

# A tale of woe

**“Stock markets have predicted five out of the last nine recessions” – Paul Samuelson, Nobel Prize winning US economist.**

It has been a long time coming, but the recession is officially here with a vengeance. The fall in GDP of 1.5% in Q4 2008 is the worst quarter-on-quarter fall since the 1980s. The wall of liquidity over the last 10 years has fuelled a massive, property led, consumer boom.

Excesses on this scale are sharp and take time to unwind. Credit is greatly constricted and consumers, fearful of unemployment and nervous of the collapse in property values, are spending less, especially on high value discretionary items. Predictably, long overvalued sterling has now overshot on the downside. The pound is at a 24-year low against the dollar and at its weakest ever level against the euro, making imports much more expensive.

The state of the retail sector is truly shocking at present and that pressure is felt all the way along the supply chain. The roll call of the fallen includes many familiar names with some forecasters stating 10% of all stores may close in 2009. Since 1955, recessions have generally lasted three quarters, but on three occasions they have lasted for five. Assuming this one is worse, lasting until sometime in 2010 and takes 5 years to wash right out of the system, then the retail sector is facing a painful period of re-adjustment.

## Key actions

Financiers cannot eradicate all risk of retail sector failure without slashing lending portfolios and in the presently constrained market, it is extremely difficult to manage away troubled borrowers. That said, lenders can minimise the risk of financial loss by enforcing the right initiatives now:

- Keep abreast of news on retailers. Despite the continuous negative outpouring from our press, there are still some blue chip retailers out there, but you should always monitor clients with high retail debtor concentrations closely. Reduced demand is painful to absorb, as are lower prices, but the insolvency of a retailer upon whom your client is heavily reliant will almost certainly be fatal and could leave you irrecoverably over exposed.
- Identify key retail debtor exposures and review their funding limits regularly. Trade credit insurers are adopting a predictably cautious approach to the retail risk in their portfolios, so if your client has credit insurance, maintain a close dialogue with the insurer.
- Step up your control procedures on clients with high retail sector dependence and avoid backlogs. You should review the adequacy and experience of your operations and risk resources. Investment in those areas now could pay dividends through the minimisation of losses.
- Ensure clients submit required information on receivables and inventory on time. Wherever possible make sure that month-end data is reviewed on receipt and any adverse indications are dealt with promptly.
- Tighten retail-related audit cycles and keep valuations up to date. Rising creditor pressure is a major warning sign. If your facility is fully drawn and

creditor payments are being stretched, then critical rent payments may be missed. MCR has had considerable recent success in our negotiations with key suppliers, landlords and HMRC, particularly on our high profile retail cases.

- Fraud is on the increase. Review ledger statistics regularly and thoroughly investigate any unusual trends. Use telephone debt verifications to confirm debtor balances. Monitor inventory levels against management accounts and forecasts.
- Monthly management accounts should be just that. Your best clients are likely to be those with accurate and timely management information, especially in retail. Late submission should be regarded as bad news and funding should be restricted for non-compliance. Encourage your client managers to discuss significant variances with their clients and to escalate any new concerns swiftly. Overly optimistic forecast assumptions about recovery in the high street should be challenged vigorously.

Retailers and their suppliers will eventually emerge from this deep trough and both receivables finance and ABL will be at the vanguard of the recovery. However if warning signs appear, then involve external advisers quickly. MCR has considerable experience in this sector. After a relatively short involvement, we can assess the true scale of any problems facing your clients and advise if their proposed response is viable.



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## Remember:

- The boom was consumer led and so is the bust.
- Domestic and commercial property values are continuing to fall.
- The weakness of sterling is being felt all the way along the supply chain.
- Retail is experiencing a painful two-year adjustment.
- Retail insolvencies are at a peak. Credit insurers are understandably nervous.
- Keep financials, returns, audits and reviews up to date and make sure they are thoroughly assessed.
- Insist on independent advice early to help both you and your clients.
- Avoid sudden collapses. Well planned insolvencies are always best.