ACS | the voice of local shops

Evidence in Advance of the Budget 2011

Summary & Recommendations

The Association of Convenience Stores represents 33,500 local shops. (Annex1) These businesses are crucially important in bringing economic recovery into communities throughout the UK. The Budget offers opportunities to support local stores to do this, but could also bring costs which would damage the recovery for these important businesses.

SECURING RETAIL GROWTH

- **Build strategy aimed at long term sustainable growth in which retailers of all kinds are supported**
- **Resist any move to liberalise 'town centre first' planning rules that prevent the depopulation of existing retail centres and encourage retail led regeneration and diversity**

BUSINESS RATES

- **Review the inflation indicators used to determine annual business rates increases.**
- **Resist moves to a localisation of the setting of business rates**
- **An urgent review of the current rating scheme for convenience stores trading on petrol forecourts.**

EMPLOYMENT COSTS

- **Avoid further increases in employment costs until the economy has developed a stable level of growth**
- **Stop 'inflation busting' National Minimum Wage increases**

LENDING

- **Empower in branch managers to investigate and agree applications at local level.**
- **Greater transparency in the process for applying for finance.**
- **Rejections of applications should come with advice to the applicant on other forms of finance and why their claim failed.**
- **Clarify the lending commitments made by Banks' in Project Merlin that SMEs will still have access to finance even if the projections for demand is low.**
- **Extend the 12 month pre re-financing dialogue for loans to other types of credit and changes to the cost of that credit.**

VAT

- **Retain the VAT exemption of food, news and magazines.**

ALCOHOL AND DUTY FRAUD

- **A radical rethink of existing enforcement priorities, agency responsibilities and sentencing aiming to recoup 50% of the revenue lost to alcohol and tobacco duty fraud – equivalent to in excess of £2 billion in revenue**
- **Penalties for bootlegging tobacco or alcohol to be brought into line with those for dealing Class C drugs.**

FUEL DUTY

- **No implement the 1p increase in fuel duty scheduled for April 2011.**

SECURING RETAIL GROWTH

In the period up to the 2009 the UK retail sector has experienced a period of significant growth. In the thirteen years between 1997 and 2009, total retail sales excluding fuel grew in real terms by 52.3 per cent, predominantly food retailing by 29.0 per cent, and predominantly non-food retailing by 73.2 per cent.

This growth has been reflected in the convenience sector[1], which has experienced consistent growth in sales throughout the past ten years. Indeed growth in the convenience segment of the grocery market has consistently outperformed the market as a whole.

The trend in headline growth in the convenience sector has not shown signs of being affected by the economic downturn in 2010. Sales had grown 6.3% on the previous year and predictions for the next five years are optimistic.[2]

However this growth is not evenly distributed, growth has also given rise to rapid and significant consolidation. A combination of aggressive expansion by the large UK grocery companies[3] and ongoing decline in the number of independent small business owners in the sector means that there are 10% fewer convenience stores in 2010 than there were in 2000.

SME businesses accounted for over 40,000 of UK convenience stores in 2000, this has declined by more than 6000 in the past ten years. [4] It has become much harder for entrepreneurs to start up and expand businesses in our industry over the past ten years. The key factors in this are:

- competition and consolidation is undermining opportunity for smaller businesses to grow and expand, this is manifested in increasingly diverging buying opportunities for products and being priced out of the market for the more profitable shop premises

- reduced access to finance undermining opportunities to borrow whether for the purpose of buying new businesses or for expanding and refitting existing ones has become much less available

Beyond these two overarching barriers there are a number of additional factors including:

- cost of employment such as the persisting increases in the national minimum wage, forthcoming pension contributions, increased cost of statutory holidays and the red tape associated with being an employer have increased the barriers to existing businesses taking on staff and thereby limiting expansion

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[1] The convenience sector here referred is as per the definition of leading industry knowledge centre the Institute of grocery Distribution. There have estimated that there are *** **** convenience stores in the UK accounting for **bn in sales.

