



NON-FOOD CONSUMER GOODS & RETAIL

From out of stock to overstocked?

Effectively manage high inventory
and limited liquidity



Key Takeaways



Overstocked warehouses

82% of the analyzed companies have recorded a significant increase in inventories since 2021



Seasonal goods particularly hit

With 93% and 95% of retailers affected, the fashion and furniture/home segments suffer the most from overstocked warehouses



Scissor effect

Inventory growth exceeds sales growth for 68% of companies



Negative consumer sentiment

The situation is aggravated by a continuing decline in demand, which exacerbates the structural market change



Higher accounts receivable worsen working capital

In addition to rising inventories, increasing payment delays lead to tight liquidity



Narrow room for maneuver

Necessity to sell at high markdowns deteriorates margins in favor of short-term liquidity and increases pressure to act

Not all retailers are equally affected

In the current market environment, these eight factors have a positive effect:



Lower share of seasonal goods



Local proximity of production



Strong market position or brand



Diversified end markets and channels



Timely buildup of liquidity



Positioning in the entry-level price segment



High degree of verticalization



Flexible fixed cost base



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From *out of stock* to *overstocked* – retailers under pressure

Current situation: unfavorable, outlook: even more unfavorable

„Discount“, „sale“, „promotion“: For several weeks now, discounts have been piling up in the retail sector – both off- and online. Sales of consumer goods are suffering from the dampened consumer sentiment and sharply slumped demand, which is falling well short of earlier expectations.

While sales have been stagnant at best since March 2022, many retailers are observing an increase in their inventories with concern. This is not only worsening their working capital on paper, but also limiting actual solvency – which, in many cases, is still be weakened by the brick-and-mortar lock-downs of previous years. And, while the situation will be tight this winter, the outlook for early 2023 doesn't look very promising either.

Structural and (extraordinary) cyclical effects

There are many reasons for this development: The economic downturn and inflation are curbing the propensity to buy, while the increased cost of living is limiting available household budgets. The expectation of further price increases is prompting many consumers to save; factual and psychological effects are thus mutually reinforcing and causing further slumps in demand. Both the HDE consumer barometer and the GfK consumer climate index are at an all-time low. Spontaneous purchases are declining in particular (people are buying more consciously), and (price-adjusted) average receipts are falling.

For 2023, the OECD forecasts a 0.3% decline in economic output in Germany, while the joint forecast by leading German economic researchers (“Herbstgutachten”) paints a similar picture. Smoldering crisis factors resulting from the COVID-19 pandemic are placing an additional burden on the retail sector: the disruptions to supply chains have not yet been overcome. The availability of goods is only partially back to pre-crisis levels, and a lack of items in certain categories could become a challenge this Christmas season. In addition, demand for stocked items has fallen. And, in many places, brick-and-mortar visitor frequencies have not reached their pre-crisis levels yet.

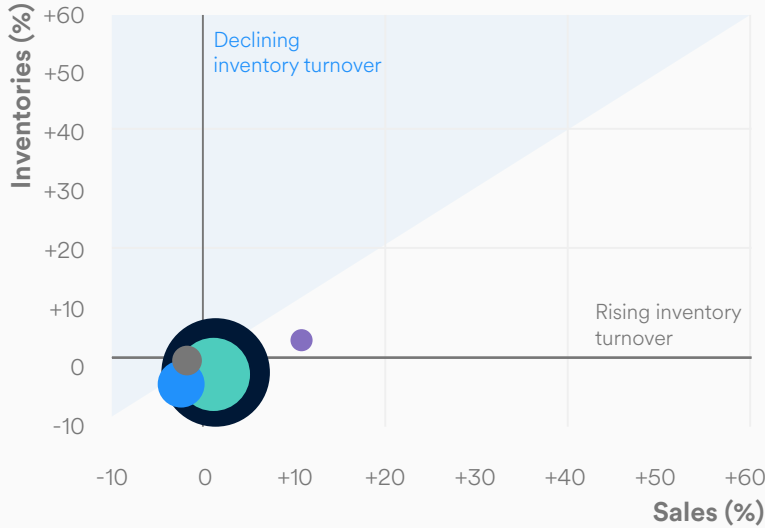
Full warehouses intensify pressure to sell

Particularly in the area of consumer goods that are dependent on fashion trends or seasonal goods, retailers are now faced with the challenge of having to reconcile reduced demand, pre-orders for subsequent collections, and restricted liquidity margins. Find out where this is currently particularly difficult and how it can still be achieved on the following pages.



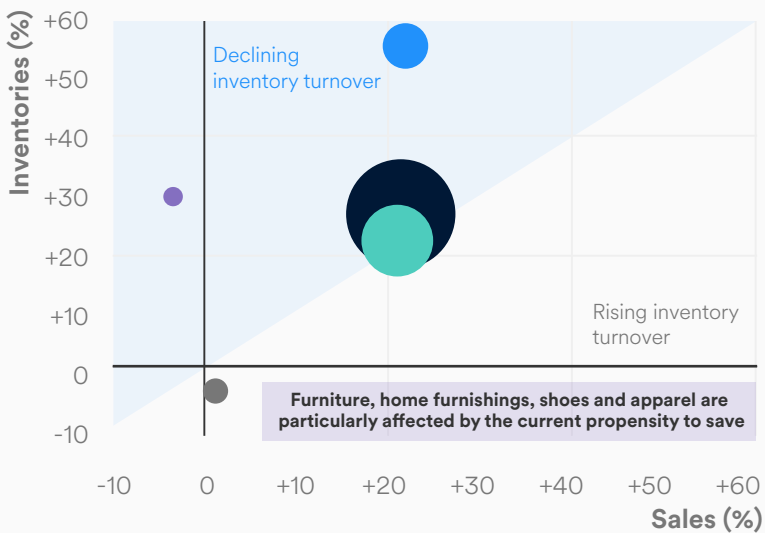
Sales vs. inventories:

From out of stock (2021) ...
Q2/2021 vs. Q2/2019



- Department stores
- Food and beverages
- Fashion
- Consumer electronics
- Furniture/Home/DIY

... to partially overstocked (2022)
Q3/2022 vs. Q2/2021



- Department stores
- Food and beverages
- Fashion
- Consumer electronics
- Furniture/Home/DIY

Note: Median growth in each case (development in %); circle size corresponds to sales (absolute figures)
Source: CapitalIQ; FTI-Andersch



Not all segments are equally affected

Challenges in liquidity management

Looking at the economic consequences for companies, shifting working capital ratios are to be noted. Increasing consumption restraint is reflected in a deterioration in the ratio of sales to inventories (*inventory turnover*), which restricts available liquidity.

Accounts payable are also being settled late: according to Creditreform, payment delays are on the rise due to liquidity bottlenecks, which is why companies are increasingly shortening payment terms. According to Coface, this is mainly due to companies operating mainly in Germany.

The cash conversion cycle is deteriorating, resulting in greater capital commitment and lower cash and cash equivalents – and thus also impacting retailers' pre-order behavior for the coming seasons.

