at heavily reduced prices before Christmas to empty the shelves. The owner, Mr Philip Shaw, said that the business was no longer viable and would close. The Company's first shop was opened in 1916 in Cardiff.

Credit insurance market sentiment

In recent years Credit Insurers have paid claims following high profile retail failures such as Palmer & Harvey, Maplin, Poundstretcher, McColl's, TM Lewin, Debenhams, Cath Kidston, Mothercare to name but a few.

They remain committed to support the retail sector and will continue to underwrite cover where possible, but will remain strategic and prudent in their underwriting line.

The speed at which a suggested good performing retail business can deteriorate often requires extra scrutiny and evaluation of its top line, profit margins, its debt position, working capital management, risk control measures employed and its roadmap etc, all key areas that underwriters will pay close attention to along with the following critical guidelines:

- Information is key - Credit Risk departments remain in regular dialogue with a variety of businesses across the retail sector with a mission to furnish updated management accounts to fully understand both the trading performance in the current environment and the funding facilities that are being made available to support working capital.
- Refinancing - When meeting with the key buyers in the retail sector, risk analysts and underwriters will seek to understand how they are mitigating inflation and the impact of increasing interest rates.
- Case by case - Each business is reviewed on its own financial merits for the purpose of its underwriting judgement.

There is certainly an air of caution radiating across the credit market, but support continues where possible to ensure strong risk management is in place whilst facilitating trade and growth.

Key essential measures & endorsed actions

The future is likely to be extremely challenging as constrictions on disposable income caused by extensive economic pressures are compounded by fundamental shifts in consumer behaviour and continued popularity of e-commerce.

It's clear that in the short term, where possible, suppliers should be considering strategic decisions to minimise their risk as well as curbing any overreliance on single customers. We are anticipating a further dip for the retail sector during the next 12 months. It's apparent with all the challenges we have seen that companies will need to become more agile, embrace change, introduce, or intensify use of digital technology and be open minded about innovation to enable survival and a positive evolution.

There are many warning signs that can easily help identify when an underperforming company is becoming highly distressed or approaching its Rubicon (Point of No Return). As a company progresses along this distress curve, its decline can quicken, therefore taking appropriate action as early as possible is vital in protecting your company's position.

Some endorsed actions are:

- Ensure you continue to tighten credit control procedures and pay close attention on sudden changes in payment patterns.
- React swiftly to late payment. It's a most accurate predictor of business failure so don't be tempted to extend agreed terms.
- Become more familiar and aware of your suppliers and their operating base.
- This ever-changing economic landscape and uncertainty can suddenly lead to problems in the supply chain.
- Look to enhance and grow levels of business with new customers steadily and prudently.
- Try to be agile and flexible. These are unprecedented times and businesses are feeling the pinch but there will be a bounce and it's important to retain the flexibility to benefit from growth when it comes.
- Be wary of customers characterised by excessive levels of discounting. Suppliers must use their judgement on whether such discount initiatives reflect fire sales, which in turn can suggest a poor cash position and ability to pay for goods supplied to them.
- Talk to Xenia if you feel there are reasons to restrict trade and do not have the adequate risk mitigation facility and expertise to assist with your commerce.

Xenia analyst assertion

The Retail landscape is undoubtedly transforming and has been since the technology revolution was inaugurated. Following a period of unprecedented change, the retail industry is now facing an environment where margins are increasingly under pressure from rising costs, lower pricing power and a compounded and costly need to invest in transformation.

The sector has seen a major change both in consumer habits and channels used as we travel through the digital age. The rise in online, mobile and click and collect services is shaping a new retail landscape. This will undoubtedly impact the way retailers utilise physical space, with many having too much and not utilising them efficiently. Physical stores have a place in a retailer offering, but their form and function will have to change. Stores will become much more about experience and will be focused on becoming physical manifestations of the brand. The extinction of the store is probably unlikely mainly owing to human psychology, social dynamics, and its tradition. This can perhaps be evidenced as we are now starting to see online only retailers establishing a presence on the high street.

Traditional retailers of course continue competing but the new breed of retailers with a host diverse operating models and varied cost bases will persist being a major threat. However, those retailers who are dynamic and forward thinking are already responding with structural and operational changes in the market and continue to compete. Nevertheless, there is a debate on whether they are moving fast enough.

Consequently, owing to macro dynamics, retailers that operate within the UK face an uncertain future, because of high inflation, higher import prices, lower wage growth and continued uncertainty owing to our exit from the single market. Higher inflation is impacting purchasing power and consumer confidence too. It could therefore be expected that we will see a continued rise in store closures and insolvencies, a long-term trend that is likely to be intensified creating winners and losers across the retail landscape.

I foresee that the companies who employ a finer risk management strategy as well as embrace and introduce innovation such as Artificial Intelligence and blockchain technology into supporting this mission will have a chance of standing the test of time.



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ROBERTO IS A SEASONED CREDIT ANALYST WITH A STRONG ANALYTICAL BACKGROUND AND EXTENSIVE EXPERIENCE IN CREDIT INSURANCE AND FINANCE HAVING WORKED IN CREDIT INSURANCE FOR THE PAST 20 YEARS, PRIOR TO WHICH HE WAS AN ANALYST AT BARCLAYS BANK. ROBERTO PROVIDES GUIDANCE AND INSIGHT ON BUYER/GROUP FINANCIALS, TRADE SECTORS, INSOLVENCIES, THE CREDIT INSURANCE MARKET AND THE UK ECONOMY FOR THE XENIA TEAM AND CLIENTS.

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