[2] IGD Convenience Retailing 2010, p14

[3] Insert data on Tesco and Sainsbury expansion

[4] This figure is the total number of independent retailers, including those that operate on their own and those that are part of one of the major symbol groups operated by the leading wholesalers.

- cost of crime – the cost of theft is a significant drain on retailers profitability, to this is added the cost of security investment and protection of people faced with an increasing threat of violence

- red tape and enforcement – particularly in locally controversial areas such as alcohol licensing imposes significant additional burdens on business and stress about possible sanctions

- rents and rates – the cost of leasing property is a barrier and phenomena such as upward only rent reviews are most punitive on the smallest. The business rate system still lacks the flexibility to provide incentives to businesses to trade in areas where service is needed but overheads are prohibitive.

Planning Policy

Significant attention has been given over a number of years to a debate about whether UK planning policy is a barrier to growth in the retail sector. We do not believe that the hypothetical benefits of reform in this area outweigh the very real threats that it would present. ACS recently commissioned a report on this issue which we have appended to our submission.

We believe the following points are crucial:

- retail growth has been strong throughout recent years at a time when the supposedly restrictive planning policy has been in place

- Those who argue for the relaxation or abandonment of TCF assert that such a policy shift will result in gains to retail productivity. We have grave reservations about the arguments as presented because:

    - there is no consistent or convincing definition of what is meant by retail productivity
    - there is little attempt to measure the putative gains
    - it is not clear who would benefit from any such gains that might emerge

- the removal of planning policy designed to focus retail investment on existing centres would lead to a flight out of town by the major retailers, the depopulation of town centres would be economically damaging for a number of reasons:

    - reduced choice and access to retail provision for consumers as retail disperses away from existing centres to separate purpose built out of town units
    - significant reduction in opportunity for small and specialist retailers that no longer have opportunity to trade in locations where larger business anchors attract footfall
    - economic costs of managing the decline of urban retail centres that no longer have a purpose

POLICY RECOMMENDATIONS

BUSINESS RATES

Business rates are the second largest outgoing for retailers after employment costs. It is therefore essential that the Government takes action to reduce the burden of business rates on small business.

Small business rates relief

We welcome the proposals brought forward by the Department for Communities and Local Government for the automation of small business rates relief.

However the current thresholds of £18,000 rateable value mean that only a small number of local shops benefit from the relief. We welcome the increased flexibility for granting reliefs being brought forward in the Localism Bill but fear that the lack of funds available to Councils at a local level will constrain the opportunity to grant reliefs where they are needed.

Inflation linked Rate Adjustments

Local shops and retailers will still see an increase in their business rates on the 1st April 2011. This is due to the high rate of inflation, as measured by the retail price index (RPI) in September 2010. ACS, along with other business representatives, believes that Government should review the use of RPI as an indicator for increases.

The Government has embraced the use of the Consumer Price Index (CPI) for pensions and it could also consider using this for the annual review of business rates. If CPI had been used for the calculation of the annual rates increase retailers would have suffered less. RPI in September 2010 was 4.6 per cent and CPI was 3.1 per cent.

Alternatively the Government could consider using the average rate of inflation across the year. This would eliminate the possibility of irregularities in the inflation rate effecting commercial property taxes.

Localisation

Proposals for the overhaul of business rates that will be considered as part of the forthcoming Local Government Finance Review give us significant cause for concern.

We understand the context of considerations that are being given to greater local decision making over the setting of rates and retention of income. However, this must not be allowed to be an opportunity for local authorities to shift the burden away from enfranchised rate payers of Council tax, to disenfranchised business rate payers.

There may be scope for incentivizing local authorities to encourage business growth under more limited reforms such as the *business increase bonus scheme*. However these would have to be built with robust safeguards against a shift away from long term growth strategies to short term decision making on new development. We would fear a situation where a Local authority

struggling for funding would be tempted to initiate and allow a new large retail development, motivated by the promise of a guaranteed increase in business rates revenue over the short term and fail to assess the likely negative impact on other centres in the local authority area.