Fast moving consumer goods are currently more robust

The overall picture of „merchandise selling pressure“ as a result of the buildup of inventories in the retail sector varies greatly by sub-segment: everyday purchases, especially in food and beverages and personal care items, offer initial savings potential for consumers. In this context, it is primarily specialist retailers (e.g. organic food retailers) that are seeing a decline in sales, while discounters are benefiting. In addition to changing the place of purchase, consumers are increasingly avoiding more expensive branded products and are turning to cheaper alternatives, especially private labels (so-called *trading down effects*).

However, food retailing is structurally comparatively resilient to external shocks – and will, for example, benefit from the foreseeable decrease in the number of restaurant visits. Large retailers are also able to limit price increases of manufacturers more frequently and pass them on to consumers due to high market concentration and negotiating power (s. chart 1, p. 07).

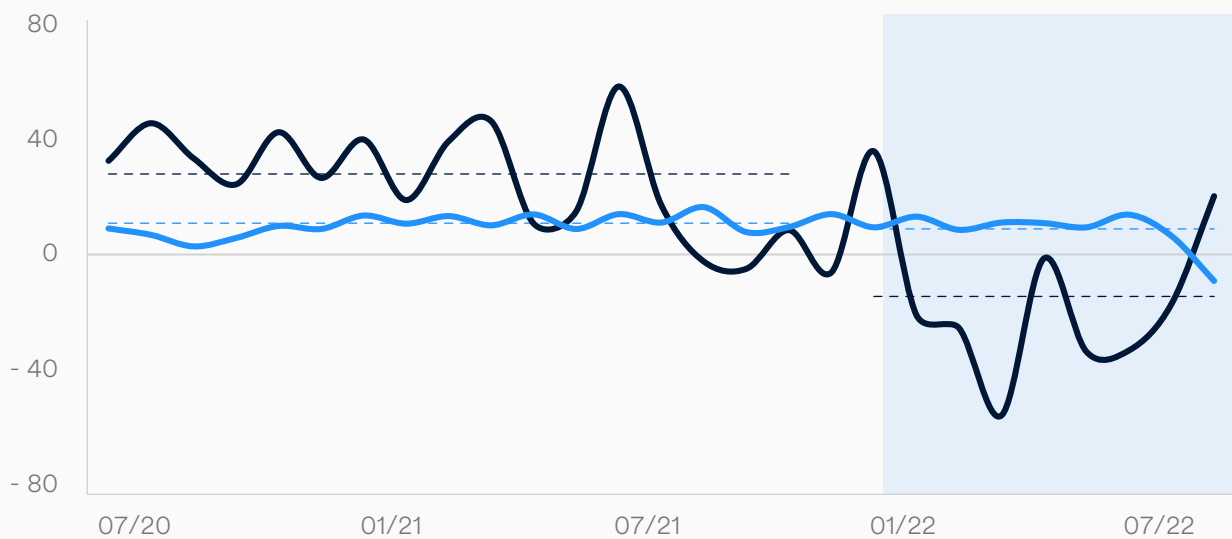


Retail in Germany: Sales and inventories

(ifo survey, 100 = good situation or improvement expected, -100 = poor situation or deterioration expected)

— Sales YoY - - - Average (2019-21 and 2022)
 — Inventories - - - Average (2019-21 and 2022)

1 - Food and beverages



Source: Creditreform; Coface; ifo Institute; FTI-Andersch

Durable consumer goods are hit hardest

The situation is different for durable consumer goods: while retailers in the furniture and home furnishings (home/DIY), leisure/sports equipment, and consumer electronics segments were the main beneficiaries of the lockdowns in 2020/21 due to the absence of vacations and the limited public life, these segments are now suffering the most from the drop in consumption.

According to the industry association bevh, online retailing in the Home/DIY segment recorded sharp sales declines in the double-digit percentage range (furniture/lamps/deco, for example, -15.6% in Q3/2022 alone) – the situation is similar for consumer electronics, where, among others, PC sales slumped by -20% year-on-year according to Gartner (s. chart 2, p. 08).

In the fashion sector (apparel/shoes), too, many consumers currently see potential for savings, which is reflected, for example, in a widespread increase in returns. Leading fashion retailers (including Zalando) lowered their sales forecasts for the current year, in some cases significantly. Here in particular, a high level of seasonal goods – and therefore high sales pressure in a limited time window – is encountering comparatively long order lead times, which is currently presenting many retailers with challenges (details p. 13), (s. chart 3, p. 08).

