Retailing bankruptcy risk rises in Europe Increase in business failures expected after a slowdown in 2022

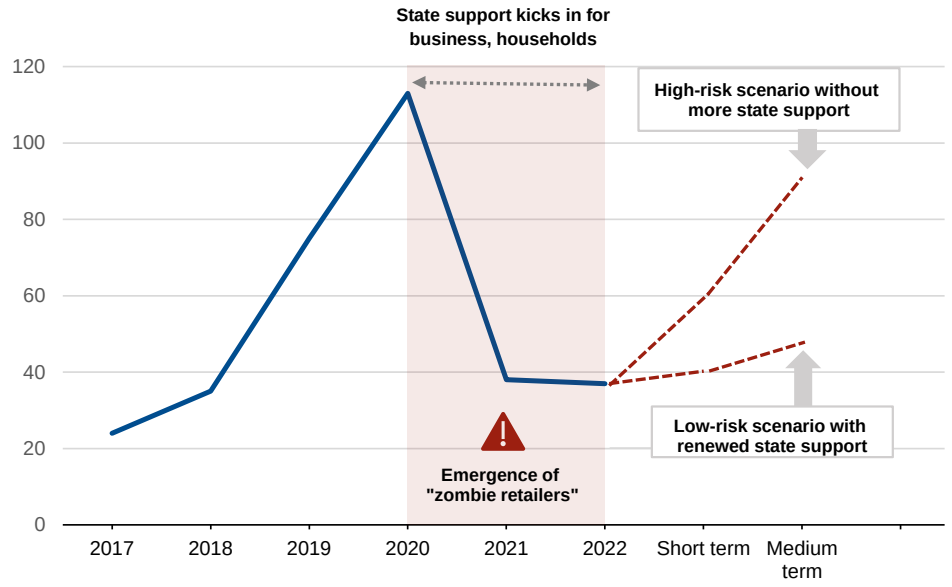
Europe's retail sector is in danger of a new wave of bankruptcies as high inflation, slowing economic growth and the phasing out of pandemic- and energy-related government support for households and business take effect. We expect an increase in the number of bankruptcies this year to levels close to those in 2019 and 2020 after a hiatus in 2021 and, to a lesser degree, last year.

The sector, like others, has benefited from governments' direct and indirect support during the pandemic and last year's energy crisis. The impact is visible in the sharp decline in bankruptcies in the sector in 2021 compared with the previous year (**Figure 1**). However, government support is waning as cost-of-living pressures grow while e-commerce's disruption of traditional retailing continues.

The risks facing retailers today are spread unevenly across Europe, a phenomenon captured by our analysis of bankruptcy rates over the past six years and Scope's retail vulnerability barometer (RVB) (**Figure 2**).

We compile the RVB from several sources: data for per capita GDP to approximate purchasing power; the proportion of retailers paying on time and with a delay of at least 90 days to approximate their liquidity; and the World Bank's logistics performance index as a measure of vulnerability to competition from e-commerce.

Figure 1: Zombie effect: retail bankruptcies to rise as government support fades
Number of retail bankruptcies in Europe 2017-2022, short-, medium-term scenarios



Source: Scope Ratings

Default risk varies widely across Europe's fragmented retail sector

Multiple factors will determine how fast bankruptcy rates rise in the European retail sector in the years ahead. The varying level of government support for consumers and business will play a preponderant role, possibly influenced by pre-election government spending in individual countries (for details, see table on **page 6**).

