Q2 2020

The Write Off Report

Every week we update Red Flag Alert with insolvent debt data, which provides critical insight into the financial health ratings we allocate to every UK business.

redflagalert

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About Red Flag Alert

Red Flag Alert is a business intelligence solution that provides real-time data on every business in the UK. From financial health to key decision-makers, our intelligence will drive your business to the next level.

- 6.5 million UK businesses
- 20 million key decision-makers
- 100,000 data updates every day
- 100+ indicators of financial health
- 50+ filters of key business data
- 7 detailed financial health ratings
- 2.6 million telephone records

Our Solution

Back in 2003, Red Flag Alert was developed by Begbies Traynor to help them identify businesses in financial distress that could be good prospects for restructuring or corporate recovery.

By collating and enriching data on a huge range of UK businesses, Red Flag Alert allowed Begbies Traynor to significantly improve its sales and marketing activities. Now Begbies Traynor is the number one business recovery firm in the UK.

The Red Flag Alert product we have today has evolved from over a decade of development and considerable investment and is an unparalleled business intelligence solution. It helps businesses from the FTSE 100 to SMEs to grow, mitigate risk and remain compliant.

Introduction

Every week we update Red Flag Alert with insolvent debt data, which provides critical insight into the financial health ratings we allocate to every UK business.

Specifically, the data highlights where companies have supplied goods or services on open credit terms and their invoices remain unpaid when the debtor enters insolvency proceedings.

If a company incurs bad debt when a customer enters insolvency, they are three times more likely to become insolvent in the next 12 months. But the circumstances provide essential context, as the impact of bad debt will depend on many factors, including the size of unsecured loss comparative to net worth, industry, and number of losses incurred.

For example, a business with a net worth of £50m incurring a £2,000 loss will experience no risk, whereas a company with a net worth of £100k will likely struggle to absorb a £75k loss.

At Red Flag Alert, losses are used in our algorithm to calculate financial health ratings. In some cases, one bad loss can take a company from being financially secure to severely at risk of insolvency; subsequently, this is one of our key indicators of financial health.

This new quarterly report takes an industry view, looking at overall trends in insolvent bad debt and drilling down into specific sectors.

We're kicking off our first report with a fascinating look at insolvent debt during the Covid-19 pandemic. Poor business performance usually correlates with an increase in insolvent bad debt, but this situation is different. A range of Government measures and short-term changes to the insolvency process has meant we've seen less insolvent bad debt.

While this is undoubtedly the calm before the storm, we can still see some early trends that indicate the tsunami of bad debt to come over the next 12 to 18 months.

Key Findings

- The total level of insolvent business debt dropped by £189m during the last quarter.
- Decline in debt is due to the reaction to the pandemic including the Government's financial support.
- A drop in total debt will be short-lived, with the retail sector showing 12.6% growth in insolvent debt.

Total levels of insolvent business debt in the 12 months to 30 June 2020 were £1.577bn, down 10.7% from £1.766bn at the end of March. The decline has been due to the Government's Covid-19 support measures, creditors flexing payment terms, and less formal action being taken against companies in serious financial distress.

These quarterly figures are in complete contrast to trends this time last year, which saw total insolvent debt grow by £161m in Q2.

We predict the recent downward trend to be short-lived and point to retail sector debt as a barometer for what the future holds.

Total insolvent debt has declined because struggling companies have been able to draw on financial support from the Government and many have been provided with more breathing space and flexibility by creditors. However, some sectors have seen insolvent debt increase. Tellingly, retail levels have grown by £6m, which seems like a much lower number in comparison, but represents a 12.6% increase during the last quarter.

This growth is important because retail performance is an early indicator of levels of consumer confidence and economic volatility. It's a sector which employs millions of people in the UK and directly impacts the performance of many other industries, such as logistics and manufacturing.

Insolvent debt in the manufacturing sector grew by 17.4% from £89.6m to £105.2m, while logistics saw a marginal increase of 0.84%, taking debt levels to £62.3m at the end of June.

Other sectors that saw rises in insolvent debt include hotels and accommodation, where levels more than doubled to £12.4m. At the same time, travel and tourism witnessed a 79% spike in write-offs, with insolvent debt growing from £5m to £9.1m during the past quarter.

