Association of Business Recovery Professionals
R3
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Business Distress Index Snapshot: Wave 10

A break in the clouds?

April 2013

Methodology

BDRC Continental conducted 501 telephone interviews with small, medium and large business owners and Financial Directors between 4th-14th March 2013. Strict quotas are set by size, region and sector and the data weighted to be representative of the ONS profile of UK businesses, each with an annual turnover above £50,000. The respondent in each case is a senior financial decision maker.

Introduction by Lee Manning, R3 President

Since the last edition of the Business Distress Index (BDI), we have endured yet another raft of rather grim economic news – not least the downgrade of the UK's credit rating, various high-profile retail failures and a Budget which, beneath the top-line beer and fuel give-aways, yet again revised borrowing projections up and growth projections down. In this wave of the BDI we have looked at the stumbling blocks to growth, with businesses reporting that the biggest problem they currently face is the rising cost of fuel and utilities, followed by reduced consumer demand. The fact that these two issues are identified as the most problematic is particularly concerning given that one affects costs and the other, revenue, essentially squeezing business from both sides. The scrapping of the fuel duty increase will have been welcome, particularly in the under-pressure Transport sector, but more action on both of these issues is needed if we are to return to anything near pre-crisis levels of growth.

Amid the gloom, however, this edition of the BDI does appear to provide a few small but welcome indications that the pressure on businesses may just be starting to ease. Having remained broadly stable in recent editions, we now see a significant decline in the number of businesses experiencing one or more signs of distress. This includes a reduction in the percentage of businesses reporting that they have recently had to make redundancies, as well as in the percentage reporting that they currently make regular use of their maximum overdraft facility. This last point is worthy of note, particularly combined with the finding in this edition of the BDI that only 5% of businesses currently view their biggest problem as the lack of access to credit. This may indicate that lending to businesses is improving or, and I would suggest more likely, that existing businesses are deleveraging where possible and adapting to life with reduced access to credit.

News on the growth front is slightly less positive as we see fewer businesses reporting growth indicators compared to both the previous wave and year on year. Beneath this headline figure is a rather mixed picture, with a rise since November in the percentage of businesses reporting increased profits but a fall in the percentage reporting that they are investing in new equipment, seeing increased sales or experiencing a growth in market share. Taken together, the findings across this edition of the BDI suggest that whilst pressure on businesses may be easing slightly, growth remains sluggish and hard to come by.

Lee Manning,
President of insolvency trade body R3 and Restructuring Partner at Deloitte

Executive summary

1. Fuel and utility costs the biggest problem for business

- **Rising fuel and utility costs** were identified by nearly a third (32%) of respondents as the biggest problem they faced. This was followed by **reduced consumer spending**, identified as the biggest problem by 26% of respondents.

- The **inability to secure further credit or bank loans** was identified by only 5% of respondents as the biggest problem facing their business, with only 2% of respondents saying their biggest problem was **more aggressive pursuit of debts by creditors**.

2. Overall business distress decreasing

- The number of businesses **reporting at least one sign of distress has declined significantly** both from the previous report and over the year as a whole, from 64% in March 2012, to 54% in November 2012 and now to 40% in the latest wave.

- The percentage of businesses **having to make redundancies has halved since** the previous edition of the BDI from 10% to 5%, equivalent to a reduction of 81,000 businesses. Furthermore, the percentage of businesses reporting that they **regularly used their maximum overdraft** facility declined by 10 percentage points over the period, from 20% in December to 10% in the current wave, a drop equivalent to 168,000 businesses.

3. Mixed messages for growth

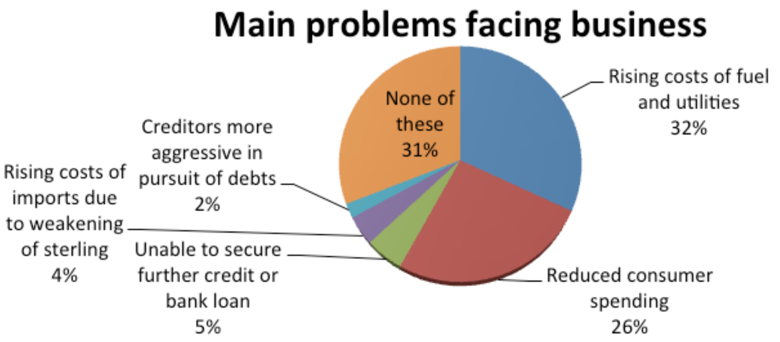
- **47% of businesses reported at least one sign of growth** in the latest wave, a marginal reduction of four percentage points from December 2012 (51%) and broadly similar to March 2012 (46%).

- Though the percentage of businesses reporting **increased profits** grew by 6 percentage points from December to 23%, the number of businesses **investing in new equipment, increasing their market share or reporting expansion** all declined over the period, by 13 percentage points, 5 percentage points and four percentage points respectively.

