Commercial Insights Report

Trade behaviour is central to driving business performance

Author: Michael Landgraf,
Manager, Bureau Analytics, illion

Data Analysis: Dasuni Gamacharige,
Modeller, Bureau Analytics, illion

Australia

July 2023

illion

A rise in overdue trade invoices and debt collection indicates that business conditions are likely to deteriorate through 2023 – the Retail, Food and Construction Sectors are especially vulnerable.

The risk to businesses failing in 2023 is on the rise, as the financial stress from falling revenues and rising costs impacts business solvency. This finding has been uncovered by illion, following its earlier investigation into business risk, published in March 2023.

While the failure risk of start-up companies and young businesses has been traditionally high and continues to rise substantially, this increased failure risk now appears to be spilling over into the mature business sector.

This increase in solvency risk is affecting most industries, with Retail, Food and Construction (and even Transport) growing especially worse recently.

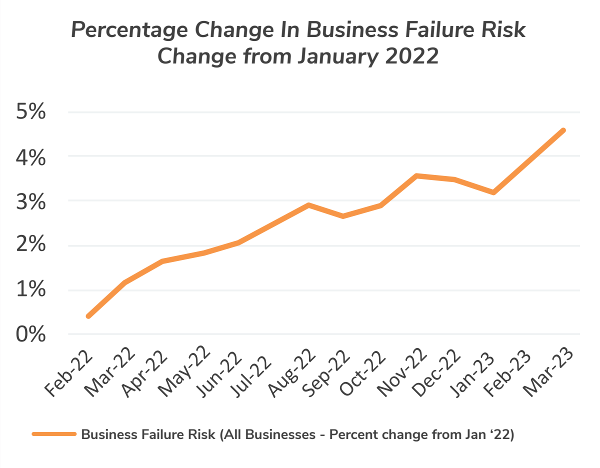
Our detailed findings from this research are as follows:

Business Failure Risk is trending higher with little evidence of near-term relief

On a national basis, business failure risk has increased steadily over the last 15 months and is now near 5 per cent higher than in January 2022, with no clear sign that this trend is moderating. Current trends suggest that the financial problems infecting businesses will continue to rise through 2023, even as some minor monthly re-tracing may occur from seasonal effects.

Focusing on businesses that are today, at severe risk of failure tells an even more concerning story. While their rise in failure risk increased by 50% from January to September 2022, it grew, in total, by 125% to March 2023 (essentially meaning that the deterioration seen in the last 6 months outstripped what we saw in the previous 9 months). While this shows that there has been some forewarning of this failure risk, it also shows that this risk is now growing at the fastest rate in recent memory.

Furthermore, there is also no substantive evidence (as seen in the graphs below) that this risk is moderating. Business failures are therefore likely to rise further into 2023/24, giving lenders and creditors limited time to mitigate their exposure. Companies exposed to these high-risk businesses will need to be nimble, reacting quickly to their debtors' changing financial circumstances.



Food Businesses, Retailers and Construction Trades are showing the highest risk of Business Failure