This is likely the tip of the iceberg in the leisure industry as the sector looks at widespread insolvency, significant consolidation and extensive layoffs.

The construction and property sectors account for some of the UK's highest levels of insolvent debt, with total amounts standing at around £371m at the end of June, representing a 2.2% rise during the past quarter.

Our financial modelling since we started our records in 2004 shows that the construction and property sectors typically operate with some of the highest levels of insolvent debt. The impact of the pandemic hasn't yet been that pronounced on these sectors. One threat they are now facing is uncertainty around office-based working caused by the pandemic, possibly leading to a long-term dip in demand for commercial property. Much will depend on Government plans to shore up the industry with infrastructure projects and easing of restrictions on planning.

This quarter's Write Off figures have been skewed by the Covid-19 measures introduced by Government and positive steps quickly taken by companies during the lockdown. We're now coming to the end of Government support and, while some companies and sectors will bounce back, insolvent debt will likely see a sharp upwards trajectory over the next 6 to 12 months.

About The Author

Mark Halstead is the Managing Director at Red Flag Alert. He works with FTSE 100 and ambitious SMEs to help them integrate big data into decision-making and critical business processes. With more and more data becoming available, Mark ensures businesses use the richest and most relevant data to build competitive advantage.

His experience in big data analytics, financial services and strategic leadership enables Mark to provide data solutions in business development, risk and compliance.

As co-founder of Red Flag Alert, Mark oversaw its growth from zero to 450 customers in seven years. He is also co-founder of commercial lender Reparo Finance and commercial finance broker Funding Options.

Mark is regularly asked to provide expert insight on business data for leading industry and national publications, including The Times, The i, Accountancy Today, AccountingWEB, CEO Today, Finance Monthly, AAT Comment, Mortgage Finance Gazette, Estate Agent Today and the Retail Gazette.

Overview

In the 12 months to 30 June 2020, the total insolvent bad debt figure for trade creditors stands at £1.57bn – that's a decrease of £189m since the 12 months to 31 March 2020 and a decrease of £205m versus the 12 months to 30 June 2019.

As we've discussed, this decrease is caused by Government measures that are delaying insolvency for many businesses. Here is a rundown of the key factors that are suppressing insolvent bad debt.

Support with wages: The furlough scheme has helped businesses cope with one of their key costs – payroll. The scheme is still ongoing and will cost more than £30bn as the Government supports almost 10 million workers.

Rent payments: The Government relieved a second significant financial pressure on businesses by providing short-term relief from commercial rent repayments. The Corporate Insolvency and Governance Act 2020 supports businesses by protecting them from repossessions if they don't make rent repayments. This is catastrophic for commercial landlords, but in the short term has enabled companies to avoid rent payments – only 13.8% of commercial rents were paid during Q2 2020.

Direct funding: Government loan and grant schemes helped keep companies afloat during the pandemic. CBILS, bounce-back loans, and rates relief were all critical lifelines for many businesses.

Formal Action: The following factors are all likely contributors to the slowdown in the number of businesses that are being written off the Companies House database:

- HM Courts & Tribunals Service has reduced the operation of the courts and tribunals that often play a part in insolvencies.
- HMRC has reduced enforcement activity.
- The Insolvency Service, insolvency practitioners, and Companies House have been adjusting to new working arrangements.

General Forbearance: Suppliers and HMRC were less aggressive in collecting debts as a sense of understanding and flexibility pervaded during the pandemic.

As Government measures start to wind down and goodwill recedes, many businesses will be left trying to operate in a very challenging market. Although the trend of insolvency is currently downward, we still see small spikes that may be a sign of what is to come.

Construction

- In the 12 months to 30 June 2020, insolvent bad debt in construction was £258m, an increase of £71m since the 12 months to 30 June 2019.
- Despite contributing 6% to GDP, construction companies account for 18% of insolvencies.
- When large contractors like Carillion enter insolvency, they typically bring down subcontractors that rely on their contracts.

