



EVIDENCE IN ADVANCE OF THE EMERGENCY BUDGET 2010

Summary & Recommendations

The Association of Convenience Stores represents 33,500 local shops. 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.

ACS Recommends:

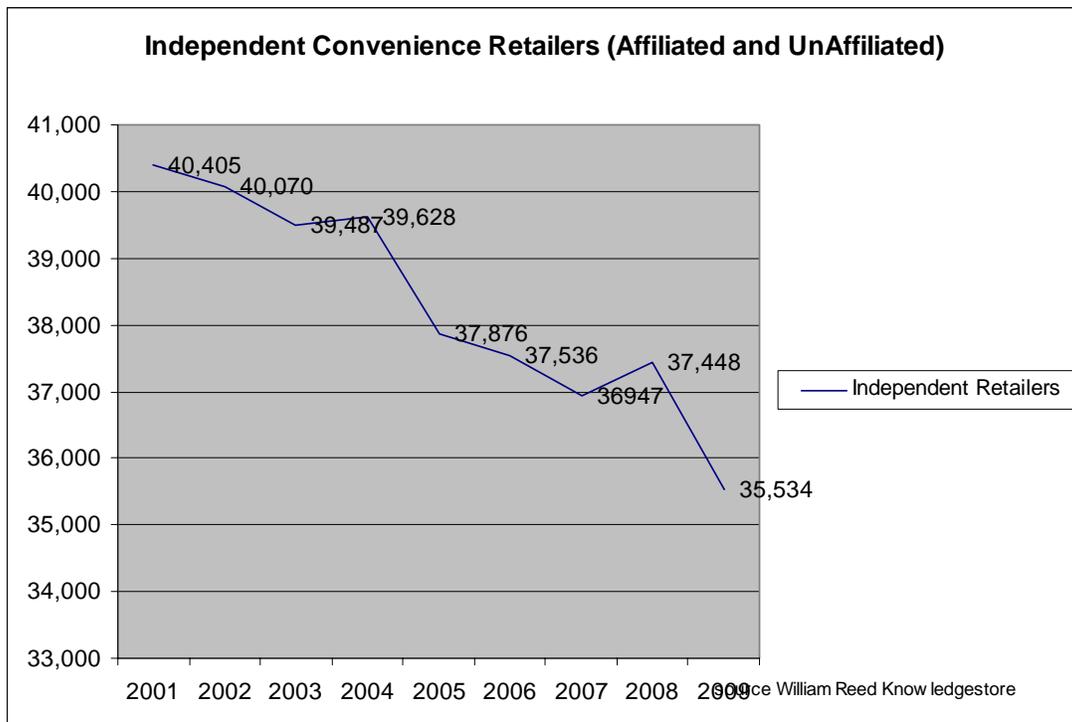
- a radical re-think of existing enforcement priorities, agency responsibilities and sentencing aiming to recoup 50% of the revenue lost to **alcohol and tobacco duty** fraud – equivalent to in excess of £2 billion per year in revenue
- no increase in the headline **rate of VAT** and no change to the criteria on non VAT-payable products like food and news and magazines.
- if Ministers decide to implement a VAT rise then:
 - changes must be incremental to prevent dramatic price increases in the short term
 - sufficient lead in must be allowed for retailers to make the necessary changes to prices and systems
- centrally set **lending targets** for banks, in place for as long as the credit shortage remains
- Government intervention to reduce the increased cost of credit and stringent terms on which banks will loan to small businesses.
- immediate action to make **small business rate relief** automatic
- no further increases in employment costs including the national minimum wage, until the economy has developed a stable level of growth.

ACS and the Convenience Sector

ACS (the Association of Convenience Stores) represents over 33,500 local shops throughout the UK; our sector contributes over £30 billion to the UK economy and employs an estimated 400,000 people. Decisions made in the Budget will be crucial to our members businesses and the people they employ.

Our sector has shown some signs of strength in spite of the economic downturn, and this is reflected in a number of retail and wholesale companies in our sector returning good sales performance. The tightening of household budgets has in part led people to eat and socialize more at home and this has increased spending on groceries for the household. Also in some communities the closer attention to weekly spending and a shift to controlling spending through using only cash has meant people shopping closer to home and more frequently, as opposed to large weekly shops at supermarkets. However, this increase in sales has in many cases been at the expense of margin as the consumer and competitive pressure led by the major supermarkets has driven down prices.

