Business Distress Index April 2012

Association of Business Recovery Professionals R3 Rescue Recovery Renewal

The future of the high street

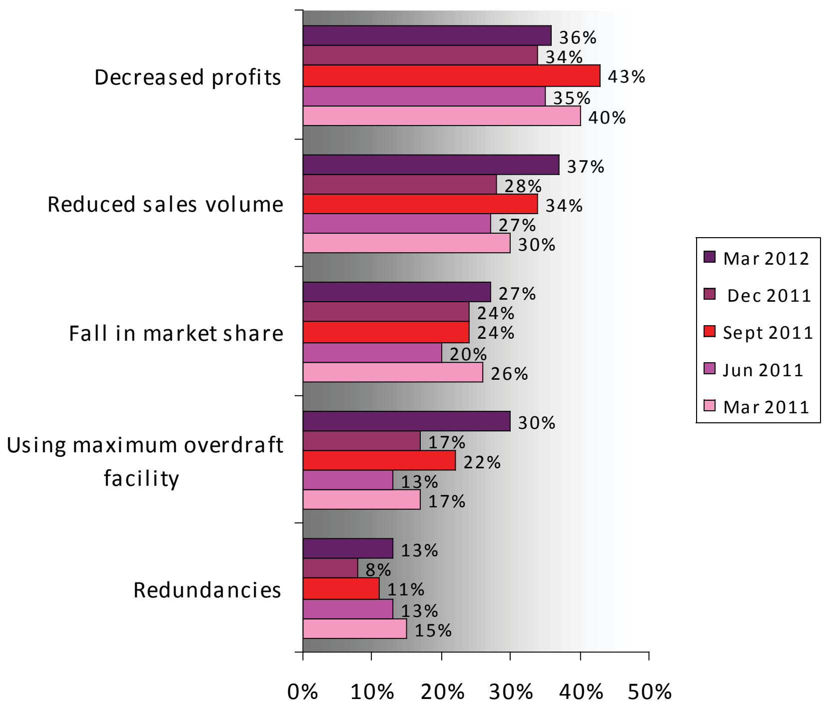
Difficult economic conditions continue to batter the retail sector and this is changing the shape of the high street. This wave of the Business Distress Index analyses how retailers are faring and asks where the future of the Great British High Street lies.

Business distress

64% of businesses report feeling some sign of distress. Distress signs are up on the quarter but the picture year on year is mixed.

- **37%** of businesses are reporting a reduction in sales volumes;
- **36%** say they are experiencing decreased profits;
- **30%** are regularly using their maximum overdraft facility, the highest percentage recorded in the last 12 months;
- **27%** say their market share has recently fallen;
- And **13%** have had to make redundancies

Distress signs year on year



Unweighted base: 559 Businesses with a turnover of £50k+

Distress is up - 64% of businesses reporting distress, compared to 58% last quarter

Mixed picture year on year as ‘zombie’ businesses continue to hang on

Half of retailers experiencing decreased profits, compared to a cross-sector average of 36%

68% of retailers think that in three years time, most shops will have moved from the high street to an online presence or that most people will be visiting out-of-town shopping parks instead of the high street

Quarter on quarter – distress is up

- The greatest increase is in businesses that have seen a reduction in sales volumes, up nine points from **28%** in December;
- The percentage of businesses regularly using their maximum overdraft is up 13 points from **17%** last quarter and is in fact the highest it has been in 12 months.

Year on year – the picture is mixed

- The number experiencing reduced sales volumes is up seven points from **30%** in March 2011;
- However, the number of businesses reporting decreased profits is down four points from **40%** a year ago.

But why is this?

Lee Manning, R3 President and retail expert comments:

"Distress is up on the quarter and for the most part the last 12 months too but we have not seen the number of corporate insolvencies we would expect. This could be down to a number of factors but will certainly have been influenced by a shift in creditor attitudes. With the realisation that economic recovery is still not on the horizon, creditors – including HMRC and the banks – have been giving businesses 'Time to Pay' on their taxes and more breathing space to settle their debts. Unfortunately, the undesired effect of this has been the creation of an economy that is saturated with 'zombie companies'. These 'financially undead' are stifling workable businesses and being given an unfair advantage over competitors who are running viable businesses."