1. Problems facing business

- In this wave of the BDI we asked businesses what they felt was the biggest problem they were currently facing. **Nearly a third of respondents (32%) said that their biggest problem was the rising cost of fuel and utilities.**
- This was followed by **a little over a quarter of respondents (26%) who identified a lack of demand due to reduced consumer spending** as the biggest problem currently facing their business.
- The **inability to secure further credit or bank loans was identified by only 5%** of respondents as the biggest problem facing their business.

  Only 2% of respondents reported their biggest problem as creditors being more aggressive in the pursuit of debts.
- Perhaps unsurprisingly, the rising cost of fuel and utilities was most prominently identified as the biggest issue amongst businesses from the **Manufacturing*** (48%) and **Transport & Communications*** (47%) sectors.
- Equally, reduced consumer spending was identified as the bigger issue for the **Retail*** (43%) and **Hotel & Catering*** (33%) sectors.
- Interestingly perhaps, 45% of the **Construction*** sector reported that their biggest problem lay outside the provided list, suggesting that there are other important factors at play – potentially a reduction in spending by the public sector, planning constraints or the cost of raw materials.



Lee Manning comments:

"The rising costs of fuel and utilities are a huge problem for business, causing significant damage to their bottom line, particularly amongst particularly energy intensive sectors such as Manufacturing and Transport.

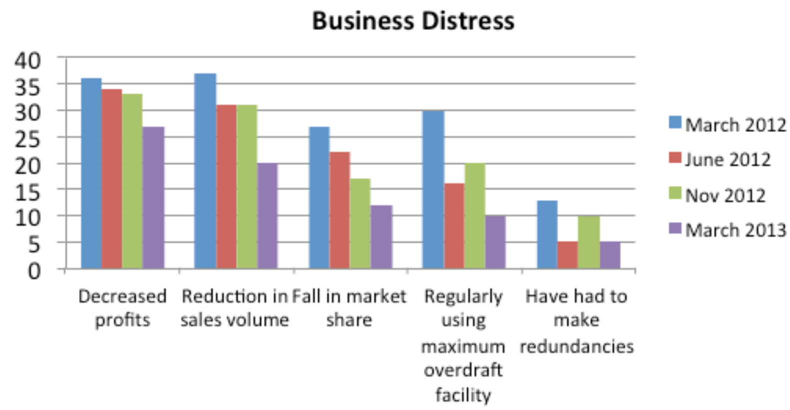
Reduced consumer spending, too, has been a big issue throughout the last few years and, despite the brief fillip last year provided by the Olympics, consumer-facing businesses are still struggling as households continue to feel the pinch.

It is interesting, however, that a relatively small proportion of businesses cite a lack of access to credit as their major problem, suggesting either an improvement in this area or, more likely, that businesses are adapting to current credit conditions."

* Sample sizes in these categories are under 100

2. Overall business distress decreasing

- The percentage of businesses **reporting at least one sign of distress has declined significantly** both from the previous report and over the year as a whole, from 64% in March 2012, to 54% in November 2012 and now to 40% in the latest wave.
- **Fewer businesses are reported as having had to make redundancies** in the latest period, with the percentage for having done so halving since the previous report from 10% to 5%. This reduction is equivalent to 81,000 businesses.
- The percentage of businesses reporting that they **regularly used their maximum overdraft facility declined** by 10 percentage points over the period, from 20% in the previous report to 10% in the current wave, a drop equivalent to 168,000 businesses.
- **27% of businesses reported decreasing profits** in the latest wave. This is a slight improvement on the 33% in November 2012 and 36% a year ago.
- Only **12% of business reported seeing a recent fall in their market share**, compared to 17% in November and 27% in March 2012.
- The percentage of businesses reporting **declining sales volumes decreased by 11 percentage points from November**, from 31% to 20%. This is a fall of 17 percentage point over the year, from 37% in March 2012,



Lee Manning, R3 President, comments:

"Whilst results can fluctuate significantly between editions of the BDI, it is welcome news that fewer businesses appear to be experiencing signs of distress. It is encouraging, too, that fewer businesses are regularly using their maximum overdraft facility. This may suggest either improving credit conditions for businesses or, rather, that businesses are deleveraging and coping better within the current lending environment."