Local shop numbers have declined by an average of around 500 to 1,000 per year over the past decade. This long term trend has been exacerbated by the downturn. The graph below shows the decline in independent retailers since 2001.



In many cases this decline can be attributed to the same factors causing malaise on the high street generally. 2009 figures showed that 12.4 per cent of shops stood empty across Britain - a 25 per cent increase on the previous year.¹

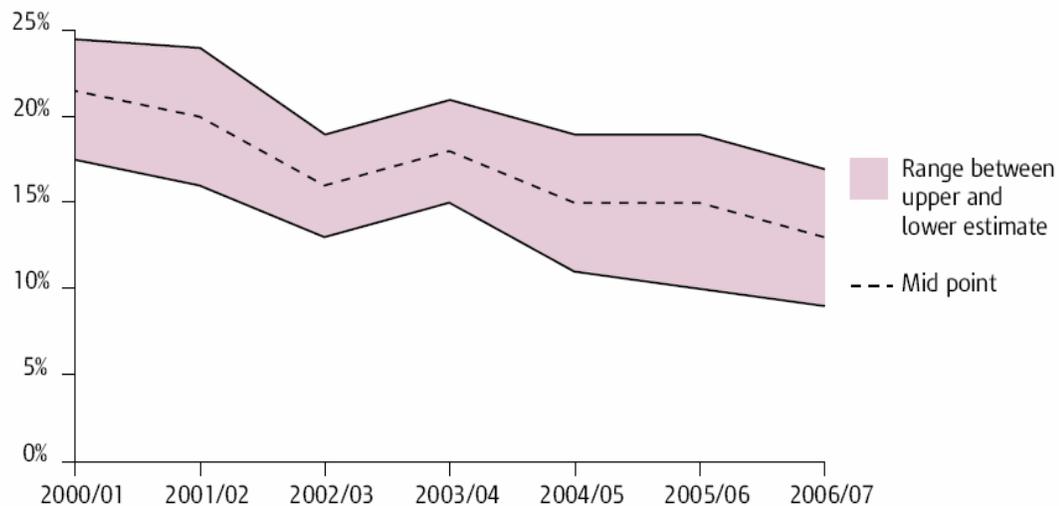
¹ Local Data Company – End of Year Report 2009 – Dawn of a better market!

However there are additional factors specific to convenience stores that have assisted this decline in store numbers. Notably, the growth of major supermarkets in large and small store formats, increasing employment costs, and a growing regulatory burden have played a part in this decline.

Alcohol and Tobacco 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 year². 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 below³ shows the market share of the illicit tobacco trade:

Figure 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 £1 billion per year⁴. 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.

² Conservative Green Paper – ‘A Healthier Nation’

³ HMRC Tackling Tobacco Smuggling Together

⁴ Westminster Hall Debate, Alcohol Fraud, 9th February 2010

UK Border Agency (and previously HMRC) have 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 2003⁵. They now have a target to reduce the illicit market to 13 per cent⁶. 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 activities⁷. 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 lead 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 counter productive 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.

Health Benefits

The illegal trade loses the Government significant revenue in duty and tax, but it also impacts on the health of our communities, which in turn further drains resources. Using data from the Department for Health ACS has calculated the health benefit cost from reducing access to the illicit market. The health benefit from a 5 per cent reduction in access to the illicit trade would range from £0.7

⁵ HMRC Tackling Tobacco Smuggling Together

⁶ HMRC Tackling Tobacco Smuggling Together

⁷ ACS Consultation Response: "Future of Tobacco Control Strategy"

<http://www.acs.org.uk/en/lobbying/issues/tobacco/>

billion over a ten year period to £6.7 billion over the same period for a 50 per cent reduction.⁸

Table 3: Costed Health Benefits of Reduction in Illicit Tobacco Trade

Reduction in illicit tobacco	Percentage of 11-15 year olds that would have ever smoked illicit tobacco	Percentage of regular 11-15 year old smokers that would not have smoked as a result of reduction	Number of each annual cohort not smoking	Total number of life years saved per annual cohort	Monetary value per annual cohort (£ million)	Monetary value over 10 years (£billion)
50%	6.5	1.5	9,718	16,131	808	6.7
25%	9.8	0.8	4,859	8,066	404	3.4
10%	11.7	0.3	1,944	3,226	162	1.4
5%	12.4	0.2	972	1,613	81	0.7

These estimates do not include the additional benefit from increased tax revenues that would also result. Overall the treasury could benefit from £4.1 billion of tax revenue plus the aforementioned health benefits.