Rates for Petrol Forecourt Retailers

Petrol Forecourt retailers were badly hit by increases arising from the Rates Revaluation of 2010. Many business owners in this market experienced 200 per cent plus increases in their rateable value. We have argued strongly against the methodology employed by the Valuation Office agency for setting this scheme, this has only been successful in moderating slightly the increases.

This presents a real problem for the industry but also for communities. Forecourt businesses struggle to remain in business as the profitability of the sale of fuel for the dealer is consistently squeezed by a combination of high duty, volatile oil prices and aggressive pricing strategies of the bigger operators. As a result industry figures[5] have shown that forecourt retailers fell to their lowest recorded level in 2010 of 8,641. This is a 2.1 per cent decrease on the previous year's figures.

As fewer customers experience reduced access to fuel, the main strategy that has been successful for our members has been to develop a strong convenience store offer alongside their fuel retail business. Given that they are providing this competitive offer we believe they should be on a level playing field with convenience store operations that do not sell fuel. As it stands a forecourt convenience store is rated on the turnover of the retail sales, and a standalone convenience store is rated according to its location and size. Forecourts are therefore consistently rated much higher than competing standalone convenience stores.

Selling fuel alongside a full grocery offer is a credible commercial strategy that allows many fuel retailers to continue trading where fuel only sites are closing at an alarming rate. It makes political sense to assist those businesses to remain competitive and ending an approach to rating that discriminates unfairly and threatens the interests of businesses, consumers and communities.

ACS Recommendation:

- ***Review the inflation indicators used to determine annual business rates increases.***
- ***Cautiously implement an incentive led local retention of business rates revenue.***
- ***Review the current rating scheme for the petrol forecourt sector.***

[5] IGD Convenience Retailing 2010 – Future Trading Strategies

EMPLOYMENT COSTS

Employment costs remain the highest outgoing for local shops across the country. National Minimum Wage (NMW) has more of an impact on the economic performance of local shops than any other employment cost.

ACS supports NMW but since its introduction in 1999 there have been continual above inflation increases. We believe that the NMW should provide a minimum standard that wages cannot fall below. Since 1999 price inflation equates to a 21.6 per cent increase in cost of living, whereas the minimum wage increased by 65 per cent.

Our members have reported the following effects of NMW increases:

Layoffs and a reduction of working hours

- The NMW level has reached a point where reducing hours is no longer viable. Latest surveys have shown that retailers are laying off staff or not replacing those who leave.
- Reducing staff means that shop owners have to cover the time themselves or reduce their trading hours.

Business Investment

- Three quarters of businesses in ACS' NMW survey[6] believed that there had been a negative impact on their ability to invest in their business.
- If rates were frozen businesses could reinvest or retain smaller stores with lower profit margins.

Pay Structures

- Retailers feel it is increasingly difficult to reward higher productivity, loyalty and experience as National Minimum Wage increases squeezes flexibility on differentials.
- Wage costs are the biggest overhead for retailers and therefore cuts are inevitable, and without flexibility among those earning the NMW employers are forced to restrict pay increases elsewhere in the business.

NMW increases at 'inflation-busting' rate have negative impact across the industry. Alongside the direct impact on the cost base of member businesses the uncertainty that the process has created has had a negative impact on financial planning. The current structure of review and recommendations every two years has reduced retailers' ability to make long term investment decisions. In the years when new recommendations have been made retailers have waited until as late as May for a decision on their wage levels to be brought in from October of the same year.

Prohibitive employment costs are the single biggest threat to economic recovery. Recent extensions to holiday entitlements have added a 1.5 per cent increase and a further mandatory 4 per cent pay contribution for employers in 2012. All of these increases must be taken in the

[6] ACS National Minimum Wage Survey 2010: http://bit.ly/fqK7C4

context that many convenience stores work on 1 to 2 per cent profit margins within their business.

