

Retail Winter 2023



Sector Overview

Over the past couple of years, COVID-19 has undeniably dominated the thoughts of retailers and consumers alike. However, the spotlight is now shifting towards the increasing challenge of rising living costs, which is emerging as a prominent focal point in the current economic environment. Sales in this sector are now mainly challenged by inflationary pressures, including high energy prices and ongoing disruptions in supply chains, which began to emerge in early 2022.

In the face of inflation and supply chain constraints, numerous businesses are now unveiling their intentions to implement price hikes across their product lines. Notably, earlier this year, the retail giant Next PLC made it known that customers could expect an 8% increase in the prices of their spring/summer clothing and home goods. Meanwhile, Marks & Spencer (M&S) took similar action by raising prices by 7% for their autumn/winter offerings in the preceding year. The move comes as companies grapple with various challenges within their supply chains, which are leading to higher production costs and subsequently impacting the prices consumers pay for these goods.

While traditional retailers are struggling with expensive store base costs, online retailers have also not been immune to cautious consumer attitudes and aggressive value-seeking shoppers. Retailers such as Boohoo and Asos have voiced concerns that softer market conditions are having a negative impact on their sales.

As the cost-of-living crisis continues to eat away at budgets, many consumers will be cutting back this Christmas. UK Christmas retail growth is predicted to increase by just 3.4%, compared to the 6.2% jump last year, GlobalData forecasts. With the “Golden Quarter” fast approaching, retailers are hopeful that easing inflation seen in recent months will help boost consumer confidence.

Key Risk Factors Impacting the Retail Sector

Several key challenges loom over the retail sector in the year ahead:

Rising Cost of Living Crisis:

The cost of living crisis is characterised by the surge in prices of essential goods and services, including housing, healthcare, education, and energy. As the cost of living rises and disposable incomes are squeezed, retailers focusing on big-ticket items or discretionary items such as furniture and electrical products are likely to see demand falling.

Inflation:

Inflationary pressures will be keenly felt by all retailers as costs increase. A retailer's ability to pass this cost onto their customers is a key challenge for the year ahead. The Office for National Statistics (ONS) revealed the inflation rate for September was 6.7%. This, in turn, will affect the cost of borrowing and mortgages and place businesses and consumers under added pressure.

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Dampening Consumer Confidence:

According to the GFK, UK consumer confidence has fallen nine points in October to -30. This is the largest monthly drop since March 2020 when the government introduced strict Covid-19 measures. This sharp fall underlines that the cost of living crisis is still exerting acute pressure for many consumers.

Trading Down:

This will continue to be a top trend in 2023/2024. About 38% of shoppers are already buying cheaper essential products from their usual retailers while 13.8% are switching to cheaper chains, according to GlobalData. As households allocate more of their budgets to essential expenses, discretionary spend on non-essential goods and services is diminishing. Retailers must pivot their strategies to cater to the evolving needs of their customer base.

The End of COVID-19 Government Support:

Insolvencies are expected to increase in 2024 as the earlier UK government COVID initiatives such as furlough, rate relief, covenant waivers, loan repayment holidays have matured, and sectoral challenges start to bite.

Business Rates:

High street shops could see their business rates bill increase by up to £1.95bn next year as rates bills are set to rise in line with inflation (Altus Group). This could lead to a slower recovery and, potentially, more inflation as businesses seek to pass on costs. Not only does this inhibit businesses from investing in their own growth, but it could also see the closure of many SMEs altogether.

Increase in Energy Prices:

Further strain is being felt by individuals and businesses due to the energy price cap rise effective on 1 October 2023. An increase in energy prices in the UK impacts the retail sector by raising operating costs, potentially affecting supply chain costs, influencing consumer spending, and putting pressure on profit margins. Retailers must adapt to these challenges by managing costs, enhancing energy efficiency, and remaining attuned to consumer behaviour and preferences in a changing economic landscape.

Supply Chain:

Supply chain disruptions, which have persisted for some time, continue to exert pressure on the availability and timely delivery of products. Retailers are bracing themselves for potential inventory shortages, delayed shipments, and elevated costs.

E-commerce:

E-commerce is not immune to the challenges faced from the economic slowdown and escalating energy costs. The e-commerce market is highly competitive, with new entrants constantly emerging. Established businesses must continuously innovate and differentiate themselves to maintain their market share.