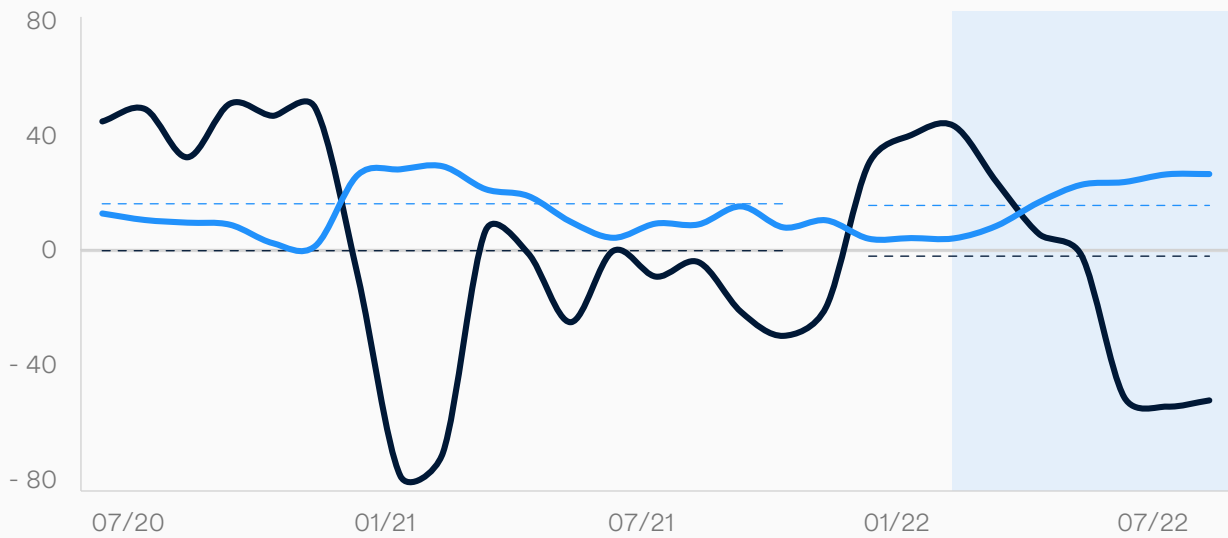


Retail in Germany: Sales and inventories

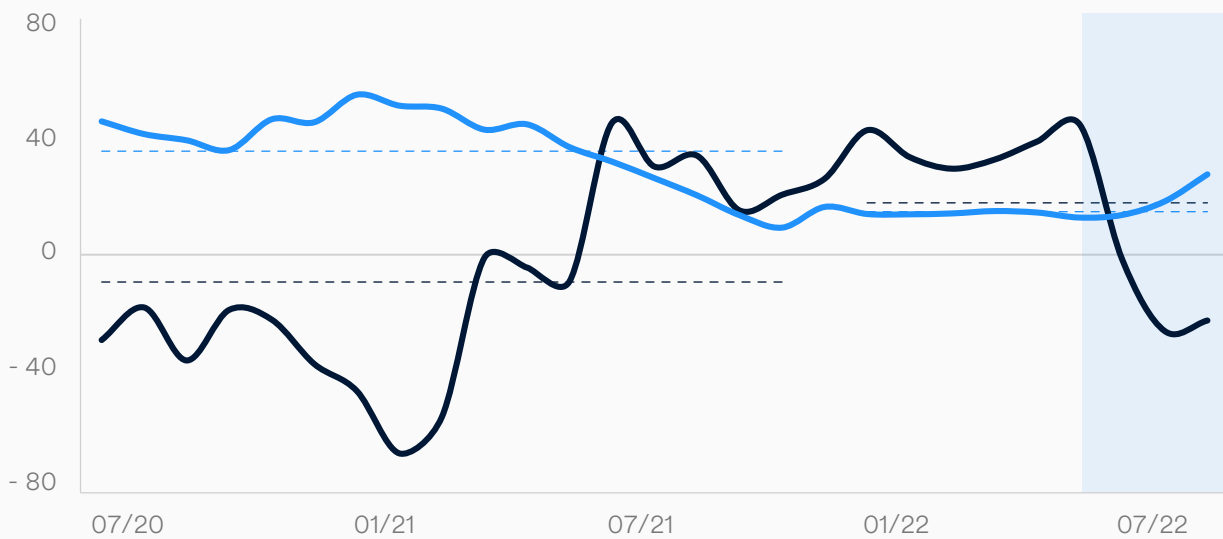
(ifo survey, 100 = good situation or improvement expected, -100 = poor situation or deterioration expected)

- Sales YoY
- Inventories
- Average (2019-21 and 2022)
- Average (2019-21 and 2022)

2 - Furniture/Home/DIY



3 - Other retail (esp. apparel and cosmetics)



Source: Creditreform; Coface; ifo Institute; FTI-Andersch



Pull-forward and compensatory effects

High inventories are thus attributable to demand pull-forward effects in 2020/21, particularly in the area of consumer durables, which inevitably had to lead to lower sales volumes as a result in later periods (compensatory effect).

In addition, many retailers had hoped that the economy would pick up after the pandemic was „overcome“ in 2022. Ongoing supply chain disruptions and (from today’s perspective) overly optimistic economic expectations were thus the reasons for excessive ordering behavior and the current overstocking.

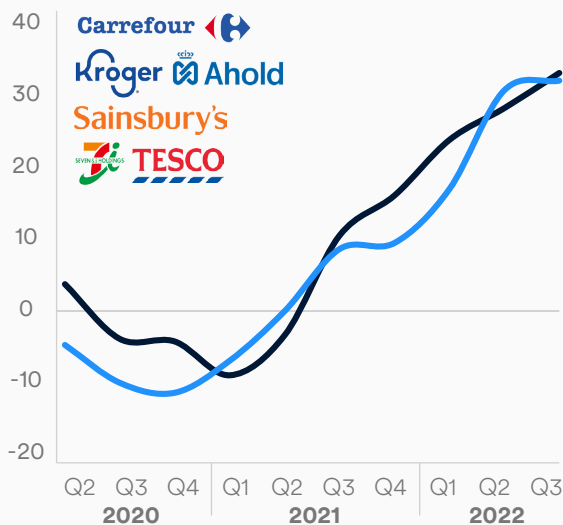
International market environment

A look at the latest financials of international listed corporations paints a comparable picture: while many retailers were still out of stock in 2020-21, they now tend to be overstocked.

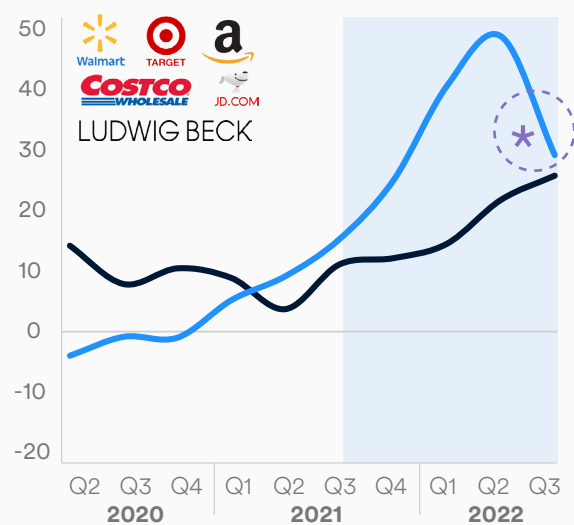
Global: Development of sales and inventories in key retail segments⁽¹⁾
(% yoy)

— Sales — Inventories

Food and beverages (n=24)

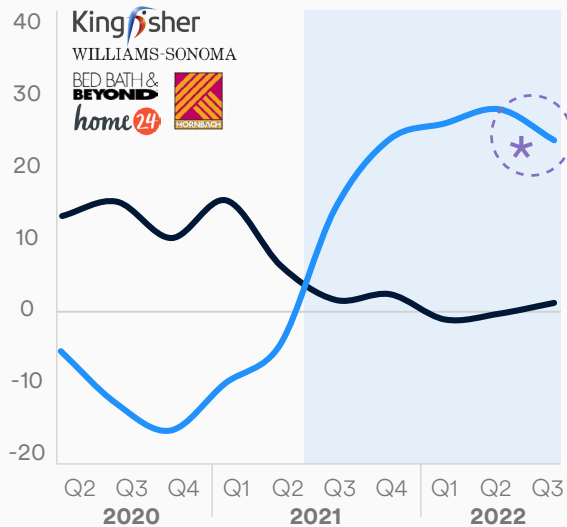


Department stores (n=27)

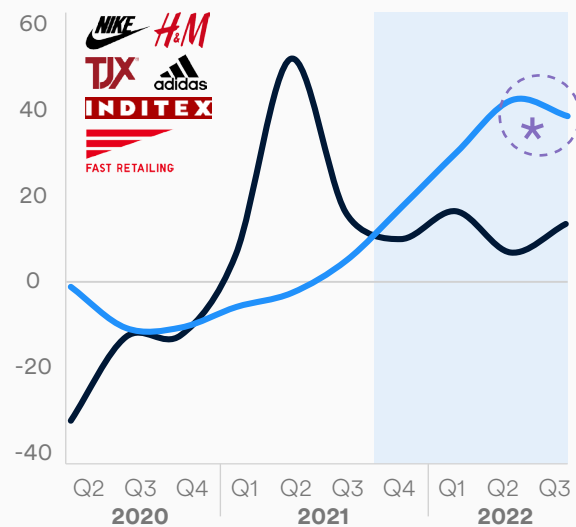




Furniture/Home/DIY (n=20)



Fashion (n=27)



(1) Due to heterogeneous quarter end dates, results from previous quarters have been included in some cases
 * Early start of the sell-off period and more selective ordering
 Source: CapitalIQ; FTI-Andersch

During the COVID-19 peak, sales of verticalized consumer goods manufacturers and retailers often grew faster than their inventory levels. In many areas, increased demand was met with limited supply due to supply chain disruptions – especially in consumer electronics, sporting goods, and furniture, the surge in demand (especially during lockdowns) was met with reduced availability. Retailers were hurt by the experience of simply not being able to meet their customers’ demand. The resulting increase in order volumes materialized in higher inventories with a delay from H2/2021 onwards. At the same time, sales growth slowed as a result of the current challenges (including a shift in consumption towards services, changes in the consumer goods mix in demand, and trading down).