3. Mixed messages for growth

- **47% of businesses reported one or more growth indicators** in the latest wave of the BDI. This represents a fall of 4 percentage points from November (51%) and is largely unchanged from March 2012 (46%). Extrapolated to the economy as a whole, this would suggest that **921,000 businesses are not currently experiencing any indicators of growth.**

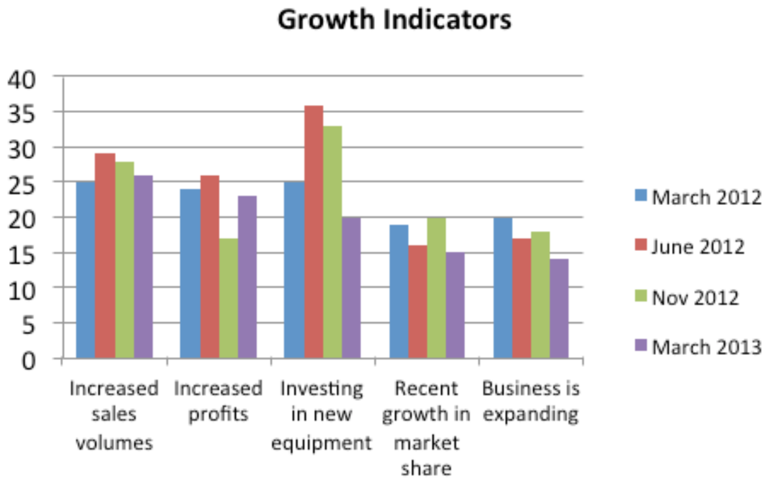
- **23% of businesses reported increased profits**, compared to 17% in November. This is, however, broadly in line with the 24% recorded in March 2012.

- Reports of **increased sales volumes decreased slightly** by 2 percentage points, from 28% in the previous report to 26% in the latest wave.

- Businesses reporting **investment in new equipment is significantly lower** in the current wave (20%) than in November (33%) and has also declined compared to last March (25%).

- The latest wave saw a **decline in the number businesses reporting an increase in market share**, at 15% down from 20% in a previous report.

- The percentage of **businesses experiencing expansion, geographically or in terms of staff numbers or new business areas, has declined** by 4 percentage points since the previous report, from 18% in November to 14% in the latest wave. This is a year on year decline of six percentage points, down from 20% in March 2012.



Lee Manning, R3 President, comments:

"The rather mixed picture on growth is more indicative of an economy that is just about ticking over, rather than forging ahead. After strong showings in the two previous waves of the BDI, the sharp reduction in the number of businesses investing in new equipment is a worrying sign.

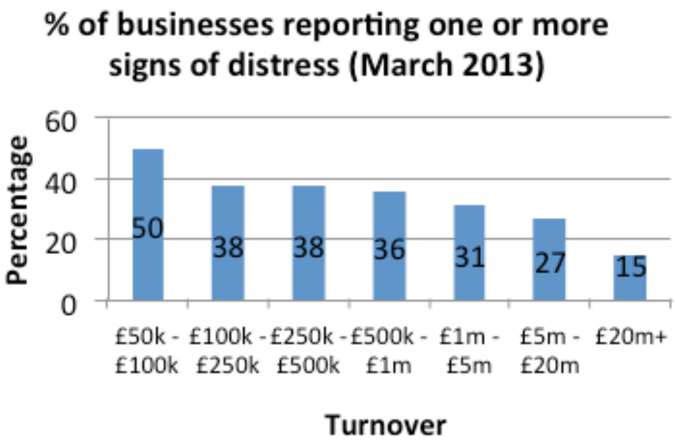
This lack of investment clearly impacts demand elsewhere and, particularly where businesses may be sitting on cash reserves, is testament to the lack of confidence out there at the moment.

Once again, more businesses are reporting increased sales volumes than are reporting increased profits. Though this gap is narrowing, this still suggests that profits are being squeezed by the high costs, including fuel and utilities."

4. Big vs. Small

Distress

- In this wave of the BDI, **50% of businesses with a turnover of £50k - £100k* reported at least one sign of distress** as opposed to just **15% of businesses with a turnover of £20 million or over*.**
- This gap has widened since the previous report, where 52% of businesses with a turnover of £50k - £100k reported one or more signs of distress compared to 30% of businesses with a turnover of £20 million or over.
- In the latest wave, **the highest percentage of businesses reporting decreased profits was amongst those with a turnover of £50k - £100k (38%)**. This was also the case for reductions in sales volumes, experienced by 30% of those in this bracket.
- Conversely, the **highest percentage of businesses reporting having had to make redundancies was amongst those with a turnover of £20 million or more (12%)** compared to just 4% of businesses with a £50k - £100k turnover.