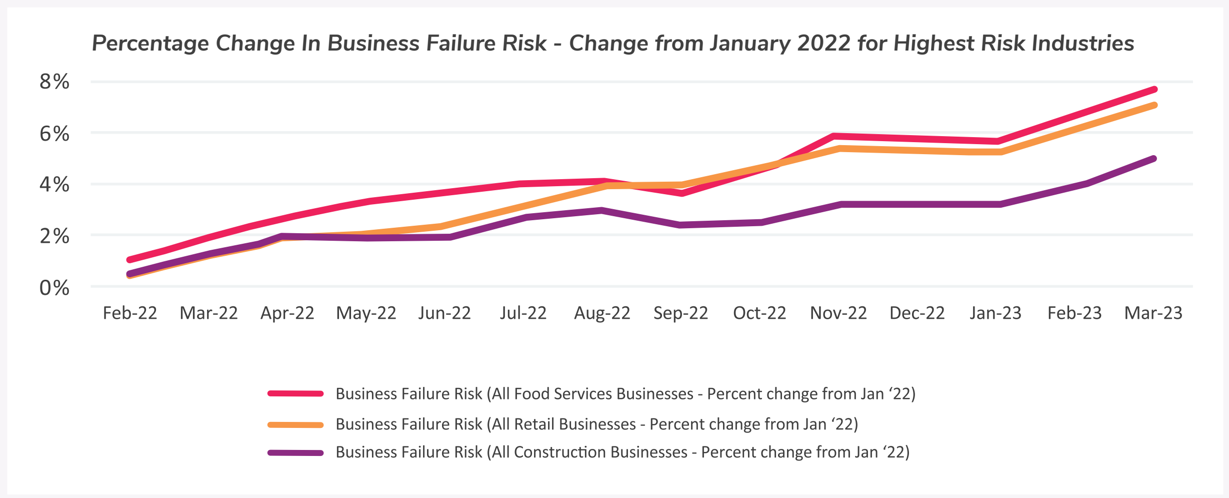
With rising business failure risk, we are seeing that that certain industries are especially vulnerable. On a national basis, the Food Services and Construction industries (at 14% and 11%) are showing the highest failure risk in Australia, closely followed by the Retail Services and Transport sectors (both at 10%). At the other end of the scale, Financial and Insurance Services, as well as Professional and Technical Services (3.5%), Wholesale Trade and Manufacturing (4%) having the lowest risk of business failure through 2023.

One reason for this difference could be that businesses with a higher fixed cost-base (through say, inventory expense and input-supply costs) and vulnerable to a fall in consumer spending have the highest risk of failure.

However, as these higher risk industries also tend to serve local communities, their failure also directly and immediately diminishes the living standards and welfare of their communities. Affected businesses, including building trades such as plumbers, carpenters, electricians; food retailers such as cafes, delis, take away outlets, restaurants, and hotels; shop retailers such as clothing, furniture, white-goods, music, and electronics stores affect people's livelihood and lifestyle if they close for business.

Industries already at high-risk are deteriorating further with little evidence of near-term relief

While the failure risk of all businesses increased generally by around 4.5% between January 2022 and March 2023, the deterioration seen in the three highest risk industries was higher; the Construction sector's failure risk deteriorating by over 5%, the Retail sector by 7.5% and the Food Services sector by 8% - this is shown in the following graph.



The increase in failure risk is especially concerning, as we can see a double-blow to business health from,

i) a broad, underlying rise in business failure risk through 2022/23, and

ii) an even higher trend in this risk in Q1 2023.

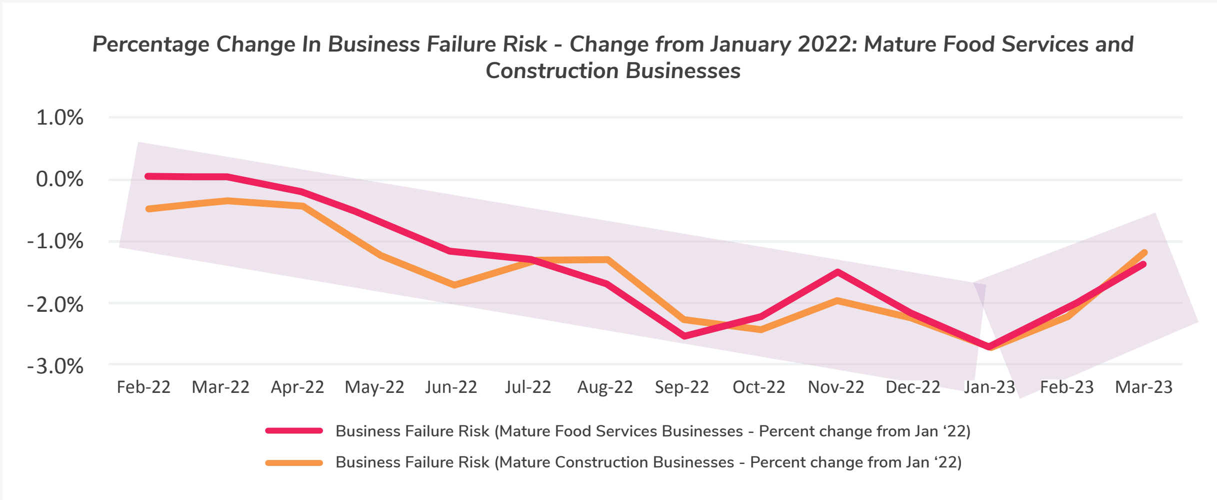
The construction sector appears to have had an unexpected shock in Q1 2023, which is consistent with reports recently published in the media, whereas the deterioration in the food service and retail sectors appears to have started earlier, with the retail sector already suffering an increase in failure risk between April and November 2022 and again, since January 2023. The deterioration in the food services sector appears to have occurred even earlier in 2022 but then stabilised until September 2022, after which, there have been two notable shocks between September and November 2022 and from January 2023.