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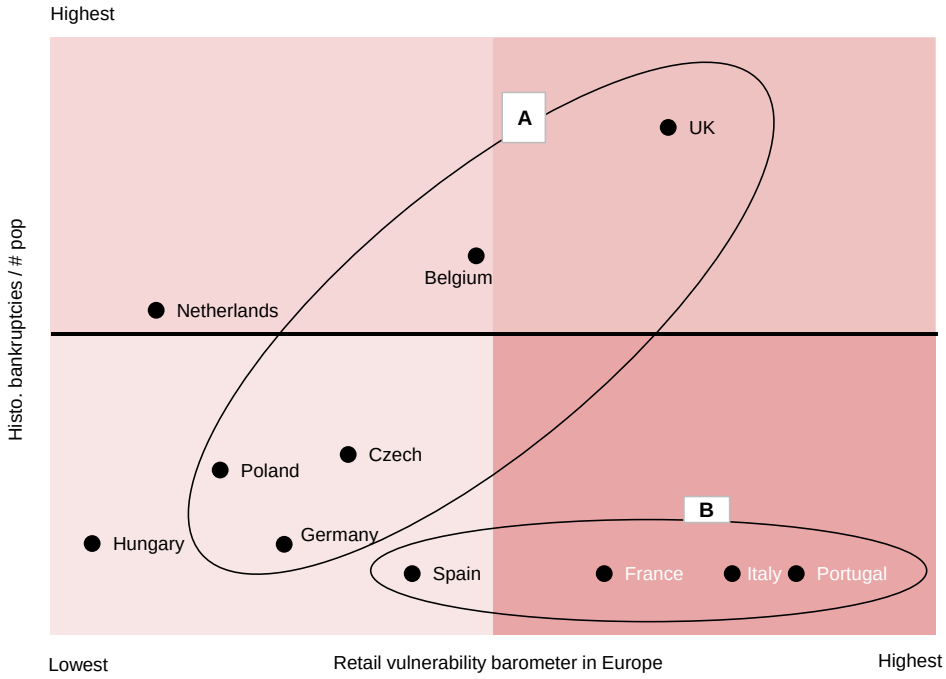
E-commerce penetration, payment terms are risk factors

Other factors such as changes to suppliers' payment terms, penetration rates for e-commerce and overall purchasing power will play important roles, as captured in the RVB.

The degree of country divergence is visible in **Figure 2**. Countries which score high in the RVB find themselves in the right-hand quadrants. The bottom one represents those countries where we expect to see consolidation in fragmented retail sectors as larger incumbents take advantage of failing small and medium-sized enterprises amid relatively difficult trading conditions.

The intense competitiveness of the UK market ensures that retailers in the sector there remain vulnerable in line with high levels of defaults in recent past.

Figure 2: Default risk: historical bankruptcies cross-referenced with Scope's retail vulnerability barometer
Historical bankruptcy rates (per capita) (y-axis); RVB in Europe (x-axis)



- Countries with highly concentrated markets dominated by (inter)national incumbents, crowding out weaker national retailers.
- Countries with smaller national markets more inclined to consumer behavior changes notably due to higher e-commerce penetration
- Highly competitive market, high level of past bankruptcies, elevate risk of more to come
- Fragmented markets likely to see consolidation led by national incumbents resulting in an increasing number of bankruptcies among SME retailers.

A Countries showing "normal" maturing of and concentration within retailing sector

B Fragmented markets with most bankruptcies happening among non-rated SMEs

Sources: public information, Scope

In contrast, the left-hand quadrants represent areas where bankruptcy risk is lower, such as in Germany (size of the market) and Hungary (regulation partially protecting the national players) where conditions favour local incumbents. The same applies to smaller economies such as Belgium, Czech Republic and Ireland where retailing has become more highly concentrated, reflecting the perhaps "natural" progression toward greater corporate resilience in the sector.

About our retailing vulnerability barometer:

We have set up a database made up of 322 cases of bankruptcies of retailers in 19 European countries.

We used the following criteria for inclusion:

- The company needs to be of a significant size or have a local strong brand recognition.
- A bankruptcy-like event must be documented in the media and tracked in the judicial systems of the country.
- The company's business needs to meet our definition of retailers, which can be found in our rating methodology.

The Scope's Retail Vulnerability Barometer (RVB) serves as a proxy to measure the vulnerability of retailers present in each country. The RVB is the product of the following factors: i) GDP/Capita (approximation of purchasing power); ii) share of retailers paying on time and with a delay of at least 90 days (approximation of retailers' liquidity); iii) the logistics performance index (approximation of entry barriers).

Limits of the approach:

In this research, we studied retailers fitting our inclusion criteria. However, the reporting of bankruptcies varies significantly from country to country in Europe, so our study is by no means comprehensive. However, we believe it provides insight into the main trends in the industry and its subsectors, for Europe as a whole and some of the region's biggest economies.