ESG:

Consumer behaviour has seen a greater shift in demand towards retailers who adopt a more ESG-friendly approach to their practices. Ethically sourced goods and a lower carbon footprint are increasingly important for consumers.

Notable Insolvency Events

Insolvencies in the sector surged 56% in the past year, the highest level in nearly a decade, according to figures from law firm RPC. Around 1,942 retailers went into administration in 2022-23, up from 1,243 in 2021-22, beating pandemic levels.

During 2023, the sector has seen some notable insolvencies with failures such as:

- > **Snug Shack Limited (January 2023)**
Upholstered furniture and floorings retailer - Equity £1.6m
- > **Tile Giant Limited (January 2023)**
Retailer of hardware, paints, and glass - Equity £1.3m
- > **Kettle Interiors (March 2023)**
Wholesaler/Retailer of furniture - Equity £3.5m
- > **David's Bridal UK Limited (April 2023)**
Clothing Retailer - Equity £2.3m
- > **Planet Organic Limited (April 2023)**
Retail sale of food - Equity £25k
- > **Wilkie's Limited (June 2023)**
Clothing Retailer - Equity £141k
- > **Ideal World Limited (July 2023)**
Transaction-based shopping channel - Equity £1.5m
- > **UK Flooring Direct Limited (July 2023)**
Online floor-covering retailer - Equity £8m
- > **Wilko Retail Limited (August 2023)**
High Street retail chain - Equity £99m
- > **Victoria Plum Limited (September 2023)**
Bathroom Specialist - Equity £13m
- > **Wiggle (October 2023)**
Multi-sports online retailer - Equity £14m

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Retail Sales September 2023

The ONS reported that The Consumer Prices Index (CPI) rose by 6.7% in the 12 months to September 2023, the same rate as in August 2023, and down from a recent peak of 11.1% in October 2022. UK inflation continues to ease but remains above the levels in many western economies.

Main points:

- > Total non-food stores sales volumes (the total of department, clothing, household, and other non-food stores) fell by 1.9% in September 2023, following a rise of 0.3% in August 2023.
- > Household goods stores sales volumes reported a monthly fall of 2.3% in September 2023 because of falls in furniture and lighting stores.
- > Clothing stores sales volumes fell by 1.6% in September 2023. Retailers reported that the unseasonably warm weather in September 2023 reduced sales of autumn-wear.
- > Department stores sales volumes fell by 1.6% in September 2023, as some retailers also reported that the warm weather affected new season clothing sales.

- > The sub-sector other non-food stores fell by 2.0% in September 2023, mainly because of falls in watches and jewellery stores. Retailers suggested that consumers were less inclined to spend in the current economic climate.
- > Non-store retailing (predominantly online retailers) sales volumes fell by 2.2% in September 2023, following a fall of 0.9% in August.

Economic Data

The Bank of England maintained the base rate at 5.25% in November 2023, taking borrowing costs to their highest level since 2008.

Analysis by the British Retail Consortium suggests that retail sales will grow between 2.3% to 3.5% in 2023. The past year has been characterised by low retail sales growth which has remained below current inflation, suggesting volumes were down compared to 2021. The trend is expected to continue into 2024.

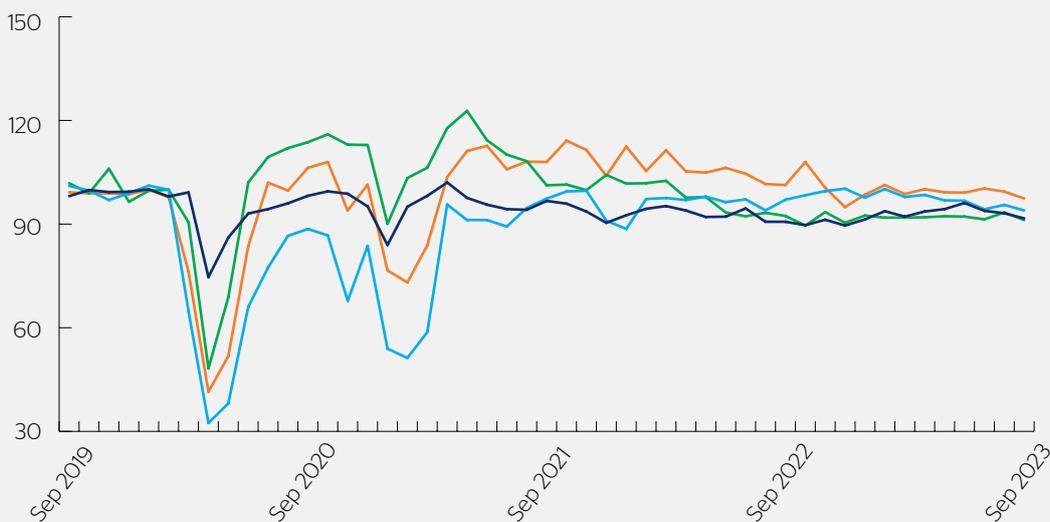
Noticeably, pharmacy, health & beauty stores enjoyed a 6.9% boost – the highest since January 2023 as consumers prioritise small indulgences, such as cosmetics and self-care products, over big-ticket items during periods of economic uncertainty (Barclays Market and Customer Insights).