The dual effect from economic shocks and longer-term trends in these higher risk sectors suggests that failures may continue to rise in the food and retail sectors. The prospect for the construction sector is less clear, as the recent shock was preceded by a long period of stable risk. Therefore, it is possible that the sector will stabilise through 2023, depending on external circumstances that affect their input supply costs.

Young businesses are clearly 'at risk' but mature businesses are also showing signs of stress

Traditionally, start-up and young businesses are known to have a higher risk of failure, as they have limited capital available when revenue falls short of meeting financial obligations. Our analysis has found that this situation is certainly present in the current economic environment, where the failure risk of businesses 'under 3 years old' is generally rising by 65% since January 2022 and by 75% in the retail and food services sectors.

However, in the current economic environment, we are also seeing a possible tipping-point in the failure risk of mature businesses (i.e. businesses over 3 years old). The fundamental economic problems, typically afflicting young businesses may therefore now be spilling over into better capitalised, mature businesses operating in certain industries; this can be seen in the following graph.



After a period of falling failure risk in the food and construction industries over 2022 (ie. close to 3% improvement in failure risk) we are now seeing a 2% deterioration in failure risk in Q1 2023. The retail sector has shown a similar trend, albeit, on a smaller scale.

Therefore, even businesses that are generally resilient (by holding more capital or having a long-term clientele and steadier cash flow) appear to be more vulnerable to financial stress in 2023. While it is too early to say definitively that this is an on-going trend, suppliers and creditors will want to closely monitor the business risk of even long-standing business customers.

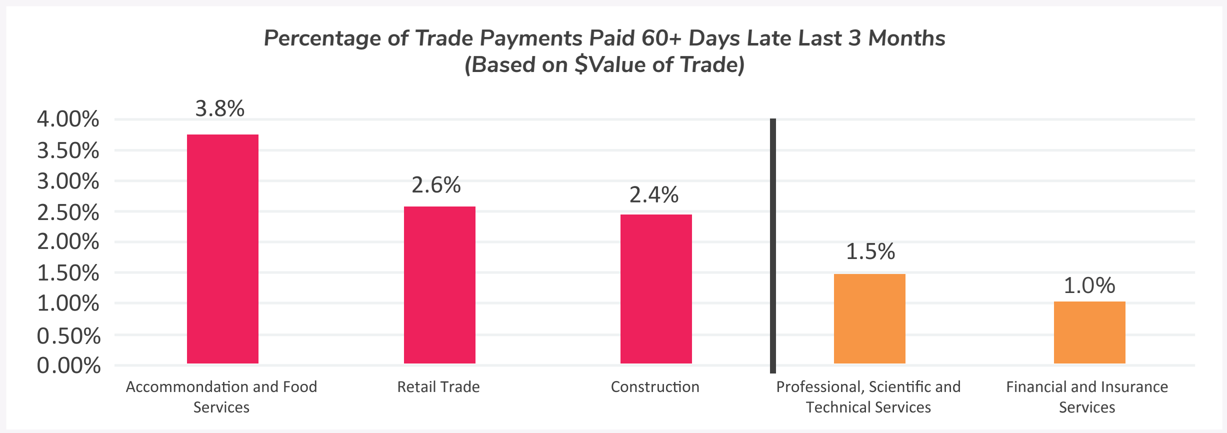
Overdue Payment of Financial Obligations and Debt Collection Activity is on the Rise – especially in Food, Retail and Construction Sectors