Retailing has idiosyncratic credit risks

Low profit margins are typical for many retailers

Retailing is a singular sector, one that adds no value to manufactured goods, hence a reliance on high-volume sales rather than profitability to generate cashflow. Retailers are therefore particularly vulnerable to macro-economic cycles and changes in purchasing behaviour by customers.

In addition, relatively low barriers to entry and reliance on brand recognition and customer loyalty for sustained sales growth make the sector extremely price competitive. The internet allows instant price comparisons and ever-faster delivery options, denying many retailers the opportunities for increasing selling prices.

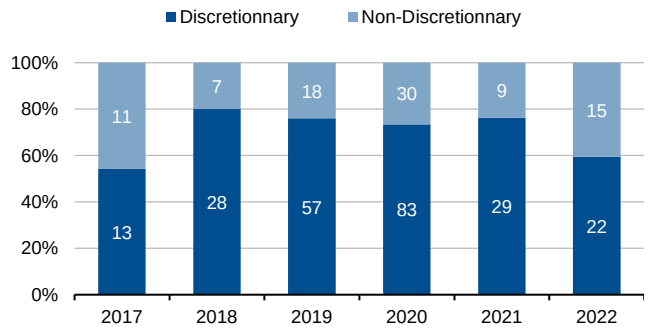
SMEs in the sector typically run into problems of scale as they grow, lacking the volumes of bigger rivals to negotiate low prices from consumer goods suppliers, limiting EBITDA margins and cashflow generation.

Internet remains big challenge… and opportunity

On the cost front, retailers must invest continually to enhance the consumer shopping experience as well as improve IT and logistics to compete in e-commerce and manage inventory. High capex and working capital requirements, and reliance on external funding can result in weak credit metrics, due to the sector's low inherent EBITDA margins which constrain free-operating cashflow.

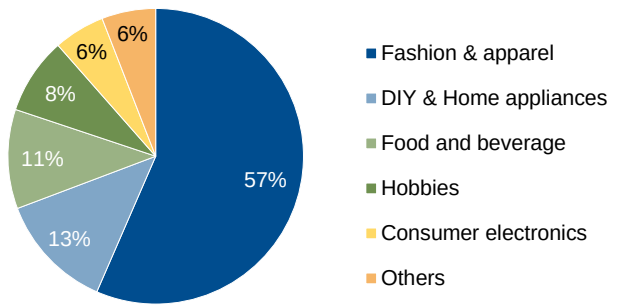
High profit margins are rare and increasingly precious commodities for retailers, vital for providing room for manoeuvre for management to finance investment for growth.

Figure 3: Bankruptcies (number of companies) by category of retailer in Europe 2017-22



Source: Scope

Figure 4: Proportion of bankruptcies by retailing sub-sector 2017-22



Source: Scope

Credit risks vary across industry's different subsectors

Fashion and apparel: the most vulnerable subsector

The fashion segment represents close to 57% of the total bankruptcies in our dataset, reflecting in part sector-specific risk[1]. Stores tend to be on or close to high streets, in close competition for visibility and footfall, and often require integrated or nearby warehouses to ensure continuous supply of goods. Real estate leasing costs are therefore relatively onerous compared with other retail subsectors.

Firms in DIY and home appliance segments also financially fragile

Other discretionary retailers – DIY stores and home appliance vendors -- are facing similar if less severe risks and exhibit slightly lower bankruptcies numbers than their fashion counterparts (13% of total). Firms in the category often have seasonal sales – think of gardening centres and DIY specialists reliant on summer trade – making for lumpy cashflow. They are also vulnerable to competition from multiproduct online retailers for which seasonality is not a problem such as Germany's Otto GmbH, Amazon.com and France's Cdiscount SA.

Food retailers remain high on the list of vulnerable firms

Vulnerability to financial distress tends to be limited for companies selling discretionary goods.

However, food retailing ranks relatively high on our list of bankruptcies. We would typically expect the subsector to have a strong financial profile, but disruptive forces have been building up for companies, possibly accelerated by the pandemic. Scale remains important but shifting consumer patterns – with growing focus on environmentally friendly foods, environmentally friendly packaging, alternative nutrition – have cut across the subsector. These trends opened opportunities for new entrants in recent years.