R3's President Lee Manning comments:

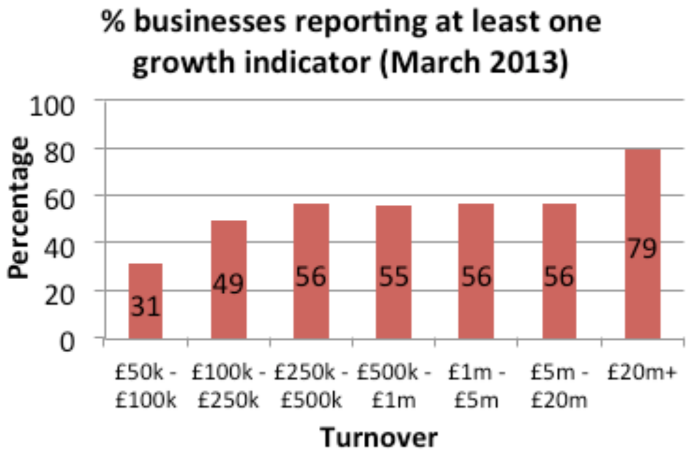
> "This edition of the BDI makes clear once again that conditions for smaller businesses continue to be tough compared to larger businesses.

Whilst the gap between the largest and smallest businesses has grown over the period both in terms of distress and growth, it is interesting to note that the percentage of businesses experiencing at least one growth indicator is broadly even across the middle of the range. This suggests that there are certain barriers to growth for small businesses, who are likely to be particularly susceptible to issues over costs and cash-flow fluctuations, which need to be addressed for these businesses to succeed."

* Sample sizes in these categories are under 100

Growth

- In this wave, **79% of businesses with a turnover of more than £20 million reported at least one growth indicator**, compared to **31% of businesses with a turnover of £50k - £100k.**
- This gap has also widened since the previous report, where the number of businesses reporting at least one growth indicator was 67% and 40% respectively.
- In the latest wave, investment in new equipment is particularly strong in the £500k - £1m turnover bracket (31%), whilst the highest percentages of business experiencing increased profits are amongst the £20 million and over bracket (57%) followed by the £250k - £500k bracket (40%).



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5. Sectors

Construction*

- The percentage of construction firms experiencing one or more sign of distress has fallen by 16 points since the previous wave, from 63% in December to 47% in the current wave. Over the year, the improvement is even more marked, with a fall of 40 percentage points since the 87% recorded in March 2012.
- There is, however, a much more mixed picture on growth in the sector. The percentage of businesses experiencing one or more growth indicators has declined from 59% in December to 20% in the latest wave.
- Just 6% of construction firms reported experiencing increased profits in March 2013, compared to a cross-sector average of 23%, with only 4% experiencing increased sales volumes, compared to an overall figure of 26%.

Lee Manning comments:

"It is a positive sign that distress in this embattled sector appears to be declining. The small percentage of businesses in the sector experiencing increased sales or profits continues to be a concern, however, and is likely to be the result of high cost pressures and a lack of demand due to capital spending restraint. The announcements in the Budget on capital spending for 2015/16 will have been welcome but may be a little late in the day for firms struggling now."

Retail*

- Distress in the Retail sector has declined significantly in recent months, with 23% of companies within the sector currently reporting one or more sign of distress, compared to 48% in November. This also compares favourably to March 2012, when 69% of retail businesses reported experiencing one or more distress indicator.
- The prevalence of growth indicators has also increased since the previous report, with the percentage of businesses experiencing one or more sign of growth rising from 49% in the previous report to 61% in the latest wave.
- The percentage of businesses experiencing increased sales volumes has risen by 9 points since November, from 24% to 33%. However, the percentage of businesses with increased profits has fallen from 25% in the previous report to 21% in the latest wave. Nevertheless, this is still 11 percentage points higher than the 9% recorded in March 2012.

Lee Manning comments:

"High-profile high street failures have dominated headlines in recent months but the latest BDI suggests things may be improving for retailers, particularly those who are able to adapt to the changing retail environment. There certainly seems to be positive news on the sales front, though in the longer term, retailers will need to ensure higher sales actually result in higher profits – ultimately by addressing their cost base."

* Sample sizes in these categories are under 100

Business Services*

- The Business Services sector continues to outperform many other sectors in the latest report, with 52% of businesses in the sector reporting increased sales volumes and 43% seeing increased profits, both representing a significant increase of 24% and 28%, respectively) on the figures for November 2012.
- The sector continues to see levels of distress broadly in line with the cross-sector average. In the latest wave, 46% of businesses reported one or more sign of distress – marginally higher than the average of 40% across all sectors, but still representing a decline of six percentage points since December.
- In the latest wave, 13% of businesses within the Business Services sector reported having had to make redundancies – the highest level across all sectors. This represents an increase of 7 percentage points from the 6% recorded in December.

Lee Manning comments:

"As we have seen from numerous media reports, the Business Services sector has undergone a significant amount of upheaval in recent times with, as the BDI identifies, redundancies more widespread than in other industries. Partly a function of the more flexible labour market in this sector, this has left such businesses better placed to weather the storm as can be seen from their relatively strong showing in both sales and profits."

* Sample sizes in these categories are under 100

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.