Insolvent bad debt in construction has increased by 37% in 12 months. Initially, this was driven by Brexit uncertainty, but the market was starting to improve in late 2019 as a resolution was on the horizon – the pandemic put a stop to the recovery.

Now, as we come out of the pandemic, many smaller construction companies are praying that large projects go ahead. If they don't, these poorly capitalised small companies won't survive for long without these critical contracts.

The Prime Minister pledged £5bn to "build, build, build" and Housing Secretary Robert Jenrick has pledged to tackle the "outdated and cumbersome" planning system. Practically, the goal is to designate more land for building homes, schools, shops and offices. If these plans become a reality, it may be the impetus the sector needs to stave off a wave of insolvencies.

Bars and Restaurants

- In the 12 months to 30 June 2020, insolvent bad debt in bars and restaurants was £32m, an increase of £9m since the 12 months to 30 June 2019.
- In the previous quarter, insolvent bad debt has decreased by 12.6% as the sector has been shored up by Government schemes.

This week sees the Government launch the Eat Out to Help Out campaign, a subsidy to get consumers visiting restaurants. It's a sign that the Government understands the importance of the hospitality sector; it's a huge employer and driver of economic activity – if people are eating out, it can be a significant economic stimulator.

But the future remains uncertain. There is little doubt that restaurants and bars will eventually bounce back. However, visitor numbers are still low, and with winter (and a potential second spike) just around the corner, it's hard to see pre-pandemic levels of activity in the next 12 months.

Hotels and Accommodation

- In the 12 months to 30 June 2020, insolvent bad debt in hotels and accommodation was £12.3m, an increase of £10m on the 12 months to 30 June 2019.
- In the previous quarter, insolvent bad debt has spiked by 108%.
- Business and conference cancellations have hit the industry.

Many hotels will suffer from a lack of tourism and will battle with low occupancy rates for the foreseeable future, but a reduction in business bookings will also have a severe impact on some providers.

Many hotels rely on business travellers and bookings of events, trade shows and meetings. These bookings are made in advance – and will certainly not be happening. Hotels will have to write off reservations, and the insolvent bad debt we're already seeing demonstrates that there are challenging times ahead.

Travel and Tourism

- In the 12 months to 30 June 2020, insolvent bad debt in travel and tourism was £9.1m, an increase of £5.8m since the 12 months to 30 June 2019.
- In the previous quarter, insolvent bad debt has spiked by 79%.
- Large travel companies are already starting to enter administration. Shearings and Maritime Voyages are two of the latest failures, and this will likely lead to a raft of insolvencies from the smaller suppliers that rely on them for business.

The travel and tourism industry has structural parallels to the construction industry: when large companies fail, it causes smaller suppliers that rely on them for business to also fail. This will likely be the case with Shearings, a specialist leisure group – they went into administration in July owing £332m to 1,021 unsecured creditors – many of them smaller travel companies.

There is hope that the staycation market can keep the industry ticking over, but walking around a deserted central London gives a sense that a return to pre-pandemic levels of tourist activity is years away.

Manufacturing

- In the 12 months to 30 June 2020, insolvent bad debt in manufacturing was £105m, an increase of £25m since the 12 months to 30 June 2019.
- In the previous quarter, insolvent bad debt has spiked by 17%.
- Manufacturers are exposed to fractured supply chains and economic volatility, so a global pandemic has presented a challenging operating environment.

Many manufacturers are reliant on a small number of suppliers, or even one key supplier. When large companies like Debenhams enter administration, the manufacturing sector will suffer insolvent bad debt.

Recent news is better. In July the sector grew at its fastest rate in three years as there are signs of a bounce back. However, employment in manufacturing fell for the sixth month in a row. The fortunes of the sector will be tied closely to the wider economy so as demand stagnates we expect insolvent bad debt to increase.