ACS Recommendation:

- ***Avoid further increases in employment costs until the economy has developed a stable level of growth***
- ***Stop 'inflation busting' National Minimum Wage increases***

LENDING

ACS responded to the Treasury's "Financing a Private Sector Led Recovery" consultation. From consultation with members we have found there remain significant problems in gaining access to all types of finance and in branch support.

Capital Finance

The smallest businesses have difficulties securing capital investment from banks. These problems start in branch where bank managers often rely on a tick box system to calculate the valid of a request for finance. This can be a frustration for well established businesses in the local community.

Many retailers have been asked for large personal guarantees on their houses, had debentures used on all of their properties or requested to move their entire bank facilities to the lending branch at considerably higher rate than they can receive elsewhere. This is even apparent in banks where the business has previously secured loans from.

The approach of branch managers in high street banks has also been raised as an issue of concern. Many loan applications have been dealt with outside of branch level or with a tick box approach to assessing an application. ACS has recommended that retail banks work to enhance in branch support for small businesses and assess applications on performance in local economies.

The inability to secure investment from banks has contributed to a shift in the convenience sector from independent retailers to symbol group membership. Symbol groups include companies such as Spar, Londis, Premiere, Budgens, which allow businesses to buy into a wholesale network and centralise their service provision. It is also possible for businesses to secure investment from wholesalers, allowing them to develop their stores or take on a new business.

Credit Facilities

Convenience stores trade on the ability to provide a wide range of products to the consumer. To maintain this it is important that there is strong cash flow within the business to maintain stock levels, pay employment costs and cover other costs.

Therefore credit facilities from banks' are essential to the day to day running of a local store. There is a general understanding that the cost of credit will increase as banks attempt to raise more capital but there have been many examples of steep increases of over draft facilities that have led to retailers turning down them down on the terms offered by high street banks. Quite often the review of terms will occur with little notice.

Project Merlin

We welcome the Government's work with the UK's four major banks to secure more lending to small businesses. We also acknowledge the other steps such as the introduction of new lending code for micro enterprises and a 12 month pre re-financing dialogue of any loan review.

ACS urges the Government to ensure that small businesses are not left behind in these banking proposals. For example the £1.5 billion committed to the Business Growth Fund will only support business with a turnover between £10 million and £100 million. Businesses of this size are considerably more resilient to the current climate when compare with small business trading in high streets across the UK. Lending to businesses with a turnover below £10 million must also be addressed.

Further clarification is required from Banks that they will deliver on their promise to increase lending to SMEs by 15 per cent, outside of the context of wider demand. The Project Merlin Bank Statement says:

"The five banks have agreed to make available the appropriate capital and resources to support gross new lending to UK small and medium sized businesses that is 15% higher than what was delivered in 2010 **should their efforts to foster demand succeed above and beyond their current expectations."** (Banks' Statement 1.3.2)

However, it also states that banks expect demand to be weaker in 2011 compared to 2010. The Government must be clear that the small businesses will still be able to secure the necessary funds even if the demand hasn't been drive by large and medium sized companies.

As outlined in the section above on credit facilities overdraft, and business account costs are highly important to local shops. These costs can often be increased with little consultation with the business customer. Therefore the Government should consider extending the 12 month pre re-financing dialogue for loans to other types of credit and changes to the cost of that credit.

ACS Recommendations:

- **Empower in-branch managers to investigate and agree loan applications at local level.**
- **Greater transparency in the process for applying for finance.**
- **Rejections of applications should come with advice to the applicant on other forms of finance and why their claim failed.**
- **Clarify the lending commitments made by Banks' in Project Merlin that SMEs will still have access to finance even if the projections for demand is low.**

- **Extend the 12 month pre re-financing dialogue for loans to other types of credit and changes to the cost of that credit.**

VAT

Impact on the Convenience Sector

The increase of VAT to 20 per cent has been a particular concern to our members. A typical convenience store will have 50 per cent of its products VAT rated, making the industry particularly vulnerable to the increase.