Despite the internationally comparable trends, retailers with a high dependency on the European market are particularly affected. According to estimates by international economic researchers (including the OECD), no industrialized country has been more severely affected by the economic slump resulting from the energy crisis than Germany; at the same time, the crisis is intensifying in the United Kingdom, among other countries. This trend will continue in 2023: further declines in demand are expected for spring 2023 in particular.



Focus segment: Fashion

– From the frying pan into the fire

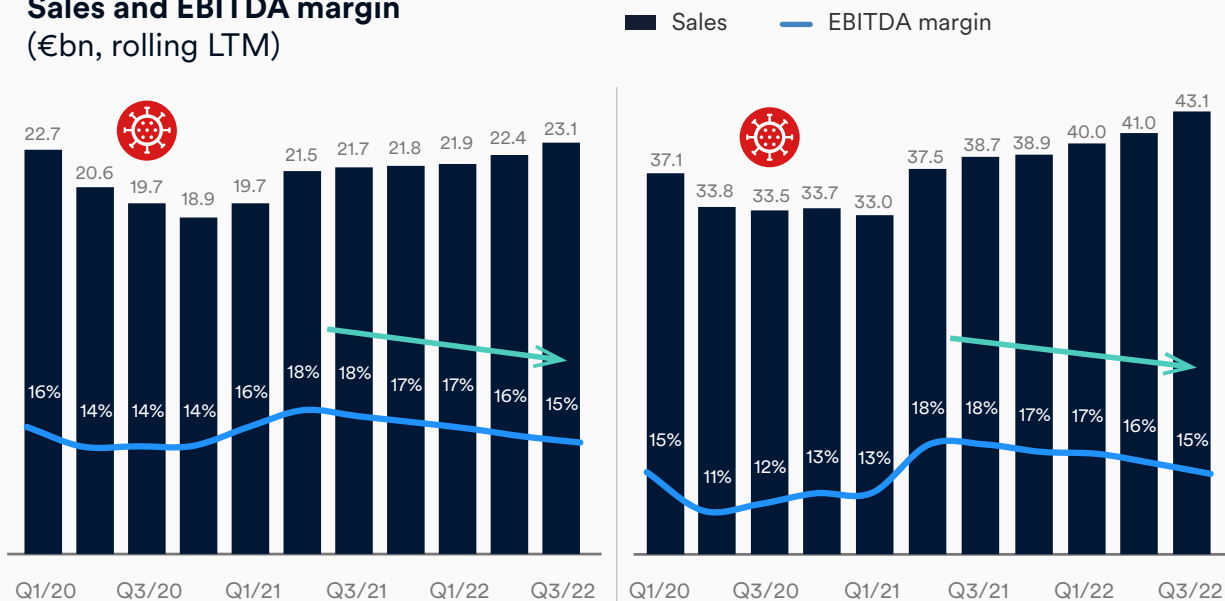
The fashion segment (apparel/shoes) especially suffers from an unfavorable combination of individual factors: the high share of fashionable and/or seasonal goods – i.e., high sales pressure in a limited time window – coincides with comparatively long order lead times due to highly globalized supply chains. Reacting at short notice is only possible to a limited extent, if at all. Once the goods have arrived after months of pre-ordering, they have to be sold.

Added to this is the current weakness of the demand side: in view of full closets, here in particular many consumers currently see potential for savings, reinforced among other things by the increased home office quota and a possible renewed run-up of the pandemic, which could result in restrictions on private and public events – albeit to a lesser extent than in previous years.

Leading fashion groups: Development of sales, profitability, and working capital

	Q3/22 YoY	Sales LTM	+6%		Q3/22 YoY	Sales LTM	+7%
		Net working capital	+34%			Net working capital	+48%
		Inventories	+72%			Inventories	+69%

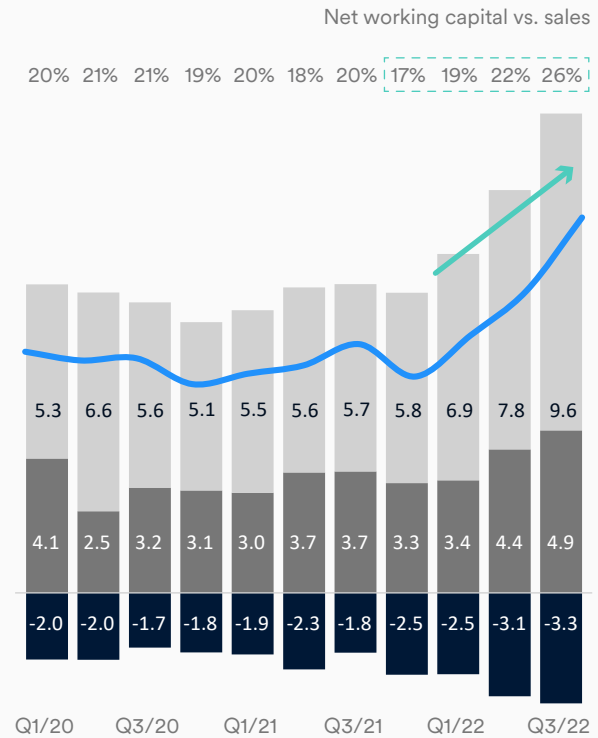
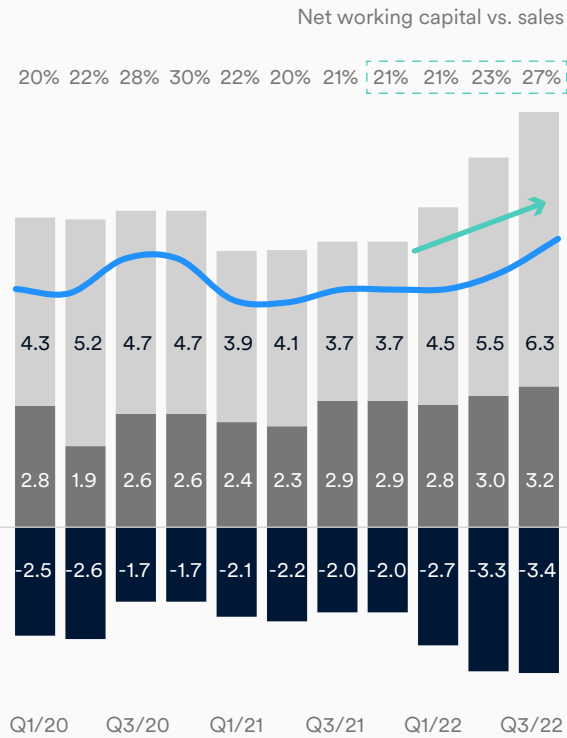
Sales and EBITDA margin (€bn, rolling LTM)





Working capital
(€m, as of the quarter end)

■ Inventories ■ Accounts rec.
■ Accounts pay. — Net working capital



Source: CapitalIQ; company information; FTI-Andersch

A look at Adidas and Nike, the verticalized market leaders in sports fashion, reflects recent developments: On the supply side, both companies continue to face supply chain disruptions. Lock-downs in Vietnam limited availability of merchandise in 2021 – longer lead times are expected in the future.

