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Analysis

Coping with a Low Growth, No Growth Economy

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Biography

Nick Hood is the Senior Business Adviser at the Opus Business Advisory Group (https://www.opusllp.com), the largest independent advisory, restructuring and insolvency firm in the UK.

Nick was a licensed Insolvency Practitioner, working in the business rescue market for 25 years. He is a committed internationalist, having created the largest global network of independent business rescue firms and having also worked overseas in Canada, Milan and Bahrain.

In his earlier career and after qualifying as a Chartered Accountant in 1970, Nick held senior executive positions in major companies in the construction, engineering and media sectors, as well as working for a boutique investment bank.

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Abstract
2023 was a difficult year with little growth, soaring interest rates, record insolvencies and an inflation crisis, which affected not just consumers but the businesses that supply them. In this article, the author looks at the background and sets out where the focus of business leaders should be in 2024 if they are to navigate their way safely through what seems likely to be another challenging time.

Introduction
No matter how much politicians and economists argue about whether or not the UK is already in recession or heading in that direction, the reality is that at best the UK economy is still lurking in the depths of almost imperceptible rises and falls from its torpor.

GDP was down by 0.2% in the three months to November 2023, with the vital services sector showing neither a gain nor a loss, but manufacturing dropping by 1.5% and construction dipping by 0.6%. The less reliable monthly figure for November alone gave us a 0.3% gain, but that only cancelled out the 0.3% shrinkage in October.

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Would a recession matter?

The technical definition of a recession is two consecutive quarters of negative growth. Q3 2023 ticked the first box with an 0.1% drop in GDP, Q4 is in the balance. The Chief Economic Adviser to the influential EY Item Club, Martin Beck recently told the Radio Four Today Programme that analysis of the high frequency economic numbers suggests that Q4 2023 may see another very small fall but added "it doesn't make a massive amount of difference to the person on the street" if the economy shrank by 0.1% or grew by 0.1%[1].

The EY Item Club's latest prediction is looking for 0.9% GDP growth overall in 2024[2], which is marginal by any judgement and less than half of the 30-year historic trend of average annual growth of 2.1% between 1993 and 2022.

This sluggishness may not matter to individuals, but it is bound to affect business confidence and that in turn impacts their willingness to invest, an area in which the UK has had a very poor long-term record. Without investment, growth will remain low key at best as our productivity and competitiveness stay shackled. The comparison with the US economy growing by an annualized 3.3% in Q4 2023 is stark[3].

Why doesn't the UK commit to business investment?

According to a 2023 report[4] from the International Monetary Fund (IMF), UK business investment has been an average of 36% lower than other members of the G7 since 1990. Looking at the latest disruptions caused by Brexit, the pandemic and the invasion of Ukraine, the IMF also reported that in real-terms, UK business investment had settled at a slightly lower level by the end of 2022 than it was in 2016. During the same period, the other G7 economies experienced an average 14% increase.

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The government has long been obsessed with throwing tax concessions at the problem, largely ignoring the reality that while tax considerations are relevant, far more important decision-influencing factors for entrepreneurs are the presence locally of sufficient skilled labour resources, affordable housing, education, transport infrastructure and the availability of capital at acceptable interest rates.

In particular, if businesses fail to stay ahead of the steeply upward curve of the global rush to digital transformation by investing in the AI and machine learning revolutions, then the UK is doomed to more decades in the economic wilderness.

Other key factors: inflation, the labour market and interest rates

Until the headlong fall ended with the surprise upward blip in CPI inflation in December 2023, all looked set fair for a commendable re-insertion of the cost-of-living genie back into its 2% bottle some time in 2024 and an early cut in interest rates to match the steady easing of the labour market. Now prospects for inflation and interest rates are less clear, especially with the initial Gaza tension turning into multiple military flash points across the Middle East.

As pundits debate the impact on the timing and extent of interest rate cuts, one major mortgage lender has surprised markets by raising their prices for some fixed rate products, reversing the previous downward trend in a highly competitive market.