Convenience stores already work to tight margins on products; as such retailers have little option but to pass the increase directly to consumers. Larger format supermarket stores with greater buying power and margin have the ability to absorb the increase.

We are disappointed by the Chancellors comments that the 20 per cent VAT increase will be a permanent feature of the Government's Tax plans.

Retention of VAT Exemptions

ACS strongly opposes the removal of VAT exemptions on food. The introduction of VAT at either standard or reduced rate would significantly increase the cost of food to all consumers at a time of reduced pay, increased unemployment and credit problems. The impact on sales would weigh disproportionately on the smallest businesses that have lower margins in their business and who would have to further depress margins in order to avoid passing the VAT increase onto their customers.

ACS also opposes the introduction of VAT on news and magazines. The news and magazine category is an important part of a local shops business accounting for a significant amount of customer loyalty and the footfall generated leads to associated sales of other goods. However the news and magazines market is in an incredibly challenged period, distribution continues to fall and the profitability of major titles is in question. The biggest area of weakness is in the local and regional press which in many areas is close to failure. Introduction of VAT would threaten to accelerate this trend driving more customers to the free papers or online for the provision of news.

ACS Recommendation:

- ***Retain the VAT exemption on food, news and magazines.***

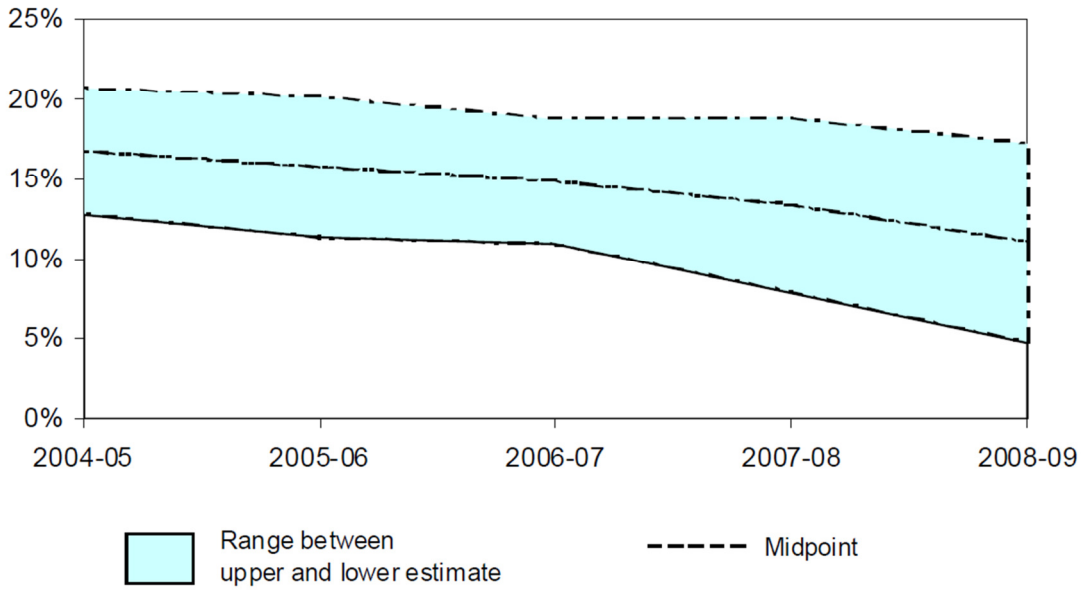
ALCOHOL AND DUTY FRAUD

Local shops understand the pressures on the public finances and know that tough decisions will need to be made across tax and spending. We do however believe that much can be done by

clamping down revenues lost through duty avoidance and fraud costing the Exchequer in excess of £4.1 billion per year[7].

It has been long standing policy to increase the tax on alcohol and tobacco products as a means to reduce consumption. Recent excise data indicates the worrying reality that sales of tobacco through legitimate retail outlets equates to less than the amount of recorded consumption in the population. The chart below[8] shows the market share of the illicit tobacco trade:

Figure 4.1: Cigarettes: Illicit market shares – estimated range



As this divergence in sales and consumption data continues a review of established policy assumptions is necessary. We should now question whether increased duty levels are justified by real social benefits or increased revenue.