Recommendations:

- **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.**

VAT

Given the pressures to raise revenue to address the budget deficit there is significant speculation that Government will increase VAT. This would harm the retail sector. In particular retailers are concerned about the removal of the VAT exemptions on food goods, which represents a large proportion of their stock.

Consumer confidence remains fragile and the outlook for the national recovery remains uncertain. If VAT is increased to 20 per cent, for example, this would reduce consumer spending and further squeeze the tight margins that already exist for retailers.

⁸ ACS Consultation Response: “Future of Tobacco Control Strategy”
<http://www.acs.org.uk/en/lobbying/issues/tobacco/>

Impact on the sector

Increasing VAT not only impacts on sales, it creates costly operational disruption. In a typical convenience store a VAT change requires price and signage changes to over 1600 lines, or 50 per cent of the range. This half of the range is likely to account for over half of the turnover of a convenience store, thus making this sector particularly vulnerable to any VAT change.

There is a tendency among retailers to attempt to absorb increases, particularly at a time of economic austerity, to ensure customer retention in a competitive environment. Retailers often work to specific price points (for example 99p) and smaller retailers are likely to include a higher proportion of products price-marked by the manufacturer. Any changes that force retailers to price over these price points will have a disproportionate impact on customer buying behaviour. We fear that this would drive custom into larger stores where the wider range of products and greater profitability of those businesses will allow them to absorb some VAT-led price increases.

In recent years there has been increased prevalence of price marked packs in independent stores which is a proven mechanic to give confidence to shoppers that the price is competitive because the supplier has set it.

Changes to the VAT level on these lines will erode the margin as the retailer will have no option, other than to absorb the loss. Whilst it is technically possible to charge a higher price than the price mark with a disclaimer, this will be counter intuitive as it will only damage confidence in pricing in the convenience market, and also cause confrontation in store from customers.

The table below offers examples of the erosions of margins on products in a convenience store if VAT went up to 20 per cent:

Product	17.50%						20%						
	Cost (Ex Vat)	Cost (inc VAT)	Unit Cost (inc VAT)	Sell	£ Margin	Margin %	Cost (Ex Vat)	Cost (inc VAT)	Unit Cost (inc VAT)	Sell	£ Margin	Margin	% reduction in margin
Mayfair 20's Price Marked £5.17	£41.61	£48.89	£4.89	£5.17	£0.28	5.4%	£41.61	£49.93	£4.99	£5.17	£0.18	3.4%	35.6%
Whiskas Rabbit 400g PM68p	£6.19	£7.27	£0.61	£0.68	£0.07	10.9%	£6.19	£7.43	£0.62	£0.68	£0.06	9.0%	17.5%
Pedigree Original 1200g PM£1.55	£13.49	£15.85	£1.32	£1.55	£0.23	14.8%	£13.49	£16.19	£1.35	£1.55	£0.20	13.0%	12.3%
Carlsberg Pint Cans 4 for £4	£16.29	£19.14	£3.19	£4.00	£0.81	20.2%	£16.29	£19.55	£3.26	£4.00	£0.74	18.6%	8.4%
Cadbury Dairy Milk 140g PM 99p	£11.95	£14.04	£0.78	£0.99	£0.21	21.2%	£11.95	£14.34	£0.80	£0.99	£0.19	19.5%	7.9%
Coca Cola 2Lt Price Marked £1.85	£7.29	£8.57	£1.43	£1.85	£0.42	22.8%	£7.29	£8.75	£1.46	£1.85	£0.39	21.2%	7.2%
Bakers Complete 1.5kg Price Marked £3.65	£14.99	£17.61	£2.20	£3.65	£1.45	39.7%	£14.99	£17.99	£2.25	£3.65	£1.40	38.4%	3.2%

We are also concerned about the inflationary pressure of any VAT increase. We have seen dramatic inflationary pressure caused by the price of fuel. We are concerned that VAT hike on fuel in particular would accentuate this economy-wide problem and put even greater pressure on forecourt retailers that are suffering depressed fuel sales as a result of the existing record high prices.

Furthermore, a VAT increase would increase the price of products like alcohol and tobacco which are also the focus of the illicit trade. This would further grow the differential between legitimate and illicit products in these markets and thus lead to more bootlegging activity.

