An Outlook on the Retail Sector Domestic Market Review

Retail is Ireland's largest Industry and the largest private sector employer. For generations, it has been a dominant force in the economy and a familiar presence in cities, towns, villages, shopping centres and retail parks across the country.

Introduction

The sector employs almost 300,000 workers[1] with almost 3 in 4[2] of those employed based outside Dublin. 85% of the 37,400 retail and wholesale businesses in Ireland employ less than 10 people[2]. The sector generates the largest contribution to the Irish exchequer of circa €7bn annually[1].

The sector has been a vital part in the Irish recovery since the Global Financial Crisis and a strong barometer of consumer confidence. In recent years, the sector has experienced significant and fundamental disruption with the shift to online shopping being a major catalyst.

At the outset of 2020, concerns remained widespread amongst retailers as to how perennial sectoral issues would be addressed and the impact of a disorderly Brexit on supply chains. The COVID-19 pandemic exacerbated concerns, resulting in lengthy closures of non-essential retailers and social distancing requirements for those allowed to remain opened.

The 'COVID-19' budget in October 2020 saw the Irish Government implement a series of welcome measures to assist liquidity, protect employment and stimulate the economy in unprecedented times. Whilst the stimulus, supports and debt warehousing have greatly assisted survival, they are temporary measures.

In this article we look at the challenges faced by the retail sector and the COVID-19 impact. We examine the restructuring options available to businesses and key considerations for retailers going forward.

1. Election 2020: Next government must address retail challenge | Retail Ireland
2. Retail at a glance | Retail Ireland

Pre-COVID-19 Challenges

In recent years the retail industry has experienced many issues to include margin pressure, a customer centric shift to on line shopping and increased competition. Looking at these issues in more detail gives better insight of the structural and operation changes within the industry.

The Retail profitability challenge has seen the industry experience severe margin pressure. This has resulted from decreasing pricing power and increasing costs. The need to invest in digital transformation has also impacted profitability. The continual shift to online shopping has left many long-standing retailers with larger store footprints and floorplates than is now required.

Rising cost pressures are combining to create a perfect storm for retailers forcing them to radically rethink what they need to do to remain profitable. In Ireland, the country's historic upward-only rent review system, high insurance costs and an outdated rates system have been long standing issues for the industry with little optimism that these will abate in the short term. The upward-only rent review system has led to unsustainable rent levels which the industry has been contending with for many years. The expectation of landlords for prospective tenants for destination locations, centres and retail parks has been to at least match the most recent letting terms agreed.

The customer centric move to online shopping has seen consumers choosing to shop more and more online and increasingly via smartphones. According to Retail Ireland the number of people who frequently shop online has increased to over 50% in recent years with the expectation of exponential growth in the near future.

New competition has resulted in retailers not only facing traditional competition but also in the form of new entrants into the industry. Many new entrants have vastly different operating models and cost bases. Most are online or businesses with smaller footprints and floorplates thereby mitigating the associated cost pressures as mentioned above.

Evolving consumer trends require retailers to continuously adapt and align with changing consumer preferences. This often requires a more experiential approach to offerings. Retailers are also under pressure to adopt more consumer-focused strategies such as increased food and beverage offerings. Evolving to meet these new consumer trends requires further investment from retailers and landlords at a time of heightened uncertainty.

Poor liquidity and market suspension have resulted in a considerable slowdown in investment in retail property. Investors are facing a fundamental re-rating of the sector and for many it remains premature to make confident investment decisions. There is a high level of uncertainty around the sustainability of current rent levels, lease structures, pricing and the future floorplate requirements of retailers.

Retail chains challenge - there have been a number of recent examples of international retail chains experiencing wider group difficulties which ultimately impact their Irish operations. In some cases there are performance contradictions between the Irish stores and the wider group but as the financial, operation and intellectual property support is maintained at group level, the distress negatively impacts the Irish operations.

The knock on effect of retailers in difficulties affects local employment, local enterprise, supply chain and key stakeholders with the most notable being landlords.

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COVID-19 Impact on Retailers

In 2020, the COVID-19 pandemic forced non-essential retailers to **close their doors** to customers **for almost 4 months**. For those retailers that were allowed to remain open during these periods of heightened restrictions, social distancing requirements resulted in additional costs and in some cases extended opening hours to alleviate safety concerns. Discretionary spend in department stores, fashion and newsagents have been most negatively affected. In an attempt to avoid public transport and crowds, shoppers have gravitated to out-of-town retail locations in preference city and town centres. As a result, some suburban locations are recovering to a more robust position and holding well in contrast to city centre locations.

Retail Ireland published their November Retail Monitor report which outlined the impact on Irish businesses; Footfall in Irish retail had fallen more than anywhere else in Europe since the onset of the pandemic. The information was gathered from Google mobility tracking data and did not include grocery and pharmacy retailers. According to the report, consumers started adjusting their behaviour long before the introduction of the level 5 restrictions in October.