Tobacco smuggling is estimated to cost the taxpayer more than £4.1 billion per year in lost revenue, while alcohol smuggling costs the taxpayer over £1billion per year[9]. Local shops accept that efforts are made and the scale of the enforcement challenge is significant, but with a concerted increase in resource and refocusing of effort in the ways we suggest below, we believe that a 50 per cent reduction in smuggling is achievable returning revenue in the range of £2 billion per year.

UK Border Agency (and previously HMRC) has pursued an effective campaign to tighten detection of smuggled products at UK Borders. The UK Border Agency reduced the illicit market from 21 per cent share to 17 per cent between 2000 and 2003[10]. They now have a target to

[7] Conservative Green Paper – 'A Healthier Nation'
[8] HMRC Measuring Tax Gaps 2010
[9] Westminster Hall Debate, Alcohol Fraud, 9th February 2010
[10] HMRC Tackling Tobacco Smuggling Together

reduce the illicit market to 13 per cent[11]. However there is much less focus on the growth of the market on the ground in communities. For example, only 12% of cigarettes seized came from inland enforcement activities[12]. Current activities and penalties, such as the use of UK Duty Paid 'fiscal mark' detector and banning orders, do not target the white vans and tab houses that make up this market.

Combating this problem requires a review and refocus of strategic responsibilities. HMRC has led responsibility for inland enforcement activity but is under resourced for the scale of its task, which has led to a tendency to ignore low level or everyday fraud in favour of larger investigations. HMRC is not well placed or adequately resourced to target low level activity. On the ground enforcement should be tackled by an effective partnership between Trading Standards and local Police Constabularies.

To accompany this new enforcement structure, there also need to be tougher penalties for those caught selling illicit tobacco. These penalties must be sufficiently harsh to act as a deterrent for bootleggers, who are often organised criminals. Currently the punishment for smuggling tobacco is half that of smuggling class C drugs and smuggling tobacco is often seen as the low risk option for criminals. The current structure of sanctions is counterproductive and needs to be tackled. ACS recommends penalties for selling tobacco and alcohol illegally are brought into line with penalties for dealing in class C drugs.

ACS also supports the recommendation in the Conservative Policy Paper 'A Healthier Nation' that there is a review of how many cartons of cigarettes can legally be brought into the UK from other EU countries. The current level of 3,200 cigarettes is too high. This level does not reflect reasonable personal consumption and offers professional smugglers the opportunity to import large quantities legally.

ACS Recommendation:

- ***A radical rethink of existing enforcement priorities, agency responsibilities and sentencing aiming to recoup 50% of the revenue lost to alcohol and tobacco duty fraud – equivalent to in excess of £2 billion in revenue***
- ***Penalties for bootlegging tobacco or alcohol to be brought into line with those for dealing Class C drugs.***

FUEL DUTY

The rising cost of fuel triggered by a combination of high duty rates, increase in VAT and the rising price of oil on the global market is having a significant harmful effect on the convenience industry in two ways:

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[11] HMRC Tackling Tobacco Smuggling Together
[12] ACS Consultation Response: "Future of Tobacco Control Strategy"
http://www.acs.org.uk/en/lobbying/issues/tobacco/

1. It is increasing the cost of distribution of goods that is putting inflationary pressure on prices and undermining retailers ability to price competitively
2. It is increasing the price of fuel at the pump and as such particularly harming forecourt retailers seeking to remain competitive and attract retail custom.

ACS agrees with the widespread call for a freeze in the planned 1p duty increase in April and calls for a wider review of fuel duty to reduce the burden on retailers and consumers.

ACS Recommendation

- **Do not implement the 1p increase in fuel duty planned for April 2011**

For further information on ACS Budget submission please contact Edward Woodall, Public Affairs Executive: Edward.woodall@acs.org.uk or 01252 533014.