Retention of VAT exemptions

An increase in the headline VAT rate would be harmful to stores in our sector, but the impact of any change to the criteria of goods liable for VAT would be more damaging still. 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' concern is the retail impacts but there are of course other societal reasons why declining news provision could be damaging.

Implementation plan

If a VAT increase is included in this years budget it is vital that retailers are provided adequate time to prepare for a change over. Activity in this sector is often planned months in advance, there are long lead-in times for seasonal goods and promotions, which are all price marked - in effect fixing the price retailers have to sell at three months ahead. Any changes implemented quickly would not allow any price changes to be made and would thus impact on overall profitability for retailers.

VAT changes would require a minimum of six months to be implemented. In 2009 retailers tended to phase in the change through different parts of the business. Retailers should have the opportunity to sell through price-marked product that would not return a viable margin under a higher VAT rate.

An increase in VAT should occur outside of the busiest trading periods. The last VAT change occurred in the busiest retailing period of the year, Christmas and New Year. This left retailers with unnecessarily inflated staffing costs due to the timing of the change over. Businesses want clarity over the length and depth of

a VAT increase. This will allow them to form strategies to deal with the inevitable squeeze on their margins.

Recommendations:

- **No increase in the headline rate of VAT and no change to the criteria on non VAT-payable products like food and news and magazines.**
- **if Ministers decide to implement a VAT rise then:**
 - **changes must be incremental to prevent dramatic price increases in the short term**
 - **Six months must be allowed for retailers to make the necessary changes to prices and systems and to sell through price-marked product.**

Lending

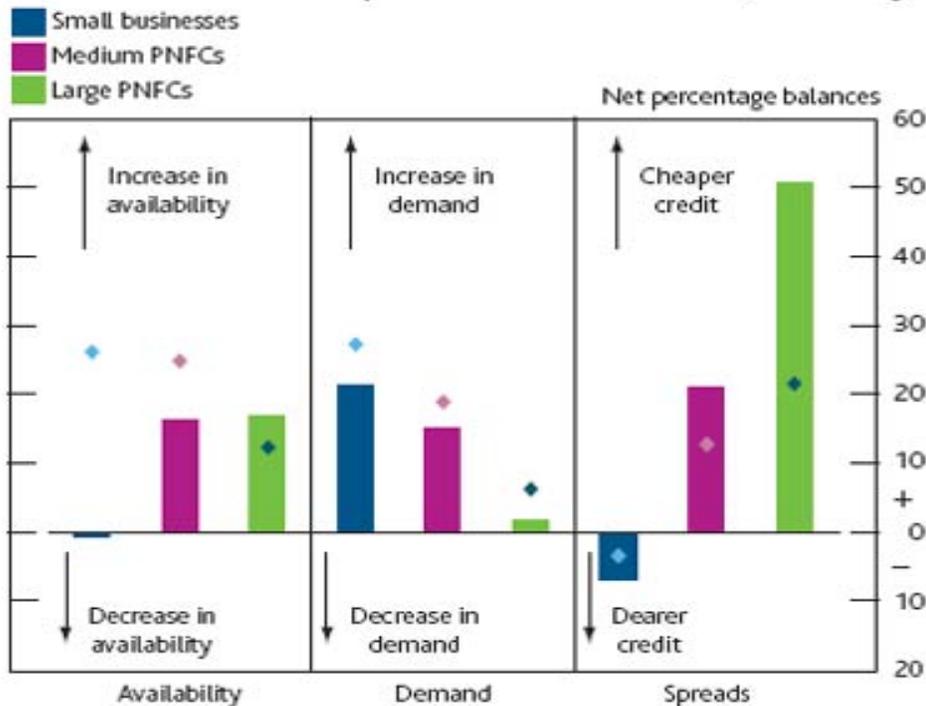
During the recession the many convenience stores that failed did so as the result of cash flow difficulties. Retailers must have strong cash flow within their business, which means it is necessary to have access to credit.

In a fiercely competitive market place the growth of the larger multiples has been dramatic. Their growth is accompanied by significant store investment, this trend provides consumer benefits, but it also places pressure on smaller competitors to keep up. To do this retailers need support to raise money to make necessary investments. The short term crunch in credit availability cannot last much longer before it starts to dramatically reduce the long term competitiveness of smaller businesses in the UK convenience market.

