Is Retail a Sector to Avoid?

by Malcolm Howard

In May 1973, Ted Heath, the Conservative Prime Minister, upon answering questions with regard to the Lonrho affair, said, "It is the unpleasant and unacceptable face of capitalism, but one should not suggest that the whole of British industry consists of practices of this kind."

It could be argued that some food retailers and some restaurant chains represent the unpleasant and unacceptable face of capitalism, although all not by the same degree.

Many large retailers have become renowned for screwing their suppliers to the deck on price and then being very slow to pay them (see table below). On top of this, we have recently seen, on a television programme hosted by Hugh Fearnley Whittingstall, the absurdity of farmers have to destroy roughly a third of their crop as the fruit and vegetables were not of a standard shape and size. This is especially absurd when the squeeze is so bad that the farmer is forced to close down, which will inevitably lead to higher priced imported food.

Well, you might ask 'what is this to do with investors?' The simple answer is that this is just one example of how inefficient these large companies have become. Rather than rejecting any out of shape produce, why do retailers not agree to buy such produce at half price and sell it at half price? There are many people who would accept so called sub shaped produce if the price was right.

This, of course, leads to what can be regarded as another unacceptable face of capitalism. These companies always sell at the lowest price possible and to achieve this they pay low wages, very near the national minimum wage. The last Labour government realised that low wages led to poverty which consequently led to ill health and a strain on the NHS. But they were afraid to appear anti-business so rather than face the real problem they introduced tax credits. Low paid employees were now surviving, but the policy encouraged employers to keep wage rates low.

At this point, we need to differentiate between the 'minimum wage' and the 'living wage'. The 'minimum wage' was introduced by the Labour government and it set a mandatory minimum rate per hour that employers have to pay. The 'living wage' is a rate per hour set by an independent organisation called 'The Living Wage Foundation' and is the minimum rate someone could reasonably expect to live on if they worked full time. The current living wage is £8.25 per hour and the London living wage is £9.40 per hour. These figures compare with the current minimum wage of £6.70 per hour. George Osborne, the Chancellor, said from next April 'the national living wage will be £7.20 per hour. I am afraid this is spin; the reality is that the national minimum wage is going up to £7.20 per hour.

Even this lower figure has caused executives from Whitbread plc and JD Wetherspoon plc to squeal that they cannot afford this increase. The Chief Executive of Tesco plc has also complained the company cannot afford business rates. An examination of the latest full year accounts clearly shows why they are moaning.

	Profit/(loss) (£'m)	Debt (£'m)	Creditor days (1)	Number (2)
J D Wetherspoon	44.8	641.1	73	17,885
Whitbread	366.1	601.8	84	31,005
Morrisons	(761.0)	2,340.0	50	+
Tesco	(5,741)	8,481.0	56	172,598
Sainsbury J	(166.0)	2,879.0	48	85,920

Note 1: Creditor days are calculated by dividing creditors by cost of sales and multiplying by 365. This is only a guide as 'cost of sales' will include items such as wages. This means that the actual creditor days will be greater than the figure shown.

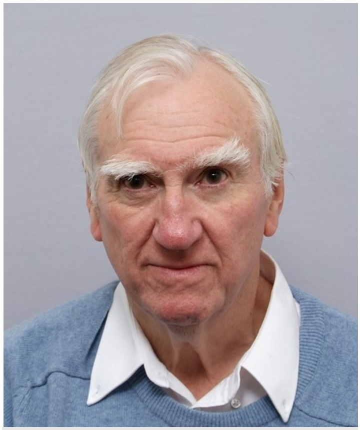
Note 2: JD Wetherspoon show the actual number of hourly paid employees. For other companies I have taken 80% of employees, based on full-time equivalents where shown. For companies operating internationally only UK figures are used where these are shown. For these reasons the numbers should be seen as merely a relative guideline.

+ No figures are available for Morrisons.

A significant problem these companies face is that the

Whitbread - 6-month share-price graph

Chancellor is of the opinion that the country cannot afford tax credits, but when he proposed to cut them the cuts were seen to be so savage that he was defeated in the House of Lords. This means that there will be pressure on companies not only to pay the revised minimum wage, but rather pay the real living wage. We can only guess what the average wage is currently being paid to hourly employees in the retail sector, but if we look at the number of employees involved it can be seen that any move to significantly uplift wage rates will cost each company several millions of pounds. What makes it worse for them is they cannot compete with the new kids on the bock, Aldi and Lidl, so it is difficult to see how they will cope as they cannot increase their prices to remain competitive.



Malcolm Howard - our former Finance Director

The ready meal retailer, Cook, a minor retailer, is already an accredited member of the Living Wage Foundation. That will not worry the above companies, but the killer blow is that Lidl announced that from 1st October 2015 it will pay the official living wage and will increase its rates if they go up. Soon, they also will be another accredited member adding to the hundreds on the list. On top of this, suppliers report that they get a better deal from the two German companies, as these companies pay for what they have ordered and do not return unsold goods. All of which suggests there is a high level of inefficiency somewhere in UK retailers; maybe the result of bloated boardroom salaries and paying unaffordable dividends to keep investors quiet. Either way, lack of profitability, huge debt and the prospect of pressure to pay the living wage (note that all political parties support this) and you get the feeling that something will have to give; that something just might be the share price.

Malcolm Howard

Tesco - 12-month share-price graph