PREVENTION IS BETTER THAN CURE

A pathway to profitable growth for SME retailers
“The 2018 summer of discontent on the High Street and the rise of the CVA, as one retailer after another looks for a way out of their current financial difficulties, are signs of how tough retail trading conditions have become."

Increased consumer caution, combined with a shift in spending habits and the rapid growth in online shopping through digital platforms such as Amazon, have led to a reduction in high street footfall while increased competition is proving hard to bear for many small and medium-sized retailers, regardless of whether they are operating on or offline, or both.

“By adopting a systematic and analytical approach to cash flow management, SME retailers can improve their operational stability and future proof their business model by focusing on profitable growth.”

Roberto Lobue
Head of Retail & Wholesale
PREVENTION IS BETTER THAN CURE

A series of high profile retail collapses has provided a stark reminder of the challenging trading conditions facing retailers of all sizes, triggering numerous discussions about the way forward for the sector.

2018 has seen the rise of the CVA (Company Voluntary Arrangement), which struggling retailers such as Mothercare have used to continue trading whilst renegotiating payment terms with creditors. Similar to the personal IVA (Individual Voluntary Arrangement), the flexibility offered by CVAs means that they have regained popularity amongst retail businesses as a platform for formal insolvency procedures. Additionally, the challenges facing department store, House of Fraser, has sparked the Chancellor to suggest the need for an "Amazon tax", to level the playing field between online and traditional retailers.

For SME retailers, prevention is better than cure. Instead of allowing profits to dwindle away, there are steps they can take to strengthen their business model and establish a platform for profitable growth.

According to research among SME retailers by Menzies LLP, getting into cash flow difficulties was identified as a top four risk factor. Findings from Retail Week in its “Retail 2018” report also indicates that retailers have woken up to the dangers of poor cash flow management.

In January 2018, 52 per cent of UK retailers surveyed said they were planning to either make no investment in new shops or reduce their property portfolios.

Similarly, at the start of the year, 53 per cent of retailers were planning a 50:50 split between driving growth and reducing costs.

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Rather than burying their heads in the sand, it is essential for retailers to take control of their destinies by adopting a proactive and multi-layered approach to working capital management and monitor cash flow closely. When performed correctly, this will enable businesses to see into the future; enabling them to take preventative action to mitigate financial risks.
HERE’S HOW 3-WAY FORECASTING WORKS

With the retail landscape constantly changing, three-way cash flow forecasting allows businesses to harness real-time data to deliver valuable insights to decision makers, which are based on reliable financial forecasts. These forecasts can focus on a variety of “what if” scenarios.

Combining data from profit and loss accounts, balance sheets and cash flow, this integrated method of financial modelling adds value when it comes to approaching lenders; giving them greater confidence about the future cash position of the business. This robust approach to cash flow management will also support senior-level decision making by increasing the visibility of costs across the organisation.

DETERMINE STRATEGIC OBJECTIVES

Before beginning cash flow modelling, it is essential to assess the business’ strategic objectives, which will in turn inform decisions about how far ahead to forecast and the different scenarios to be factored in. For example, if a retailer is looking to reduce its product portfolio over the coming year, its strategy will vary significantly from that of a business about to embark on a five year expansion programme. Different potential risks and opportunities will have to be taken into account.

DECIDE HOW FAR AHEAD TO FORECAST

When considering how far ahead to look, businesses should aim to keep forecasts as short term as possible – one year is often a good place to start. At the very least, it is important to ensure that forecasts cover the entire trade cycle, from receiving an order, through to fulfilment and taking payment. Inevitable peaks and troughs, due to factors such as seasonality and shifts in market conditions due to Brexit related uncertainties, for example, should also be taken into account. Taking this approach to forecasting will reassure decision makers that the resources exist to cover any operational overheads and react quickly to fluctuating market conditions, without experiencing cash flow difficulties.

INTERGRATE DATA SOURCES

Combining real-time data from profit and loss accounts, balance sheets and cash flow reports will provide business owners with the greatest possible visibility of their future cash position and greater understanding of how it might be impacted by different factors.
CONSIDER “WHAT IF” SCENARIOS

When using data to build cash flow forecasts it is important to consider a variety of “what if” scenarios. For example, what if certain product lines prove more successful than others or there are big fluctuations in sale volumes from one month to the next? Modelling based on these scenarios helps retailers to plan ahead. In this way, they will avoid being impacted by unexpected costs, which could potentially result in business disruption.

IMPROVE THE CASH POSITION OF THE BUSINESS

It goes without saying that simply conducting cash flow modelling for the sake of it is not enough. Once financial insights have been gained, it is vital to take appropriate steps to improve the future cash position of the business and ensure a healthy profit margin.

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LOOK BEYOND THE HEADLINES

As part of their efforts to maintain a healthy cash flow and maximise profits, it is important that business owners don’t focus solely on headline sales data and footfall. While they may be reluctant to shut down their flagship stores, access to real-time data about each store’s profitability can equip them to make better and more informed decisions. If stores have high overheads for example, strong sales may not equate to strong profits and cutting volumes of less profitable items may be an effective way of driving business value.

The importance of not being blinded by headline sales data also applies to product ranges. Through the use of data analytics, businesses can determine which products deliver the greatest value to the bottom line. Where a specific product is selling strongly but not providing a healthy profit margin, a dynamic pricing strategy could be used to adjust costs and boost profitability. Before adopting this approach however, careful consideration should be given to how this might impact brand loyalty, as well as assessing how it might match up against competitor pricing strategies.
While it might be tempting for smaller retailers to emulate the Amazon model, by increasing inventory and stocking a diverse product range, this strategy could carry significant risk. To compete effectively, retailers should stay true to their core proposition and take steps to ensure that they fully understand each product’s value and market potential. Using a 'product selection tool', such as the one shown, will help retailers to determine where profit potential lies; allowing them to make better, more informed decisions about their product strategies:

By plotting individual products according to their impact (in terms of sales volumes, profit margins and their likelihood to encourage further sales) and their financial value to the business, SME retailers can streamline the product selection process.

Using this ‘product selection tool’ will facilitate long term strategic planning by identifying which products, regardless of whether they are past, present and under development, should be part of the retailer's portfolio. Crucially, it can also help the business to predict potential cash flow risks.
THE TIME TO ACT IS NOW

It seems that hardly a week goes by without there being news of another high profile retailer in financial distress, and with Brexit on the horizon, the rapid state of change in the industry seems set to continue.

Before the situation gets critical, SME retailers aiming to succeed in spite of the tough trading conditions should take steps to get their business in order. Those willing to adopt an analytical approach to cash flow management will be able to anticipate future risks and opportunities; enhancing their ability to implement strategic long term plans.

By making use of three-way forecasting and product profiling to gain a true picture of the value inherent in their business, retailers can mitigate risk, optimise their portfolios and invest in product lines that will set them on the path to sustainable growth.

CONTACT

For further advice on how your business can protect cash flow, maximise product profitability and achieve growth, contact the retail sector team at Menzies

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