The concentrated opening of non-essential retailers during the year, and especially in the weeks before the Christmas, has resulted in concern for retailers about their ability to manage social distancing, extended opening hours to alleviate safety concerns, queueing and stock replenishment especially given the significant pent-up demand.

However, the pandemic did see the resilience of Irish retailers. Retailers focused on grocery, specialised food and drink, DIY and electronics are performing strongly. Many smaller operations who had little or no digital presence began to utilise social media channels and fintech to reach their customers with 'click and collect' becoming prevalent. The pandemic also saw greater awareness in Irish consumers to support both local and domestic retailers. Despite footfall still being well below pre-COVID-19 levels in the cities and larger towns, trends indicate that consumers are capitalising on their occasional shopping trips with higher basket prices.

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Navigating Volatility, Financial Distress & Irish Restructuring Options

There are practical steps to assist businesses through periods of volatility and distress that involve critically assessing the business model and operations, eliminating or mitigating cash burn, utilising available supports and stimulus, and engaging with key stakeholders and creditors.

The key messages for businesses experiencing volatility and financial distress is to act early and seek out professional advice. Whilst consensual informal negotiations can assist short term liquidity, very often these measures are temporary in nature and are unlikely to achieve binding agreements.

Informal negotiations can result in limited engagement from creditors over a protracted period of time. Given the heightened liquidity risk faced by many business as a result of COVID-19, incurring significant time in informal negotiations can lead to weaker financial position and limited restructuring options.

Examinerships and Schemes of Arrangement under Part 9 of the 2014 Companies Act offer companies the opportunity to reach a binding compromise with shareholders and creditors.

Examinership is Ireland's corporate rescue process which affords an insolvent (or likely to become insolvent) company protection from its creditors for a period of up to 100 days. This period can be extended to 150 days for any examinership application made before 31st December 2020.

The protection afforded under examinership legislation allows a company (through a Court appointed Examiner) secure investment and put a legally binding scheme of arrangement in place with creditors for the settlement of debts. The scheme of arrangement requires approval (by simple majority) of one class of impaired creditor and must also ensure that all creditors affected receive at least the same or (in most cases) a better a return than they would get in a winding up scenario. The scheme of arrangement can be negotiated and modified right up until the end of the examinership process.

Once a company has been placed in examinership by the Court, it is afforded immediate protection from creditors. This prevents creditors taking enforcement action (i.e. seeking the appointment of a Liquidator or a Receiver) for the recovery of debts owing. All liabilities which accrue from the start of the Examinership protection period, including borrowings or rental obligations, must be discharged as they fall due. Companies need to demonstrate they have adequate cash flow for the protection period and funding can sometimes be required to facilitate. When possible, Companies should engage creditors and stakeholders before pursuing examinership.

The 2014 Companies Act saw the introduction of examinerships lite which allows for applications through the Circuit Court making it more cost effective for SMEs.

In the retail sector, a feature of the Examinership process has been to help companies in the renegotiation of leases terms and repudiation of onerous contracts where renegotiated commercial terms cannot be reached.

Examinership has similarities to the UK Company Voluntary Arrangement (CVA) and Administration processes and also with the US Chapter 11 process. Similar to examinerships, both administration and chapter 11 provide an automatic stay on creditor enforcement which affords time to a company to restructure. Administration differs from Examinership, CVAs and Chapter 11 in not allowing management stay in control during the process.

The opportunity and flexibility which the examinership process affords to restructure debts can be invaluable for retail operators facing challenges. Getting advice prior to and guidance throughout the process is critical to a successful outcome as the window of opportunity to take advantage of the process can be fleeting. Early action by a company and its directors provides more opportunity for a successful outcome.

A **Scheme of Arrangement under Part 9** of the 2014 Companies Act is a statutory framework for a company to compromise debts with its creditors. Similar to examinerships, a scheme of arrangement under Part 9 is binding on creditors once approved by the court. However it does not provide automatic protection from creditors prior to court approval.

To commence a scheme of arrangement under Part 9 of the 2014 Companies Act, a company does not need not be insolvent. It can be used to restructure the debts of a solvent company or group of companies (including holding companies) as well as financially distressed companies.

Advantages for retail businesses
There are a number of benefits to a scheme of arrangement under Part 9 of the 2014 Companies Act to include:
- less court interaction
- less costly to enter and exit the process
- no finite time limit to agree the scheme and the company remains in control to effect the scheme / compromise.

They do require a higher level of approval at 75% compared to 50% in examinerhips. The absence of court protection and a set time frame to conclude the scheme can result in protracted and unsuccessful creditor engagement. For Irish retailers, schemes of arrangement are rare in comparison to examinerships as a formal process to agree a compromise with creditors.

In the UK more recently, CVAs and schemes of arrangement have become preferred restructuring tools as both allow the company to remain in control and can be implemented before a company has reached a distressed financial position. They also more readily lend themselves to refinancing however neither benefit from statutory protection from creditors taking enforcement action and both require a 75% majority for approval.