Non-food stores sales volumes report strong decline

Volume sales, seasonally adjusted, Great Britain, September 2019 to September 2023

— Department stores — Clothing stores — Household goods stores — Other non-food stores

Index 2019=100



Sources: ONS

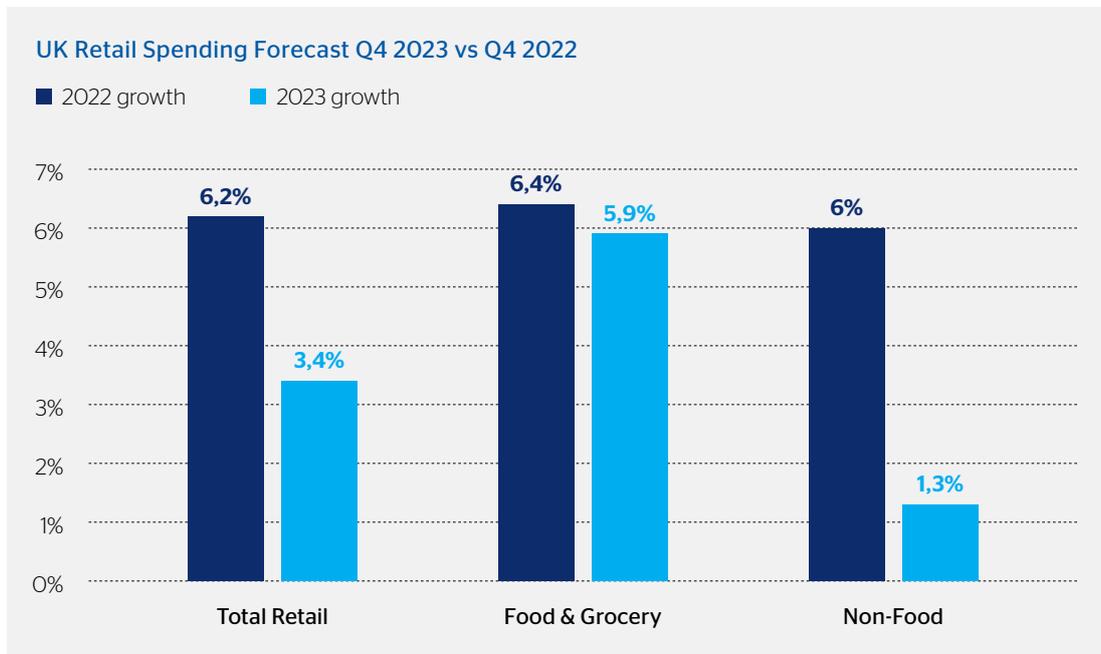
Outlook for Christmas 2023

Retailers are making efforts to increase sales through early seasonal offerings with prominent brands like Boots and John Lewis already rolling out Christmas deals and offers on their websites. Nonetheless, the overall outlook for the last quarter of 2023 presents a challenging scenario.

GlobalData's projections indicate that total retail sales for Q4 2023 are expected to exhibit a growth rate of 3.3%, notably lower than the robust 6.2% increase observed in the preceding quarter, suggesting that retailers will need to motivate consumers and encourage them to spend.

Underwriting Approach

- > **Information is key:** we remain in regular dialogue with a variety of businesses across the Retail sector. We seek to obtain updated management accounts to fully understand 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, we will seek to understand how they are mitigating inflation and the impact of increasing interest rates.
- > **A case-by-case underwriting stance:** each business is reviewed on their own financial merits.



Sources: GlobalData

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