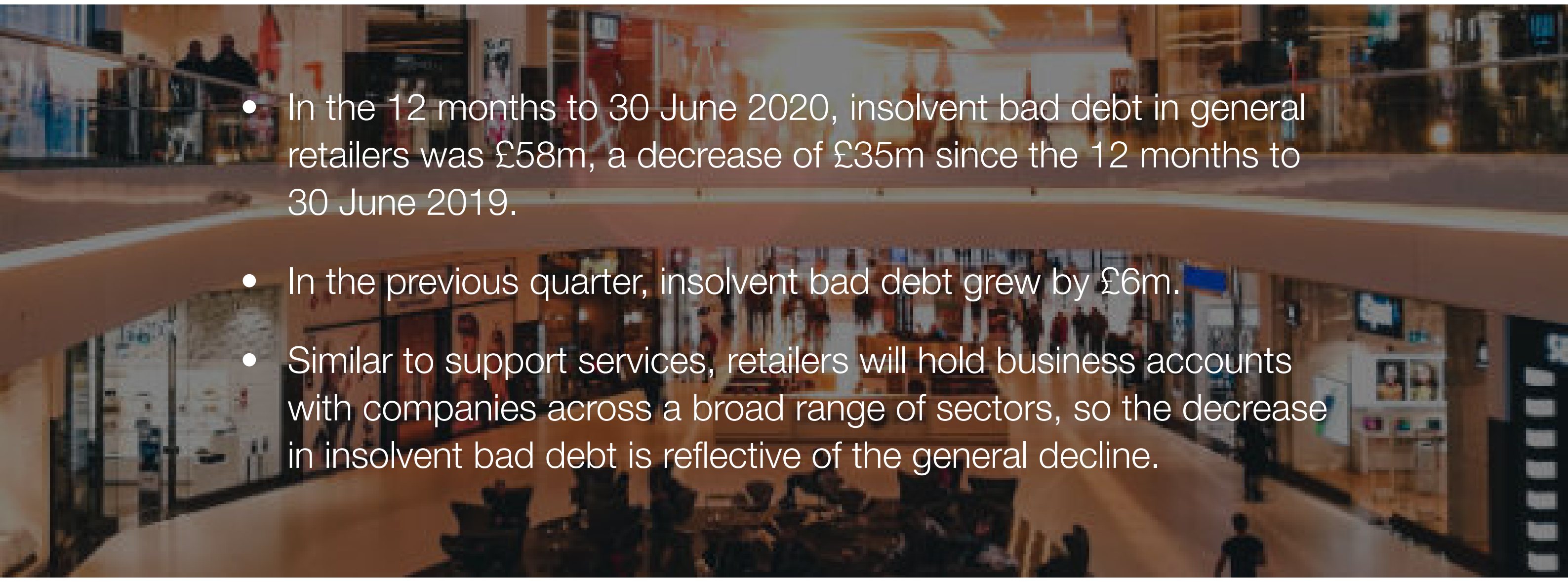
Support Services

- In the 12 months to 30 June 2020, insolvent bad debt in support services was £245m, a decrease of £241m since the 12 months to 30 June 2019.
- Support service businesses work across a broad cross-section of industries, so the decrease reflects the wider trend.
- As insolvent bad debt increases in the coming months, expect the support services sector to be affected.

The UK support services industry is robust and a favourite of private equity firms that see its dour efficiency as a sound investment. Although the sector can offer consistent revenue streams and long-term growth, it is exposed to market forces. When their clients perform poorly, support service businesses struggle.

Consider a facilities management company with a hospitality client base – its success is directly linked to the venues it serves and many businesses are exposed in this way. Expect insolvent bad debt in the support services industry to grow in the coming months.

General Retailers



- In the 12 months to 30 June 2020, insolvent bad debt in general retailers was £58m, a decrease of £35m since the 12 months to 30 June 2019.
- In the previous quarter, insolvent bad debt grew by £6m.
- Similar to support services, retailers will hold business accounts with companies across a broad range of sectors, so the decrease in insolvent bad debt is reflective of the general decline.

Retail bad debt figures reflect trade accounts held by retailers (think about a large furniture store also supplying local offices).

The modest quarterly growth in insolvent bad debt is driven by Government measures to protect business; once these measures are relaxed, retailers will likely start accruing much larger bad debt as customers file for administration.

Spot Financial Risk Before It Derails Your Business

Billions of pounds in bad debt are written off by UK businesses every year, causing thousands to become insolvent. We help you avoid this fate by providing detailed financial health data on your clients, so you can set the right credit terms and take action where necessary.