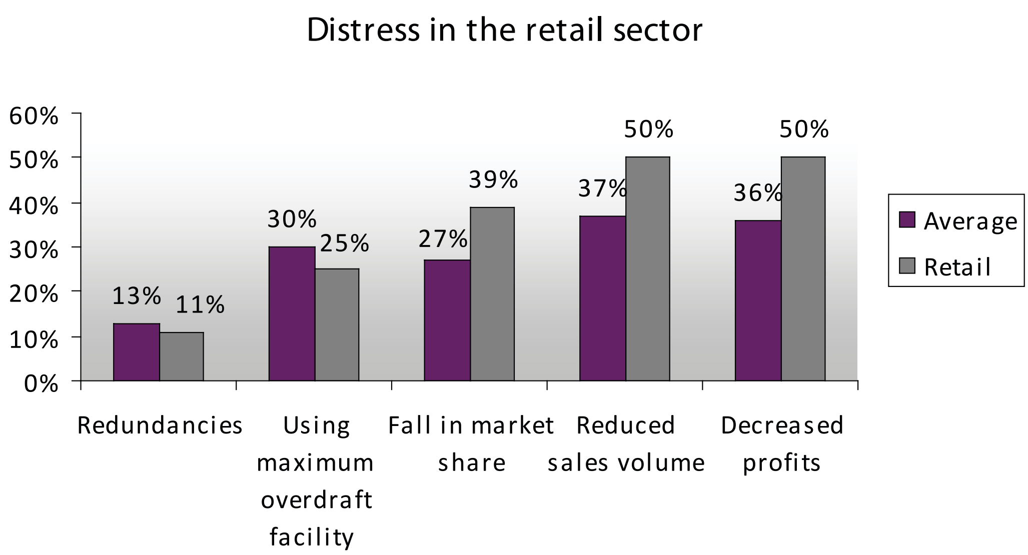
Manning continues: "But why then are more businesses reporting distress? Well, regardless of the sympathetic attitudes of creditors, consumers' disposable income has shrunk, confidence is at rock bottom and the impact of this is bound to be felt. Suppliers and investors are also reluctant to take the plunge and support businesses perceived to be struggling so we are seeing more and more suffering but this is not manifesting itself in business failures."

How does the retail sector compare?

Across three out of the five distress signs, significantly more retail business are suffering when compared to the cross-sector average.

- Half (**50%**) of retail businesses report a reduction in sales volumes and the same proportion are experiencing decreased profits;
- A quarter (**25%**) say they are regularly using their maximum overdraft facility;
- **39%** say their market share has recently fallen;
- And **11%** have had to make redundancies.

The greatest difference in comparison to other sectors is in the proportion of retail businesses experiencing **decreased profits**, 14 points higher than the cross-sector average of 36%; and the percentage which are seeing a **reduction in sales volumes**, 13 points higher than the average of 37%.



Unweighted base: 559 Businesses with a turnover of £50k+ and 70 retail businesses

Lee Manning, comments on why this is:

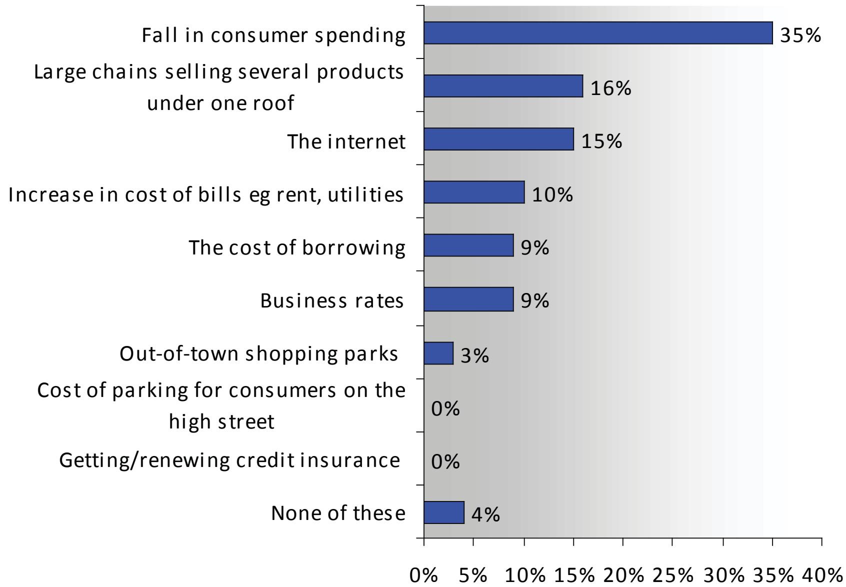
"The retail sector is in a state of flux. Retailers live or die on the back of the consumers' spending power and the likes of Game, Peacocks and La Senza show us that the consumer can be fickle. Furthermore 18 million people are worried about their current level of debt. They are also struggling with increases in the costs of basics such as food and heating and it is clear that retailers are feeling the impact of this. This is further evidenced by that fact that in the last 15 months there has been an increase in the number of high profile retail failures. Since January 2011, the top 15 retailer failures have seen their property portfolio shrink from 2,725 to 1,350 and seen job losses of circa 20,000 combined.

"A large number of retail businesses will need to give serious consideration to their current business model and its viability. Bricks and mortar retailers are finding that supply is outstripping demand for products and there is fierce online competition. Rates and utilities are a significant cost for retailers and so they need to critically appraise the contribution of individual stores to central overheads and profits. They should also perhaps look to renegotiate contracts with suppliers and landlords to ensure they are getting the best deal. Clearly, negotiations for discounts from suppliers and for rent for underperforming stores can help rescue struggling shops. The high street is changing, as are consumer spending habits and as out-of-town and online shopping becomes increasingly popular, these findings indicate that many retailers are not keeping up with the pace."

So what do retailers think?

We asked retailers to tell us what they perceived to be the biggest threat to their businesses in the next six months and over a third (**35%**) said a fall in consumer spending. Only **15%** of retailers perceived the internet and online shopping as a threat and even fewer cited (**3%**) out-of-town shopping parks.