Increases in Nike’s inventories are, among other things, also due to higher in-transit inventories (i.e. goods that have not yet arrived at the final point of sale). According to Flexport Ocean Timeliness Indicator, the transport time for containerized cargo from Asia to Europe is currently around 80 days – around 25 to 40 days more than in 2019. In Western Europe, port congestion off Hamburg and Rotterdam is further exacerbating the situation.

Sales in Q3/2022 – in addition to general consumer weakness in Western markets and volatile currency effects – continued to be impacted by Zero-COVID-driven lockdowns in China and the dissolved Russia business. Excess inventories were partially reduced by low-margin promotions.



Focus segment: Fashion – Contrasting developments

The shifts in consumer behavior since the start of COVID-19 can be seen in the development of selected market participants: while e-commerce specialists such as Zalando and ASOS profited strongly until the end of 2021, a reversal of the trend has recently become apparent. The development of market participants in the entry-level price segment such as TJX (or in Europe: TK Maxx) and INDITEX (including Zara) is contrary to this. Consumers are increasingly turning to lower-priced alternatives and promotional merchandise – or opting for lower-priced retailers (*trading down effect*).

The growth of the e-commerce specialists was mainly driven by the lockdowns in brick-and-mortar retail. Sales grew faster than inventories, which increased significantly in the following quarters. However, due to increased competition (e.g. SHEIN), loosening of restrictions for brick-and-mortar retail, and the clouded consumer sentiment, sales growth eased recently. Between March and October 2022, real sales declined by -9.6% on average.

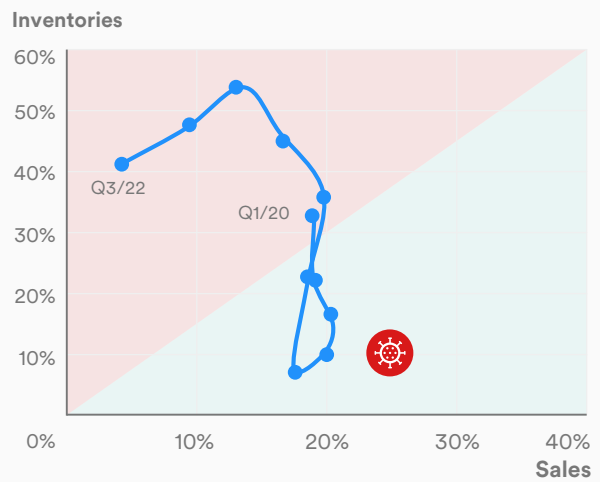
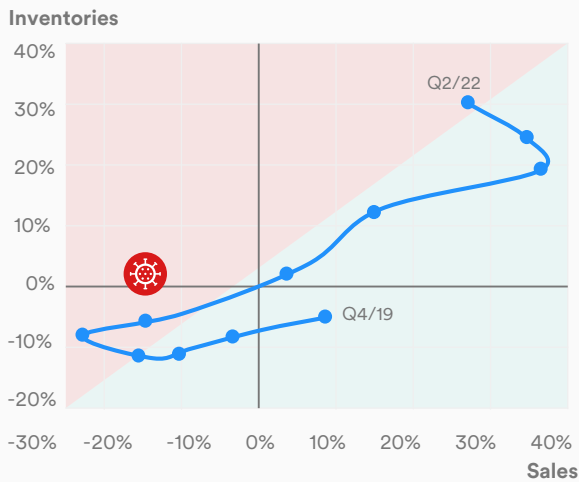
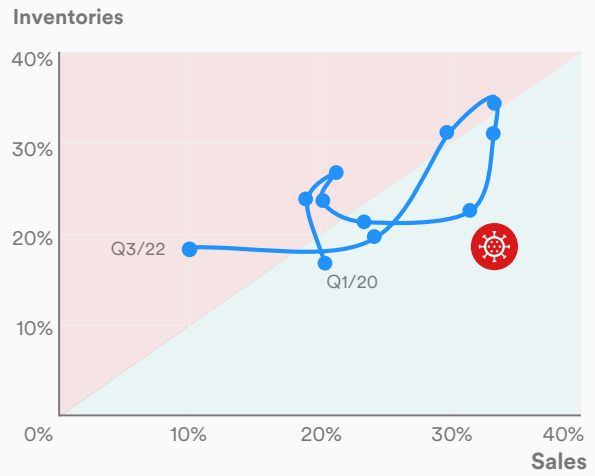
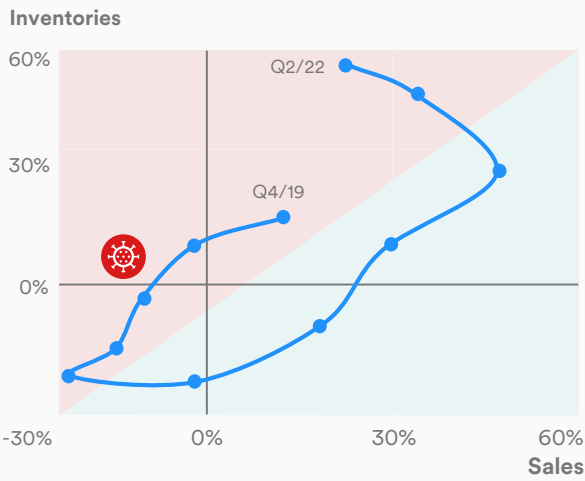
As a result, inventory turnover fell sharply. The first market participants filed for bankruptcy (e.g. Missguided in May 2022), listed companies recently announced disappointing results and outlooks. The gloom is reflected in the stock prices since the beginning of the year: -62% for Zalando, -76% for Asos, -74% for About You (until Nov. 30, 2022).

As a measure to stabilize working capital and the supply chains, some market participants (e.g. Zara, Uniqlo) halted free returns, also in order to reduce return rates. The buildup of inventories at INDITEX is a result of concerns about supply shortages in the next six months. It is not unlikely, however, that many fashion retailers will again experience bottlenecks in the coming year – on the one hand, they often lack the liquidity to pre-order the next collections, and on the other hand, the experience of too full warehouses is likely to cause many retailers to plan for significantly lower demand in the future.



Global: Development of sales and inventories
 (Sales LTM rolling and inventories LTM average, % YoY)