The financial strain on businesses can be largely blamed for the rise in failure risk through 2023. This appears clear from the trade invoice data held by Illion from its proprietary trade payment program. Analysing this data, illion has found that,

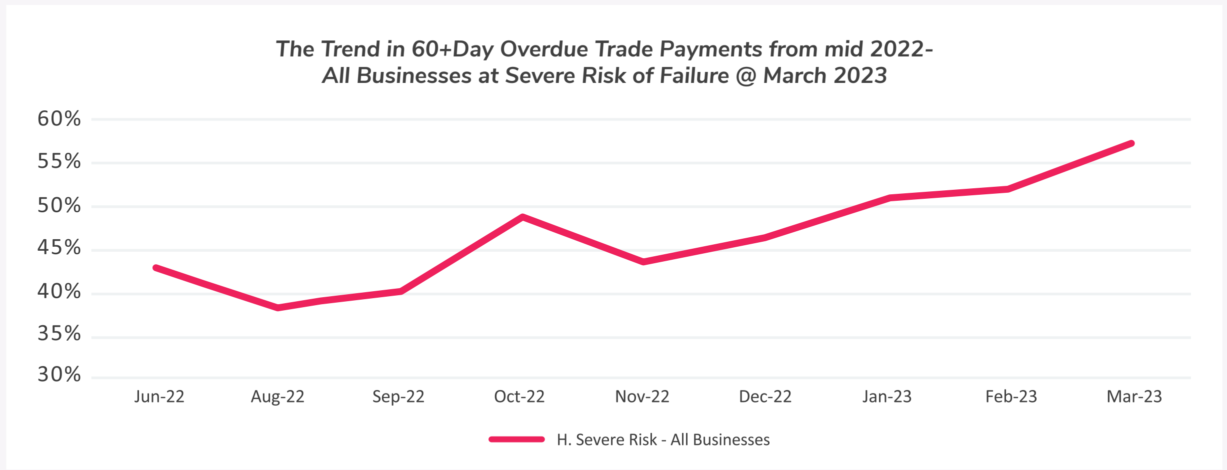
- businesses operating in high-risk industries have the highest percentage of overdue trade payments (by dollar amount) and

- high-risk businesses are taking longer to pay outstanding invoices in 2023, as compared to previous years – ie. their trade payment obligations are more likely to remain unpaid or substantially overdue when finally paid.

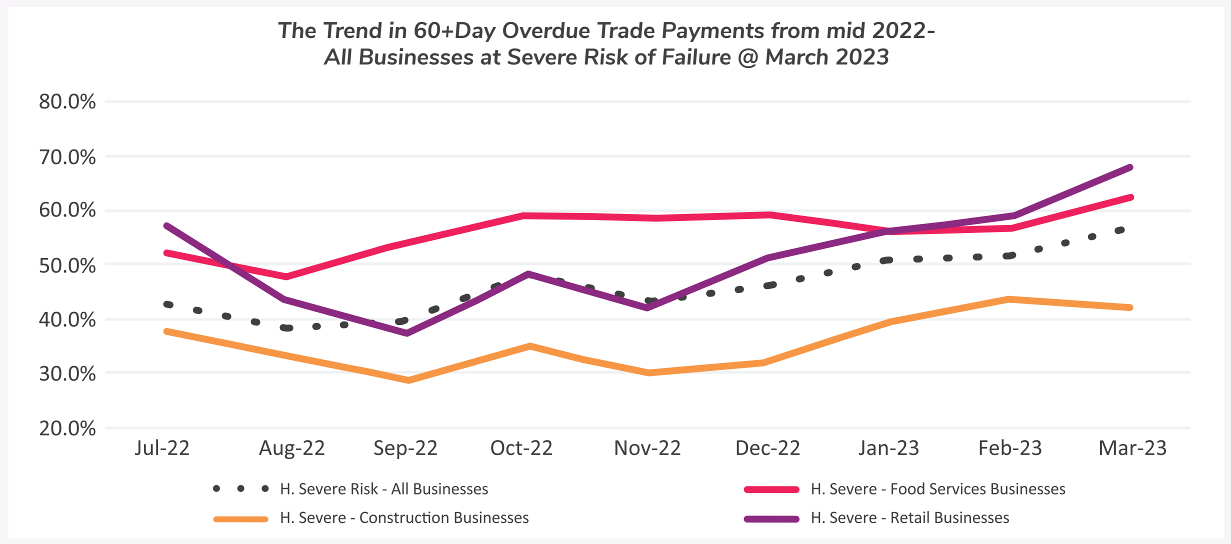
To illustrate, we can see from the following graph that trade obligations invoiced very recently (ie. billed in the last 3 months) to businesses in the three higher risk industries were far more likely to remain unpaid for at least 2 months than invoices due for payment from the lower-risk professional and financial services sectors. This difference ranged from 60% higher, when comparing construction to professional services, to 3-times higher, when comparing food services to financial services. The food, retail and construction sectors, therefore, appear to be the most vulnerable to financial stress – ie. from rising costs and lower sales.