Red Flag Alert is powered by an algorithm that has evolved over decades to provide health ratings that are highly specific to each business. Billions of data points have been collected, and these vast datasets power our algorithm to make accurate predictions on business failures.

Detailed financial health ratings: We allocate every business a financial health rating that accurately predicts insolvency. Our clients use this to monitor their clients, set credit limits and ensure onboarding is smooth.

Unique expert insight: Our experts are always adding new data points, looking at every angle from accounting period changes to bad debt exposure – anything that gives us an insight into what's really happening in a business.

Efficient onboarding: Make quick risk assessments in your onboarding process, avoid companies that don't meet your criteria and set appropriate credit limits for those that do.

Real-time monitoring: Our data points are updated daily so you can monitor businesses and be alerted the moment any change happens to their financial health. This early warning system means you can proactively manage risk.

To discuss how Red Flag Alert can help your business develop world-class risk management, contact Richard West on richard.west@redflagalert.com or 0344 412 6699.

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Appendix

Total insolvent debt by sector for the 12 months to 30 June 2020, compared to 12 months to 30 June 2019 and 12 months to 31 March 2020.

Sector	12 months to 30th June 2020	change vs 12 months to 31st March 2020 (%)	change vs 12 months to 30th June 2019 (%)
Automotive	26,207,165.29	-2.27	42.06
Bars & Restaurants	32,566,532.57	-12.63	37.02
Construction	258,992,969.50	0.57	37.97
Financial Services	199,404,178.41	14.19	10.67
Food & Beverages	32,042,123.25	4.25	-3.98
Food & Drug Retailers	8,636,733.89	3.27	-41.14
General Retailers	58,736,055.67	12.65	-37.06
Health & Education	21,151,409.40	8.87	4.70
Hotels & Accommodation	12,398,472.23	108.42	268.73
Industrial Transportation & Logistics	62,303,920.75	0.84	-21.47
Leisure & Cultural Activities	14,385,935.16	-12.74	8.47
Media	32,347,949.51	3.92	0.35
Not Available	44,146,572.93	9.54	-21.83
Other Manufacturing	105,273,016.29	17.43	30.52
Others – not reported	25,768,057.87	5.63	39.44
Printing and Packaging	10,156,207.78	-27.67	-30.34
Professional Services	57,414,715.53	-4.51	-13.78
Real Estate & Property Services	111,584,416.48	6.21	2.87
Sport & Health Clubs	6,043,245.90	-1.06	-56.13
Support Services	245,905,077.29	-47.55	-49.49
Telecommunications & Information Technology	71,717,398.52	-8.33	1.99
Travel & Tourism	9,101,343.55	79.05	175.23
Utilities	34,708,379.41	-10.94	34.54
Wholesale – not reported	96,153,240.38	-15.12	-30.02
TOTAL:	1,577,145,117.56	-10.71	-11.52

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Total Insolvent bad debt for the past nine periods.