However, scaling up these new food retailing businesses is proving difficult as inflation has gathered pace, borrowing costs have risen, while larger incumbents have fought back with competitive product offerings of their own. In the background, there is also the continuing competition from hard-discount chains which tend to gain market share when the cost of living rises as it has done in the past 18 months.

[1] Due to the non-standardized aspect of most of fashion and apparel goods (composition, innovation, technology, colour, season, size, etc..), retailers are having a risk of not being able to sell their inventories in time or in full amount, leading to potential "stranded inventories".

Mapping Europe's retailing bankruptcies: UK remains an outlier

UK has one of the highest retail-vulnerability scores

Numbers of bankruptcies have varied considerably across different European countries between 2017 and 2022, even if a few broad trends are discernable (**Figure 5**).

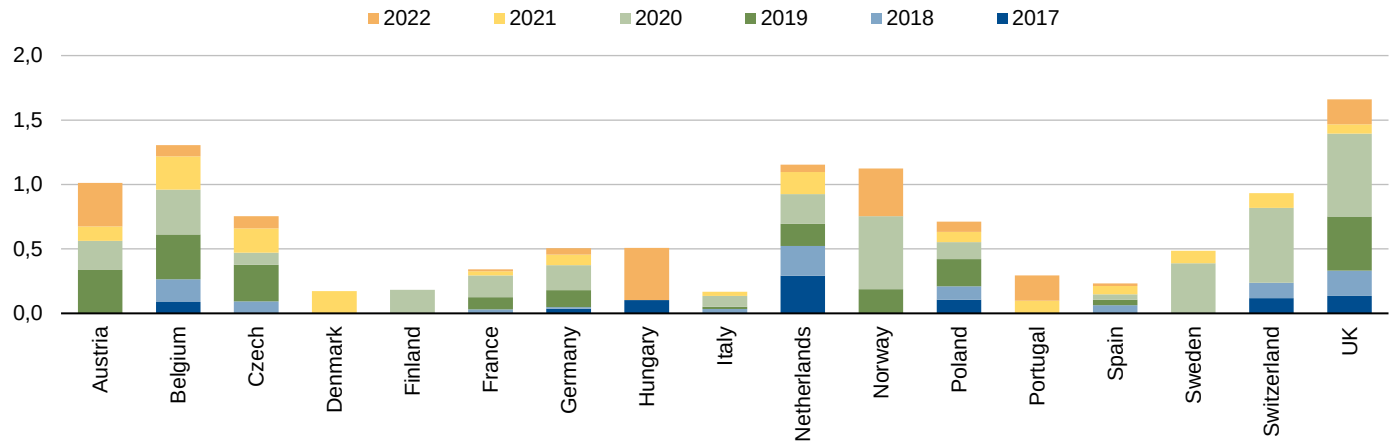
Retailing firms went out of business in growing numbers in many countries between 2017 and 2019. Then the pandemic struck, putting extra pressure on the sector. However, numbers declined sharply in 2021 with only a most increase in 2022 if at all, as firms benefited from widespread government support for householders and business.

UK remains outlier with high bankruptcy rates

Regarding specific countries, the UK remains an outlier, with significantly higher number of insolvencies than all other European peers. The country differs importantly through the much higher penetration of e-commerce, making consumers more price sensitive and providing tough competition for physical stores. This leads to significantly higher price competition among retailers as customers will favour lower prices over brand loyalty.

Brexit has further complicated the retail landscape, partly by exacerbating specific costs pressure (tariffs, cost of border controls, sterling's weakness against the dollar and euro). Given the current high inflation that UK households face, the number of retailers in situation of bankruptcy will increase drastically in the coming years without continued government measures to support firms in trouble.

Figure 5: Number of bankruptcies per capita by selected countries in the period 2017-2022



Source: Scope

Problem of "zombie retailers" varies by country

The increase of insolvency will be common to all European countries, as the number of "zombies retailers" [2] is likely understated.

Most European governments introduced a variety of measures to support businesses and householders in the past three years, first to offset the impact of pandemic-related lockdowns and other restrictions, and then to soften the blow of soaring energy prices.