When we focused on high-risk businesses, irrespective their industry sector, we found that 57% of all outstanding trade invoices were 60+ days overdue in March 2023, many times higher than the overdue rate across all Australian businesses (around 6%). Overdue trade obligations were therefore strongly indicative of business failure risk.



In addition, high risk businesses also suffered a large deterioration in overdue trade payments between July 2022 and March 2023, climbing from 42% to 57%. This deterioration in invoice payments was especially notable recently, rising from 44% in November 2022 to 57% in March 2023 and was consistent with the rising business failure risk of these businesses over 2023. As such, trade payment behaviour was highly indicative of business trading risk, with the, already high underlying financial stress continuing to climb, with no indication of any improvement through 2023. We therefore expect to see overdue trade payments and higher business failure risk continuing through 2023.



The situation for high-risk businesses within the food services and retail sectors is particularly concerning, as shown in the above graph. In the food services industry, the percentage of substantially overdue trade payments now exceed 62% (up from 52% in July 2022); in the retail sector, it is now at 68% (up from a range of 40-50% during 2022). In both industries, high-risk businesses appear to have struggled for some time now, but have also deteriorated substantially in the last 6 months.

This trend in overdue payments suggests that a recent economic shock has had an especially significant impact on retail businesses; potentially, resulting from falling revenues post-Christmas and rising input costs from shop rents, power prices and inventory costs.

This recent rise in overdue trade payments can also be seen in vulnerable construction businesses (up from 29% in September 2022 to 42% in March 2023) and is likely to be attributed to the fall in cash flow from rising building supply costs and contract labour costs coinciding with fixed contracted project revenues.

The financial risks besetting the food services, retail and construction sectors have now also coincided with a significant rise in debt collection activity; most notably, in the construction industry, which has seen a 3-fold rise in daily collections activity in Q1 2023, compared with the previous 9 months. Similarly, the retail and food services sectors have had 75% rises in collections activity. This contrasts with the Professional Services and Financial Services sectors where we have seen no change in collections activity over the last 12 months.

Concluding remarks – visibility to trading behaviour offered the best chance of managing this risk

While Australian businesses have been affected by economic shocks in 2023, an underlying trend to higher failure risk has been evident for over 12 months. Vulnerable businesses have shown a gradual deterioration in their trading behaviour, which has then been exacerbated by these recent shocks. Illion business and trade information has offered both early visibility to this risk, by shining a microscope on the underlying business trading behaviour as well as insight into these recent shocks, by showing recent trading trends and collections activity. Suppliers and creditors that used this behavioural data at their earliest opportunity were best placed to react to changing circumstances; either avoiding exposure to new risks altogether or mitigating their exposure to existing risks.

illion

illion is a leading independent provider of trusted data and analytics solutions and services in Australasia, with the company's consumer and commercial registries representing a core element of Australia and New Zealand's financial infrastructure. illion leverages consumer and commercial credit registries, which comprise data on over 24 million individuals and over 2 million commercial entities, to provide end-to-end customer management solutions.

www.illion.com.au

Empowering Intelligent Decision Making

Have a question?
Contact us today.

customersupport@illion.com.au

illion