Article

D&O Insight: Retail Risk in 2024

Ashley Dietz • March 19, 2024

Retail businesses are on the front line in today's challenging economic environment. Whether selling directly to consumers or through wholesale channels, the industry is highly exposed to the prevailing climate, since consumer spending typically declines first during periods of economic uncertainty. Retailers face other challenges too. Shifting patterns of consumer demand can dramatically impact those not nimble enough to spot changing trends.

This is all particularly true at the current time. Last year saw an overall surge in large corporate bankruptcies: filings in the first half of 2023 exceeded the total number for the whole of the previous year[1]. Interest rates remain elevated, and while many feel they may have peaked, the possibility of an economic downturn remains. Consumer spending is still volatile. In this environment, how can retailers become more resilient? And what will Directors & Officers Liability (D&O) insurers be looking for in assessing their needs?

It's about what you sell and who you sell it to

Those retailers that sell to businesses that are themselves in the strongest financial health – such as big online or physical retailers – are likely to be more secure than those exposed to struggling companies that are a bankruptcy risk. Similarly, while demand for discretionary products can decline quickly in a downturn, essential items like groceries and baby clothes tend to see less of an impact during times of economic uncertainty.

How a retailer serves its customers is also important. Physical shops with a higher footfall located in mixed-use lifestyle centers are generally better placed than those in malls, which have sometimes struggled in recent years. And many successful companies have taken a multi-channel approach since the pandemic, selling through a combination of physical stores and online platforms. Businesses such as these are better able to stand up to competition from the big online retailers, which can potentially undercut prices more easily.

Ignore the hype

Demand for products that are held to be the latest ‘fad’ among purchasers is also likely to be more volatile. A new brand or idea that dramatically increases in popularity over a short period can often fizzle out quickly. Meanwhile, a product with a longer-term base of devoted customers is likely to be more resilient when times are tough.

As well as examining what a retail business sells, looking deeper into a company’s financials can often help sort the good from the not-so-good. Is the debt sustainable? Will its structure stand the test of economic time, and how sensitive is it to interest rates? During the last downturn, owing too much to lenders - along with a lack of adaptability to change - led to the downfall of several big retail names.

If a company provides guidance to analysts about its financial performance, is it being upfront, realistic and honest about its prospects? Does the retailer face supply chain restraints, and does it have a diversity of suppliers in case one begins to struggle?

Environmental Social and Governance (ESG) excellence will also be increasingly necessary for retail businesses to thrive. Responsible supply chain resourcing is important: failing to do so exposes companies to risks if they do not spot abuses. Promoting more diverse senior management, as well as creating leadership positions and committees dedicated to diversity and inclusion, are all likely to be seen as evidence that a company understands the importance of the issue. Indeed, in our recent Risk & Resilience survey of more than 3,000 business leaders around the world that looks at their sentiment towards risk and resilience across various categories of risk, more than a quarter of the retailers surveyed said they planned to boost workforce diversity. However, regulations linked to ESG vary state by state, so a keen eye on governance requirements is important.

A changing world of risk

The dramatic swings in the retail environment in the last 36 months have led to a series of potential extra risks for businesses in the sector. This was demonstrated in our recent Risk & Resilience survey undertaken this January, where more than 90% of retailers surveyed, felt they now operated in an environment of high or moderate risk.

After a short-term boost from stimulus funds in the wake of the COVID-19 pandemic, consumer spending has slowed in recent years, resulting in issues for retailers that - if not addressed - could potentially lead to securities litigation. Some, for example, were too slow to communicate the changing conditions to investors, leading to lawsuits about the accuracy and timeliness of their disclosures. Many others are experiencing inventory challenges: they stocked up when demand was high and supply chains were tight, but as consumer spending declined, they were left with an oversupply of goods. This has opened them to the potential for litigation around their inventory management.

Exposures like these can trigger a requirement for different or extended insurance policies to ensure a company is fully protected. Indeed, many retail businesses appear to understand this. Nearly 30% of respondents in our Risk & Resilience survey said they were planning to explore insurance with risk/crisis services in the future.

The past *can* be a guide to the future

Retailers which have gone through prior recessions are likely to be better placed to survive economic upheaval than their rivals. And those that have in the past been able to evolve their offerings are likely to prove the nimblest in the future.

Resilient retailers are likely to have a diverse range of products, sell through multiple channels and already have solid financials. But the current economic climate will be testing. To navigate the uncertainty, they will need to work with an insurer offering quality coverage and a long history in the sector. Retailers that partner with an insurer that is flexible to their needs and has a deep understanding of their industry based on many years of experience and are alert to the risks they face, should be better placed to thrive in the years ahead.

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[1] Reuter, Dominick. “More than 2800 stores are closing across the US in 2023. Here’s the full list.” October 18, 2023. Business Insider.