While their amplitude varies from one country to another[3], most of these programs have ended or will do so this year. The phasing out of government support comes at a difficult time for all retailers, as high inflation erodes consumer purchasing power. Further government support may materialise, particularly in countries where elections are due, but with on a lesser scale than during the pandemic and energy crisis.

[2] Retailers which should have gone bankrupt but remain operational due to direct, indirect state support.
[3] To cite a few: the Spanish government's suspension of the obligation to declare bankruptcy in March 2020, later extended until June 2022; UK's coronavirus Job Retention Scheme; France's Solidarity Fund, government-guaranteed loans, exemption or deferral of social-security contributions; Germany's suspension of the requirement to file for insolvency within three weeks of failing to meet debt obligations and other debt-relief measures,

Country	Comments
Austria	One-off energy support in late 2022/early 2023 is unlikely to re-occur. Electricity price caps run until 30 June 2024 and look unlikely to be extended for now.
Belgium	Government has extended household support until April, likely to be gradually phased out by end-2023
Czech Republic	State support likely to be phased out in 2023.Though the economy remains vulnerable to impact from Russia's war in Ukraine,
Denmark	Government continues to support households in 2023 with measures such as additional child benefit payments, partial energy-bill freeze and reductions in electricity taxes.
Finland	The government offered only modest support to households and business during the energy crisis, but it is continuing this year ahead of elections due in April.
France	After comprehensive support for consumers and business during the pandemic and energy crisis, continued government support is likely be more targeted, temporary, and less generous than it was.
Germany	Caps on electricity and gas prices are in place until at least April 2024, but unlikely to be extended thereafter.
Hungary	Hungary is characterised by a significant degree of state intervention to support the economy.
Ireland	The 2023 budget included several measures offering energy-cost related financial support to households and business, including price ceilings on wind, solar, oil and coal-fired power generation.
Italy	Italy's measures to shield households and firms from the 2021 energy crisis was sizeable vis-à-vis other EU countries at the equivalent of more than 5% of GDP. Support will likely to be ratcheted down this summer but could be reinstated. Covid-related support is on its way out.
Luxembourg	The government has enacted a price cap on gas prices and price freeze on electricity through December 2023. Other support measures are likely to remain at least until this summer. We expect them to be phased down by early 2024.
Netherlands	The government allocated around EUR 45.3bn (4.8% of GDP) in energy support between Sept. 2021 and Oct. 2022.
Norway	Support measures, announced or implemented, include price support scheme for households, increased housing allowances and subsidies for agricultural and some industry.
Poland	With 2023 an election year, the government is likely to resume fiscal support for households and business, followed by a gradual winding down of the programmes in 2024.
Portugal	With relatively modest exposure to the energy crisis, government provided fiscal support equivalent to 1.5% of GDP, primarily focused on household support and social benefits, to be phased out from April.
Spain	Relatively unaffected by Russia's war in Ukraine, Spain's economy has proved resilient, with a robust economic outlook compared with the rest of the euro area.
Sweden	In January 2023 the government announced new measures to support households by compensating for high electricity prices during November and December 2022.
Switzerland	Households can participate voluntarily in an energy-conservation campaign launched by the government.
UK	The government extended an energy price freeze for households until April 2023, while it has also offered cost-of-living support in 2023 and 2024 for some of those on benefits and for pensioners.

Delays in payment are expected to worsen

Delay in paying suppliers and creditors due to a lack of liquidity is the most critical of the numerous factors which can lead to corporate bankruptcy. Based on latest payments data for the retailing sector in Europe[4], the median number of retailers paying their suppliers on time deteriorated in recent years, decreasing to 41.2% in 2021 from 53.6% in 2018 in the countries we have studied.

At the same time, the median number of companies making payments over 90 days has increased to 3.8% from 2.8% over the same period. We expect that fashion retailers and wholesalers are among those firms with the most significant delays beyond their contractual terms[5]. In an inflationary context where cash is king, we expect suppliers to be less and less lenient in term of tolerating longer payment delays, increasingly likely to impose penalties which could lead indirectly to bankruptcies.

[4] Data from D&B Worldwide Network

[5] Altares highlights that French fashion retailers have 17.6 days of delays while French fashion wholesalers have 18.1 days of delays, well above the average of 11.6 days in Q2 2022

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