Declining inventory turnover
 Rising inventory turnover



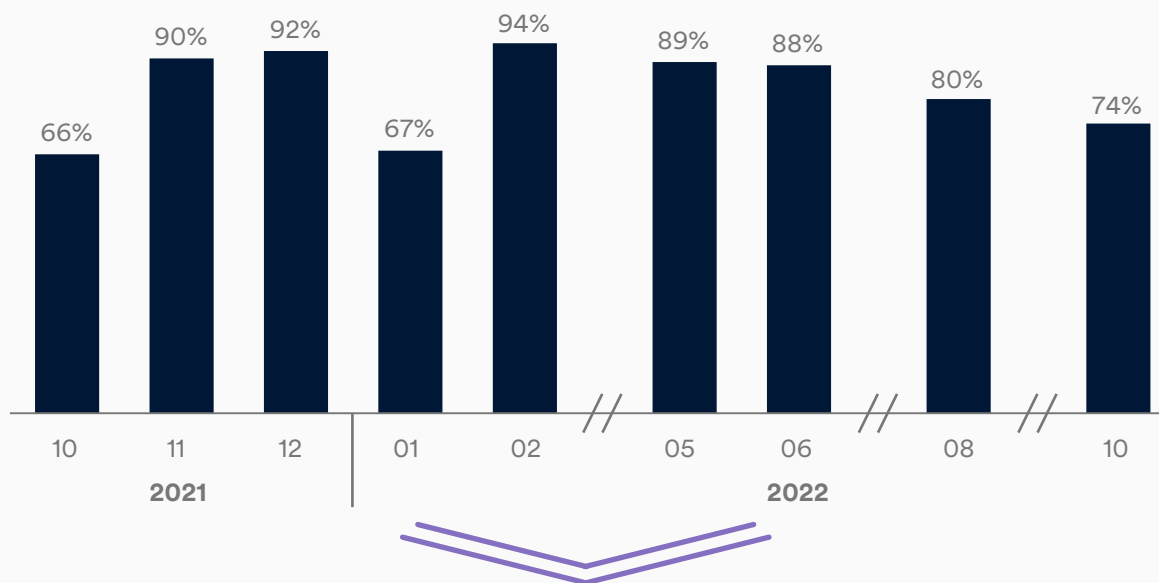
Source: CapitalIQ; Drapers; Financial Times; company information; DESTATIS; FTI-Andersch



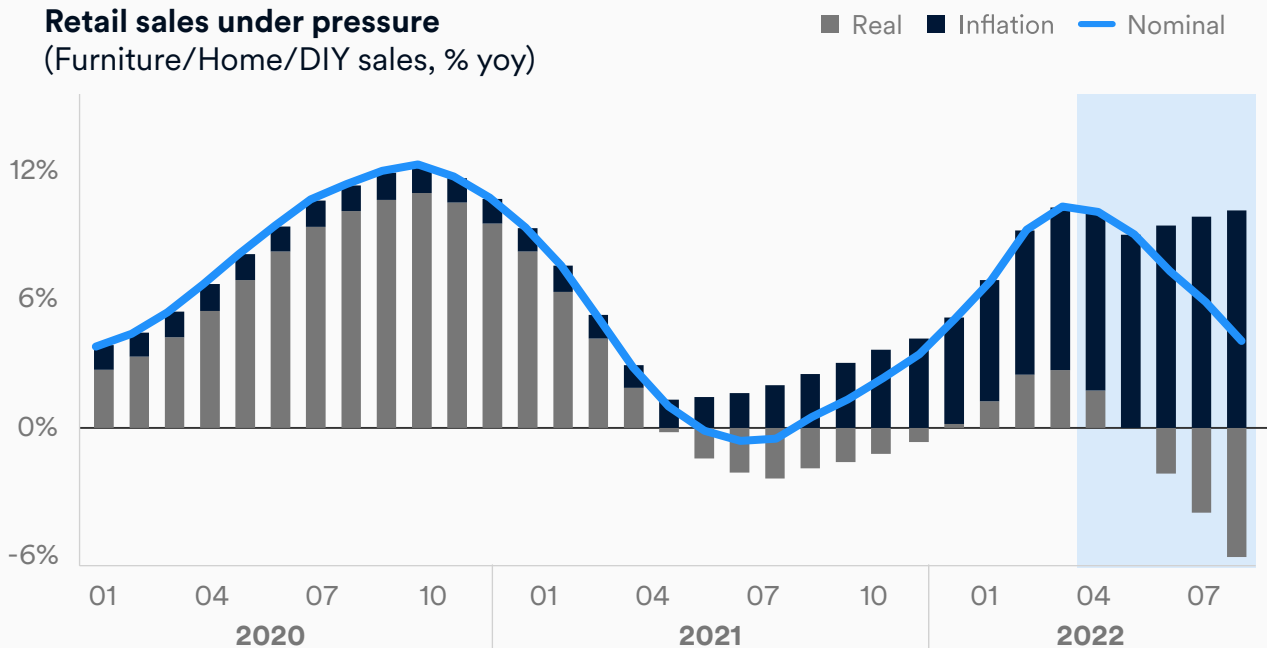
Focus segment: Furniture/Home/DIY – a rollercoaster of emotions

The development of the furniture, home, and DIY segments is subject to similar market drivers – from „cocooning“ during the COVID-19 lockdowns to dependency on new construction activity, and declining consumer sentiment since the beginning of 2022. Therefore, the sub-segments are considered collectively here, even though they are partially characterized by different portfolios, distribution, and sales channels (furniture retailers, home furnishing specialists, verticalists, DIY stores, etc).

Persistent supply bottlenecks in furniture retail (% share of companies affected)



Retail sales under pressure (Furniture/Home/DIY sales, % yoy)

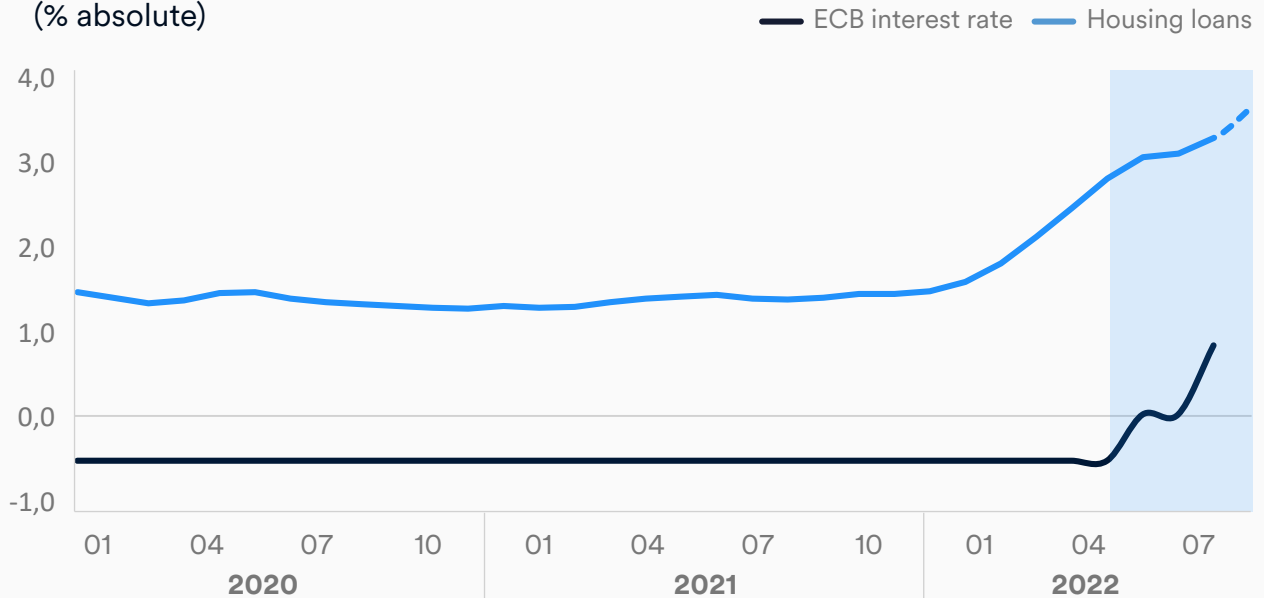




As a result of the „cocooning“ effect during the COVID-19 peak, the segment recorded high growth until spring 2021. However, following strong prior periods, real growth stagnated in the subsequent months, and increasing supply bottlenecks and raw material price increases were reflected in rising price inflation.