Sector	12 months to 30th June 2020	12 months to 31st March 2020	12 months to 31st December 2019	12 months to 30th September 2019	12 months to 30th June 2019	12 months to 31st March 2019	12 months to 31st December 2018	12 months to 30th September 2018	12 months to 30th June 2018
Automotive	26,207,165.29	26,815,842.72	27,137,305.40	21,682,409.72	18,447,404.28	16,582,868.53	20,860,723.92	22,421,600.99	22,491,105.21
Bars & Restaurants	32,566,552.57	37,273,491.88	38,777,147.43	29,954,970.58	25,767,706.35	21,409,986.62	18,759,211.09	10,056,717.27	9,520,940.84
Construction	258,992,969.50	257,519,522.30	251,579,516.20	223,967,540.99	187,721,347.18	180,992,463.71	235,997,981.55	234,677,435.40	241,845,758.89
Financial Services	199,404,178.41	174,829,414.00	176,465,472.82	181,750,912.58	180,185,869.59	205,554,409.47	209,494,001.11	209,084,027.16	201,278,516.40
Food & Beverages	32,042,123.25	30,737,276.05	39,194,698.35	26,734,092.90	33,370,968.08	35,778,138.92	68,857,908.17	68,945,678.88	64,267,870.61
Food & Drug Retailers	8,636,733.89	8,363,152.79	9,237,553.81	11,145,777.42	14,674,525.40	17,059,549.58	138,891,401.41	136,535,262.07	131,109,551.29
General Retailers	58,736,055.67	52,139,083.91	59,260,272.62	99,900,273.42	93,313,576.83	96,012,935.69	96,596,455.06	55,507,725.41	58,470,194.02
Health & Education	21,151,409.40	19,428,783.76	18,737,295.77	19,615,785.16	20,201,481.83	21,633,600.65	22,449,966.46	18,997,368.45	15,650,915.61
Hotels & Accomodation	12,398,472.23	5,948,864.18	4,284,249.56	2,755,625.85	5,362,438.61	4,560,704.10	4,811,405.71	4,470,675.28	5,576,709.08
Industrial Transportation & Logistics	62,303,920.75	61,787,644.37	82,208,329.04	82,204,971.81	79,338,513.56	74,482,844.70	48,951,494.73	37,321,388.74	37,294,146.43
Leisure & Cultural Activities	14,385,935.16	16,487,128.53	13,876,798.47	13,165,948.51	13,262,712.28	11,659,433.39	10,566,551.13	16,109,909.74	15,862,890.81
Media	32,347,949.51	31,126,378.71	25,760,115.72	28,616,808.86	32,233,569.94	32,153,411.96	24,201,139.63	25,646,634.43	23,519,261.00
Not Available	44,146,572.93	40,303,165.94	56,077,948.44	58,525,194.87	56,478,286.18	110,430,533.82	117,491,725.06	116,103,446.02	117,731,433.83
Other Manufacturing	105,273,016.29	89,643,721.44	85,576,302.66	82,811,195.62	80,658,063.03	79,118,112.86	180,126,856.35	177,746,211.79	189,397,399.21
Others - not reported	25,768,057.87	24,394,189.84	24,138,739.49	20,028,721.67	18,480,291.93	18,303,425.91	22,780,429.25	15,281,294.81	18,991,762.20
Printing and Packaging	10,136,207.78	14,040,698.57	15,259,678.38	14,859,792.77	14,378,991.58	12,959,575.42	13,009,630.64	13,977,596.50	18,212,547.12
Professional Services	57,414,715.53	60,127,859.88	59,548,234.35	66,692,774.36	66,588,795.47	66,781,295.85	68,279,041.34	62,538,452.80	78,320,514.48
Real Estate & Property Services	111,584,416.48	105,055,452.22	119,308,278.30	94,567,015.90	108,471,744.34	117,139,214.83	95,573,913.49	104,235,418.92	88,228,180.99
Sport & Health Clubs	6,043,245.90	6,108,113.89	2,129,827.30	13,649,766.82	13,774,549.46	13,816,729.29	14,249,127.14	2,164,451.59	8,541,992.04
Support Services	245,905,077.29	468,849,486.32	481,647,159.20	485,595,012.70	486,798,018.02	272,461,047.53	268,789,037.36	237,591,323.74	240,277,474.61
Telecommunications & Information Technology	71,717,398.52	78,238,481.51	79,868,068.33	83,124,565.49	70,315,298.73	62,975,089.59	82,354,330.29	73,990,910.95	80,161,026.08
Travel & Tourism	9,101,343.55	5,083,153.13	5,208,063.33	3,681,745.01	3,306,785.46	2,247,721.75	2,019,808.88	2,149,899.09	6,642,337.13
Utilities	34,708,379.41	38,973,432.09	39,296,291.96	25,602,365.06	25,798,743.65	21,088,615.42	19,553,715.02	22,135,972.94	36,719,239.15
Wholesale - not reported	96,153,240.38	113,282,030.10	121,111,655.15	135,007,755.02	137,393,825.38	128,488,869.06	148,111,269.19	135,515,851.98	131,467,252.65
TOTAL:	1,577,145,117.56	1,766,356,368.13	1,835,689,002.08	1,821,619,022.65	1,782,523,500.16	1,621,650,578.64	1,932,777,123.98	1,803,185,254.95	1,839,379,019.63

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