2023 saw record business failures and 2024 could be worse

Last year had none of the feel of imminent disaster that marked 2009 as the full impact of the global financial crisis ripped through the economy. Yet when the dust settled, the total for corporate insolvencies 2023 came out as the highest annual figure on record. There were 26,595 failures, compared to 26,566 back in 2009. Close but a definite record[5].

Numbers apart, the two peaks could not be more different. In 2009, systemic issues in global banking markets squeezed commercial lending and investment, whereas in 2023 it's a story of battle fatigue from the pandemic, the impacts of the Ukraine War and the cost-of-living crisis.

The appetite for business rescue seems to have gone in 2023, with only 1,633 Administrations representing 6% of failures compared to 4,167 (23%) in 2009. At the same time, Creditors' Voluntary Liquidations (CVLs) where Directors throw in the towel and admit their damaged businesses have no future soared. They rose from 57% of failures in 2009 to 81% in 2023. This is a significant comment on the vulnerable current state of UK businesses, especially less well capitalized smaller companies.

Given the poor economic prospects for 2024, it is difficult to see why insolvencies would drop. Indeed, the trade credit insurer Atradius has forecast that they will continue to rise, although at the more modest rate of 5%. That would lead to some 28,000 failures this year[6].

How should business react?

What can the owners and managers of businesses do to avoid joining this sad roll call? The year ahead is going to be a time for doing the basics as well as circumstances permit and avoiding unnecessary risks. It will be a case of concentrating on good commercial housekeeping.

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Financial control

There needs to be a particular emphasis on credit risk management, which will be difficult with such widespread financial vulnerability. Avoiding bad debts or mitigating losses where customer failure is unavoidable is essential. Equally important is gross margin preservation and overhead expense containment, even in the current inflationary environment.

Challenging profit sources

How many businesses earn a significant proportion of their profits from a limited number of customers, products, or service lines? Too many, in reality. This would be a good time to ask why resources and capital are being tied up with loss-making or only marginally profitable activities and to explore what the implications might be if these were to be ended.

Checking funding adequacy

Does the business have sufficient funding and how much is it costing in this era of sharply higher interest rates? Staying on top of cash flow is one thing, making sure there are adequate funding lines in place is equally important and should be where good cash management should start.

Internal reporting

Are management reporting routines up to scratch? Are they succinct and focus on the crucial issues, or are they reams of impenetrable financials designed to demonstrate the virility of the finance function and sure to put recipients to sleep or make them hit the delete button? In a year when there will be many challenges for managers, are they helpful? Are they honest about the bad as well as the good news?

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Internal and external communication

Is there a meaningful internal comms strategy designed to keep staff in touch with what's happening with the business, where it's heading and what contribution is expected from them? Every bit as vital is managing the expectations of external stakeholders, whether they are customers, suppliers and credit insurers, landlords or lenders. This year will be a year when unpleasant surprises will not be easily forgiven, even if some may be beyond management's control. Relationships with internal and external stakeholders must be sufficiently robust to facilitate adult conversations about problems.

Staff management and retention

The labour market is easing, but recruiting and replacing staff is time consuming, disruptive, distracting, and expensive. Here too there must be a strategy designed to minimize unnecessary staff issues.

Carefully planned investment

For all the need for caution, companies which don't invest in maintaining their present and in developing their future will eventually wither and die. Blanket prohibitions on CAPEX are rarely a successful approach. The trick is to prioritize what must be done to preserve the fabric of the business and what is a sensible commitment to future opportunities. There needs to be a logical, well thought-through and properly funded investment plan.

Seeking expert advice

Getting through what is bound to be a difficult year is likely to challenge the bandwidth and skillsets of management teams. A particular issue will be if the right course of action is to shrink the business. After decades of dogged determination to achieve and then boast about growth, we have a current generation of managers who may not be so good at downsizing. Other issues may call for knowledge and experience beyond that of the incumbent team. Calling in outside experts may look like additional cost, but properly handled, it should be a net benefit.

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