Threats to retail businesses



Unweighted base: 70 retail businesses

Lee Manning:

"It is surprising that only 15% of retailers perceive the internet as a threat to their business but perhaps this means they are viewing it as an opportunity, which is exactly what it can be if a multi-channel offering is part of the future business strategy. However, retailers need to face up to the fact that the over supply of retail footage, in the face of a squeeze in disposable income, means that those less financially able to withstand the downturn or with a marginally less profitable offering than competitors, will be next to fall to the wayside. Discounting and offers may tempt some customers back into the stores but they still need to maintain profits to survive, and as people struggle to make ends meet, this will become harder and harder."

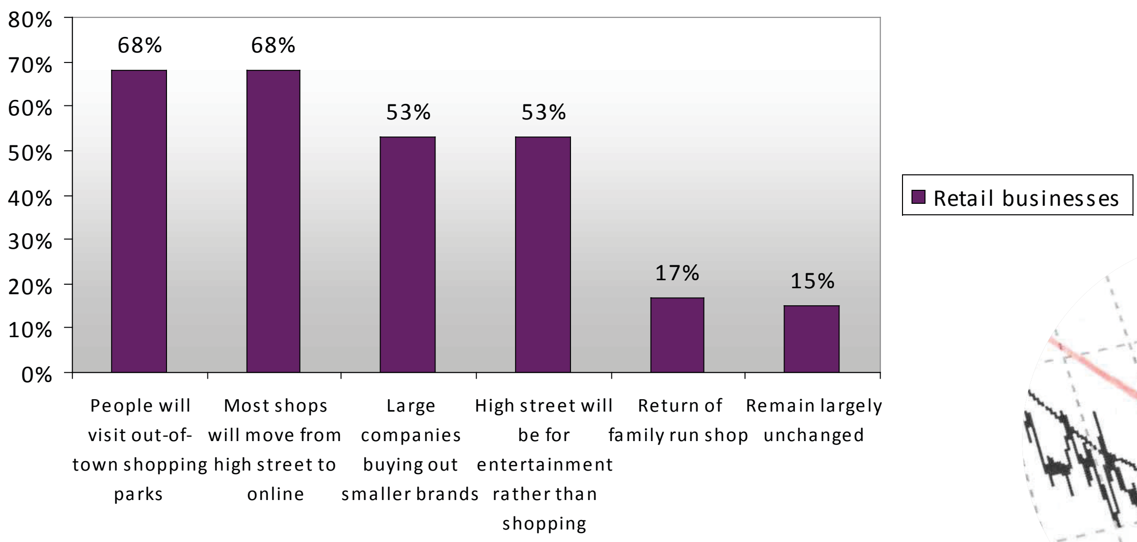
We also asked retailers what they thought the high street would look like in three years time. **68%** said more people will be visiting out-of-town shopping parks instead of the high street and the same proportion said most shops will have moved from a physical presence to an online one.

Lee Manning comments:

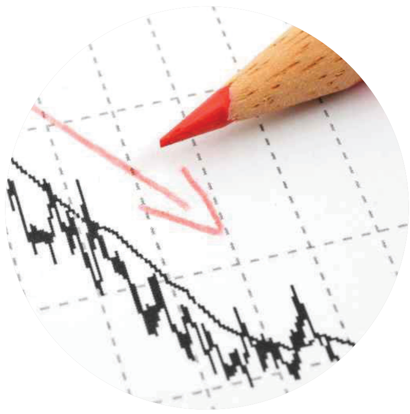
"This starts to paint an interesting picture. In three years time, it is very possible that much more shopping will be done in out-of-town retail parks where many shops are in close proximity and parking is readily available and often free. We can expect more retailers to withdraw from the high street and instead have an enhanced online presence, with some, if not most of their stores in these out-of-town parks, which will draw a wider catchment of customers than the high street.

"This is supported by the fact that 53% of retailers believe than in three years time the high street will be a place for entertainment with bars and restaurants, rather than shopping."

The high street in three years



Unweighted base: 559 businesses with a turnover of £50k+ and 70 retail businesses



Lee Manning concludes:

"We know that the high street has reached a crossroads and the way we choose to shop will probably never be the same again. The retail sector is arguably facing its biggest challenge ever but it can be an opportunity for those who have the foresight to revise their business strategy with that in mind. Many retailers are struggling to come to terms with the challenging business landscape but a change does not mean the end. We would urge all retailers, and all businesses to seek the advice of a restructuring professional if they find themselves in financial difficulty, before it is too late."

Methodology note: BDRC Continental conducted 559 telephone interviews with small, medium and large business owners and Financial Directors between 5th-16th March 2012. Quotas are set by size, region and sector and the data weighted to the profile of UK businesses. The respondent in each case is a senior financial decision maker.

About R3

R3, the insolvency trade body, represents over 97% of insolvency practitioners. R3's full members are all regulated by their recognised professional bodies, they can be licensed insolvency practitioners, solicitors, chartered accountants or certified accountants. They have extensive experience of helping businesses and individuals in financial distress.