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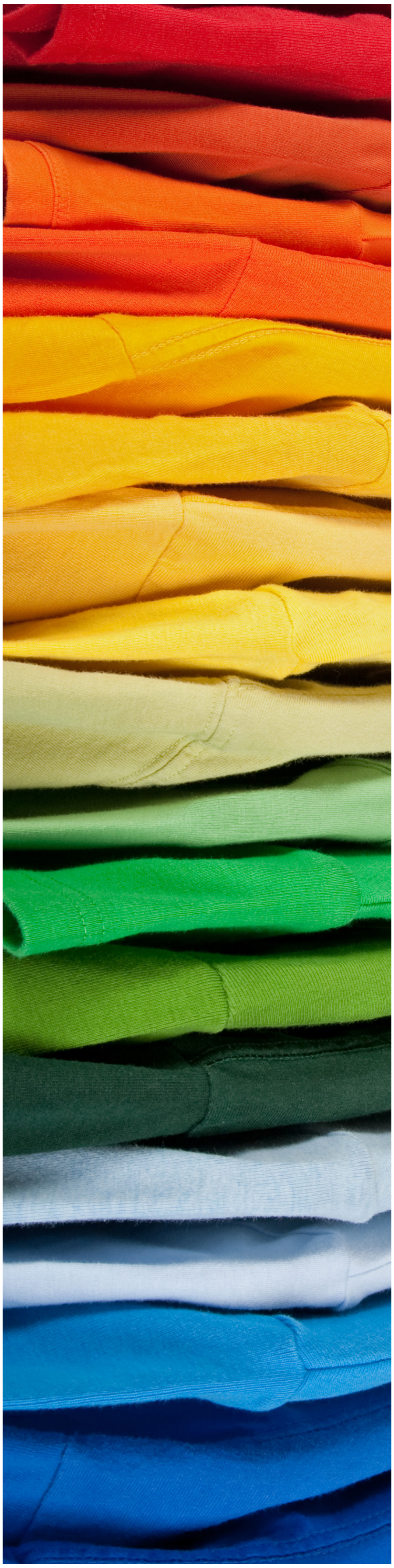

Priority considerations for Retailers going forward

At the beginning of 2020 it was widely recognised that the Retail industry was transitioning at speed against the backdrop of a looming Brexit. As a result of both the impact and restrictions imposed by COVID-19, the industry became almost unrecognisable overnight.

Against this challenging and evolving environment, priority consideration for retailers going forward should include:

1) Digital – Consumer behaviour has changed and retailers need to continue to adapt to find new ways to reach and serve their customers. Getting the right mix of digital channels will provide opportunities to drive engagement and growth

2) Consistent cost focus – Retailers need to continually monitor all costs and overheads. Dealing with legacy costs and moving to more flexible payment terms should be pursued where possible

3) Sustainable supply chain – Retailers have an opportunity and, in some cases, a necessity to reconfigure their supply chains. COVID-19 exposed weaknesses that can be mitigated by diversifying supply and improving both local sourcing and manufacturing. The new retail supply chain will also need to be more collaborative, sustainable and agile to allow for severe fluctuations in demand

4) Resilience – Whilst the priority for many retailers will be to secure the financial position of the business, there is also a need to focus on leadership and staff commitment. Ensuring there is a proactive culture and that decisions are made quickly have been crucial during the COVID-19 pandemic. Those retailers with a mindset of test, learn and move forward with a minimal viable product have been key to the acceleration of digital in the industry

5) Safety and wellbeing – In-store, in warehouses and when delivering products there is a need to ensure that safety measures are in place to protect customers, employees and suppliers. The customer experience also needs to be adapted to make customers feel safe and give them the confidence to return to stores

6) Future of work – the COVID-19 pandemic has fundamentally changed the future of work. Most commentators would agree that both the number and frequency of people returning to work "on site" will likely never return to pre COVID-19 levels. This presents an opportunity for retailers to re-engage, retrain and redeploy their workforce to support new organisational priorities. This may also require a redesign of workspaces and the acceleration of agile working

Conclusion

It is clear that businesses within the Retail Sector are facing significant challenges that materially impact future success. The impact of COVID-19, the move to online, addressing legacy costs bases and future proofing supply chains are critical issues for retailers.

Aside from the positive economic impact of the sector in terms of employment, contribution to the exchequer and investment, retailers play a vital role in the communities in which they operate. The sector invests heavily in training and development, supports social interaction and a wide range of community and social projects. The successful evolution of the retail sector is critical from both a financial and societal perspective.

Acting early in times of distress affords businesses more time and options. Given the underlying liquidity challenges arising from the COVID-19 pandemic, carefully assessing and understanding the available options, and engaging with stakeholders can allow a business to navigate through this period of unprecedented volatility.

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