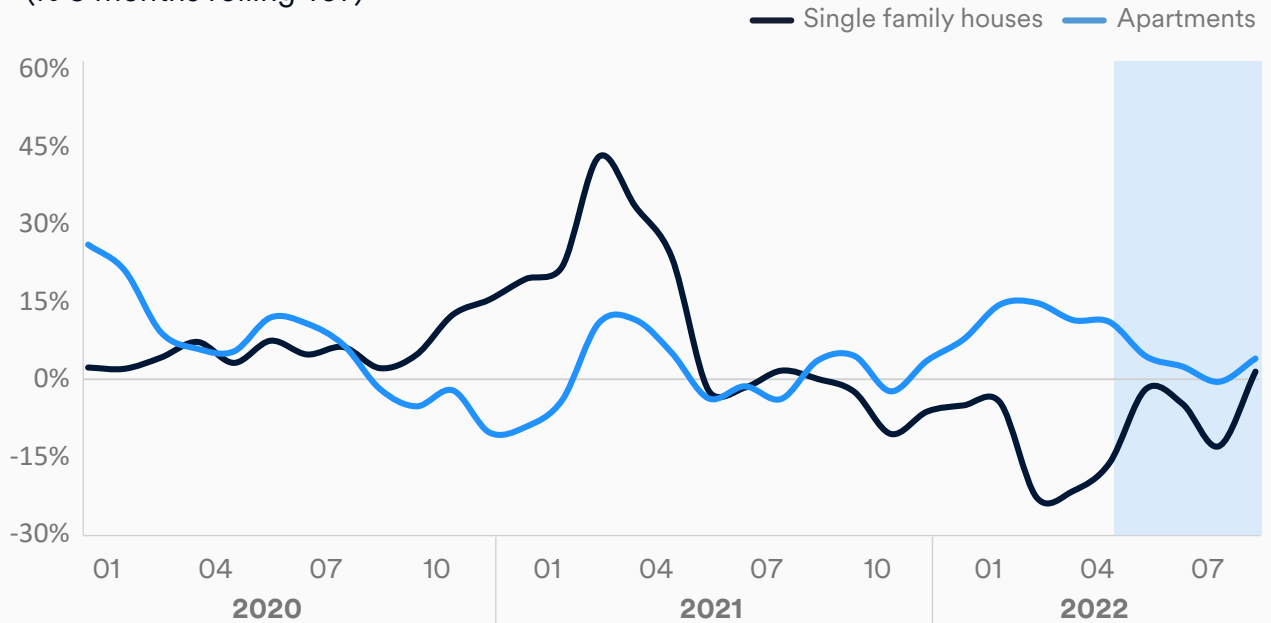
In the first five months of 2022, sales developed robustly despite the Ukraine war and the high level of the previous year. Since June at the latest, the declining consumer sentiment and consumption shifts have impacted retailers, exacerbated by the subsequent balancing effects of the demand in 2020/21, which was partly pulled forward. The upholstered furniture and home furniture segments as well as online retail are particularly affected (based on the very high prior-year figures). In Q3, 79% of the furniture retailers reported low customer frequency – a negative record in the overall weakening retail sector (Ø 46%).

Rising interest rates in housing financing
(% absolute)





Declining construction activity: new housing starts approvals (% 3 months rolling YoY)



Source: Bundesbank; CapitalIQ ; DESTATIS; ifo; Möbelkultur; TextilWirtschaft; company information; FTI-Andersch

The segment will remain under pressure for the foreseeable future: the decline in new construction activity will have a negative impact on demand for furniture and furnishings. Due to rising financing costs (increase in borrowing rates of +1.6%-pts. between 1-8/2022), applications and permits for residential construction are declining sharply – especially for single-family houses. At the same time, cancellations increased sharply recently (15% of construction companies affected).

Initial distortions can be observed, for example, in the share prices of online retailers in the furniture/home/DIY segment (including Home24). Competitors with strong market positions are using the current period to drive market consolidation. For example, Home24 was acquired by Germany's second largest furniture retail chain XXXLutz, fashion retailer Next Retail acquired Made.com from insolvency. Market leader IKEA (Germany) recently published positive results (*trading down effect*) and has not yet recorded any decline in visitor frequencies despite price increases.



How to deal with overstocked warehouses?

How can market participants deal with a situation that poses major challenges even to global market leaders – especially since the situation is the result of decisions made months ago that were often too optimistic and must be dealt with in the short term?

In particular, retailers with a high proportion of seasonal merchandise sales and/or a high degree of fashion (fashion and home segments) only have a limited time window in which to sell their merchandise. They are forced to reduce their inventories through discounts or sales to secondary sellers (e.g. TJX, Best Secret) in order to ensure adequate liquidity – this is essential for the pre-financing of a sufficient volume of upcoming seasonal merchandise.

In view of an expected further economic slowdown at the beginning of 2023, the sale of inventories before Christmas 2022 is of critical relevance. Discounts play a central role in this.


However, there is no universal answer to the question of when and to what extent goods should be discounted: among others, it is necessary to define the right time and price points based on the concrete liquidity requirements and specific competitive environment. If discounts start too early and extensively, this will have a negative impact on both profitability and brand image. However, if discounts are initiated too hesitantly, there is a risk of customer churn and insufficient inventory reduction – retailers are literally left sitting on their goods.


Cash profile in seasonal retail








Which aspects increase resilience in the current market environment?


- 


Lower share of seasonal merchandise
reduces sales pressure due to possible sale at a later date
- 


Local proximity of production
reduces necessary pre-order lead times and thus increases response speed
- 

Strong market position and/or brand
enables strong negotiating position towards suppliers and possibly customers
- 

Diversified sales markets and channels
to cushion weak sentiment, especially in DE/UK; multi-channel at advantage
- 

Timely buildup of liquidity
allows enhanced perseverance in weak sales and margin market environment
- 

Price positioning benefiting from trading-down effects
to gain market share as consumer budgets shrink
- 

High degree of verticalization
grants recourse to production and increased inventory and cost control
- 

Flexible fixed cost base
to cushion sales declines while protecting margins and liquidity

Source: FTI-Andersch



Leveraging financial resources

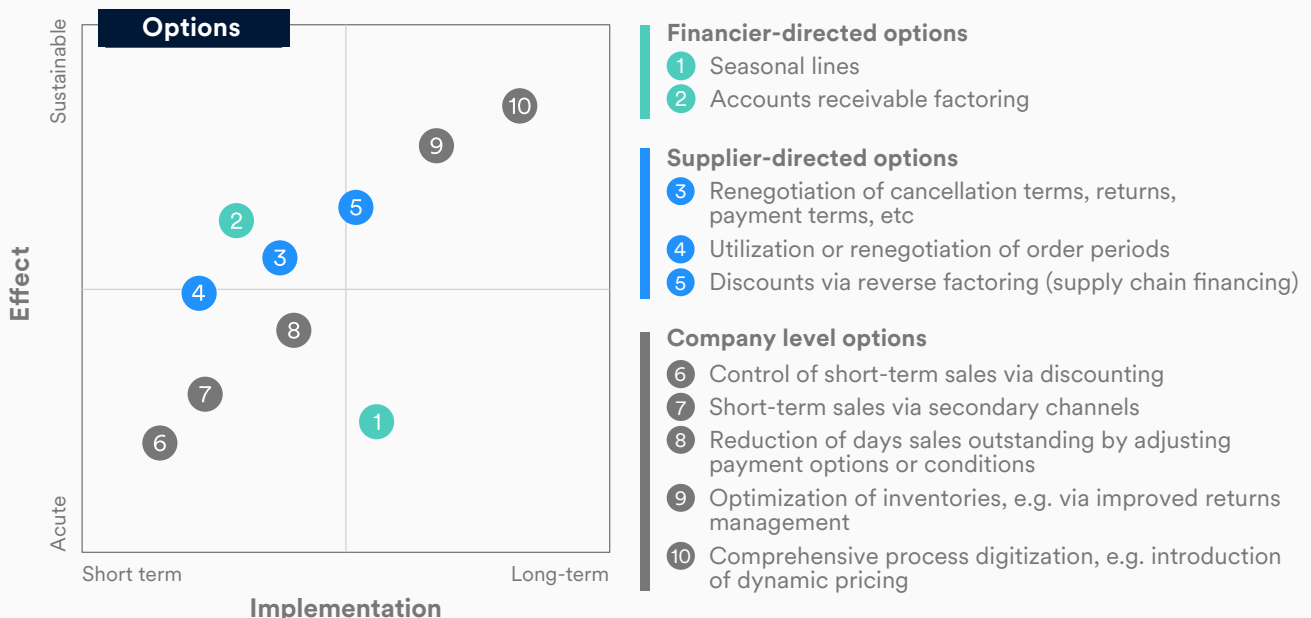
Retailers' standard tools include external financing options such as seasonal lines and factoring. In order to cushion the financial pressure in the short term, it can make sense – even in the current situation – to actively pursue discussions with financiers. In this context, it is important to demonstrate a reliable perspective to the providers of capital.

However, the economic slowdown is fostering increasing caution on the part of financiers and requires a stable asset base (including equity capitalization). In addition, many retailers are still cash-strapped as a result of the COVID-19 crisis, while the latest key interest rate hikes have led to a further clouding of the (re)financing environment: according to a recent ifo survey, 15% of the retail companies already report more restrictive lending.

In addition, the growing online business increasingly ties up liquidity due to the required returns management (including return periods of up to 100 days), the comparatively more complex supply chains, and the option of purchasing on account.

Against this backdrop, instruments of classic internal financing are gaining in relevance, primarily the optimization of working capital. This is particularly true since an overall deterioration in relevant working capital ratios has been observed since the beginning of the COVID-19 crisis (*for analysis, see page 22*), especially in fashion retail.

What are the options for action?





Maximizing liquidity

On the one hand, liquidity management should be optimized through internal measures (including digitization of operational processes, establishment of a “cash culture”, etc). On the other hand, the negotiating power vis-à-vis and mutual willingness to cooperate with suppliers and – especially in the case of consumer goods manufacturers – also with customers and marketing partners play a central role.

Particularly in the current situation, targeted negotiations with suppliers can help to maximize order periods, renegotiate cancellation conditions, or grant a 100% right of return in order to reduce the company’s own marketing risk.



In order to release liquidity in the short term, in addition to early sales through early discount campaigns (see page 18), inventory-optimizing options for secondary sales through alternative channels should also be considered. It is also important to analyze options that would not normally be considered for strategic reasons – but may be unavoidable in an emergency („fire sale“). Marketing via secondary channels can offer the advantage of reducing negative spillover effects (e.g. conditioning of end customers, damage to (premium) brand image, etc).

More fundamental measures, i.e. measures that have a more sustainable effect but at the same time need to be established over the longer term, include a dynamic pricing system that is based primarily on market information such as supply, demand, etc (if demand increases, prices are increased – if demand falls, prices fall). The aim is to set optimal parameters for the so-called dynamic pricing and/or to enable readjustment in the algorithm/continuous adjustment of the parameters. Since the ideal time and the optimal level of discounts regularly shift within a season, retailers should ideally be able to react in real time – based on the latest demand/customer information.



Working capital: focus on the essentials

Development of working capital KPIs of selected retailers (Ø in days)

SEGMENT	DIO		+	DSO		-	DPO		=	CCC			
	2019	2022 ⁽¹⁾		2019	2022 ⁽¹⁾		2019	2022 ⁽¹⁾		2019	2022 ⁽¹⁾		
 Fashion	Top ⁽²⁾	97			4			100			31		
	Ø	119	▶	139	26	▶	26	69	▶	78	75	▶	87
	Bottom ⁽³⁾	154			41			47			116		
 Furniture/ Home/DIY	Top ⁽²⁾	93			6			81			31		
	Ø	106	▶	117	13	▶	11	82	▶	82	37	▶	46
	Bottom ⁽³⁾	130			15			51			72		

Retailers in the fashion and furniture/home/DIY segments are currently under pressure. The main driver of the increased cash conversion cycles is DIO due to full warehouses.

Definition DIO
Ø Inventories / COGS * 365 days

The picture within the segments is heterogeneous, depending on specific markets and channels as well as price positioning and verticalization.

(1) Last six months; (2) Start of 3rd quartile; (3) Start of 1st quartile
Source: CapitalIQ; company information; FTI-Andersch

Dealing with conflicting goals

When optimizing working capital management, potential conflicting goals must be accounted for. Otherwise, for example, the ability to meet demand will quickly be impaired by a blanket reduction in inventories of the wrong items. The optimal amount of “safety inventories” must also be reconsidered due to the consequences of the COVID-19 crisis and the Ukraine war. Since, on the other hand, blanket hoarding can quickly lead to an overextension of liquidity, a differentiated approach is essential.

System-side simulations of efficiency and measure effects help to identify dependencies and minimize the risk of unintended side effects. This type of analysis, deriving measures from uncondensed system and mass data bottom-up, enables new approaches to optimize working capital: tailored individual measures replace blanket empirical variables and simplify best possible decisions in multi-dimensional problems.



Identifying the „right data“

Difficulties in implementing working capital measures often arise in connection with low levels of digitization – for example, because analyses are based on aggregated key figures or implementation is based on delayed control information. Heterogeneous data sources also complicate the analysis.

To exploit existing liquidity potentials as far as possible, the first step is to create a transparent data base. For this purpose, suitable digital tools and automated processes for data processing (e.g. ETL processes) must be established that homogenize the “flood of data”, process it in a structured manner, and reduce manual work significantly.

Optimizing sustainably

Sustainable working capital optimization requires a high level of expertise in the digitally supported extraction and processing of extensive data volumes. Liquidity potentials are identified through granular analyses (single document level, transaction data) and formulated in a way that can be implemented. Movement and valuation data of receivables, payables and inventories can be analyzed by means of algorithms regardless of the size of the company. In this way, the right levers can be pulled in a targeted manner, so „yo-yo effects“ can be avoided.

Often, the implementation of the corresponding digitization steps is delayed due to supposedly long implementation times and high investment requirements. However, the path to individual digitization can be divided into any number of small phases. This promotes practical feasibility and helps to pragmatically overcome any hurdles.

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From out of stock to overstocked? Effectively manage high inventory and limited liquidity

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