Even Government owned banks have not met the lending needs of the retail customer. The graph below⁹, from the Bank of England, reflects that there is demand for lending from small businesses. It also shows that availability to small businesses for credit has fallen, yet the cost of borrowing has increased.

⁹ Bank of England: Trends in Lending April 2010

Chart 1.7 Credit Conditions Survey: credit conditions across firm sizes reported in the 2010 Q1 survey^{(a)(b)}



- (a) Net percentages are calculated by weighting together the responses of those lenders who answered the question. The bars in the chart show the net percentage balance reported over the three months to early March.
- (b) The diamonds show the associated expectations for the next three months. In the first panel, a positive balance indicates that more credit is available. In the second panel, a positive balance indicates an increase in demand. In the third panel, a positive balance indicates that spreads over reference rates have become narrower, such that all else being equal, it is cheaper for corporates to borrow.

Many retailers have also voiced concerns over the cost and terms that banks require for loans. As we have identified in the previous graph smaller businesses, such as convenience store owners, require access to credit the most; however currently this can only be secured at great expense. Often retailers are asked to provide numerous personal guarantees and move their entire banking portfolio to the lending bank on inflated terms. We understand that banks need guarantees but the stringent terms that they currently require makes securing a loan very difficult for entrepreneurs in the local shop industry.

For small business owners in particular there is a major barrier created by the increasingly centralisation and formula decision making structure of the major banks. These systems reduce the ability of sound businesses with strong track records from securing lending. Assessment of an application for a loan will be more informed if made in the local branch where there is an understanding of the local economy and the applicant.

ACS welcomes the explicit mention of lending to small businesses in the new coalition Government's agreement, which states: "ensuring the flow of credit to

viable SMEs is essential for supporting growth and should be the core priority for a new Government.”¹⁰

We support the introduction of lending targets to viable small businesses and the continued delivery of loan guarantee scheme to foster confidence in bank lending.

Recommendations:

- **Centrally set lending targets for banking sector, broken down by sector type in place for as long as the credit shortage is in place**
- **Government intervention to reduce the increased cost of credit and stringent terms on which banks will loan to small businesses.**

Business Rates

ACS has communicated to the Government, and directly to the Valuation Office Agency (VOA), the difficulties caused by the 2010 revaluation. Although the VOA figures show only a 1 per cent increase in rates across the retail sector this does not reflect the detrimental affect it has had on many high street and forecourt retailers that saw dramatic increases in their rateable value.

The revaluation rental figures were in the most part based on 2008 rental figures, which does not reflect the significant deflation in property values in the economic downturn that ensured from 2008 until 2010. This has meant that many businesses saw increases in their rateable value. The purpose of revaluations is to realign rateable values given changes in rental value taking into account economic circumstances. As such there are both winners and losers in each revaluation; the measure of the revaluation's success is the support it provides for those businesses that lose out.

Of all the businesses in our sector petrol forecourts have been hardest hit by the revaluation. The steep increase in petrol forecourt rateable value is the result of the VOA rating scheme forecourts. There are three main issues that forecourt retailers have to contend with: on site shops are rated by turnover not the zoning method (used on all other retail outlets), the application of oil company and supermarket fuel margins to independent sites and a 20 per cent rates charge on car wash turnover in an increasingly competitive market. Petrol forecourts in the most will only qualify for transitional relief, which in the short term provides some support. However, all the costs over the 100 per cent mark will be added on at the next revaluation. Further analysis is needed into the VOA's rating scheme.

This being the case it is important that relief schemes support as many businesses as possible. We have called for small business rate relief (SBRR) to

¹⁰ Conservative Liberal Democrat Coalition Agreement, 12 May 2010.

be made automatic for all those under the threshold. Currently only 50 per cent of those eligible for SBRR claim, this is the result of naivety to the relief available or the complication of the application. It is counter intuitive for funds to be put aside to support businesses and half of it lies dormant. Automatic SBRR would rectify this problem.

We also believe that the thresholds are too restrictive excluding many businesses that provide an important local employment and vital amenity to local people. The increase in the thresholds for SBRR to £22,000 rateable value will support a large number of community businesses.

Recommendations:

- **Make small business rate relief automatic.**
- **Increase the small business rate relief thresholds to £22,000 RV.**
- **Review the VOA's forecourt rating methodology.**

Employment Costs

Employment costs represent the largest outgoing for our sector; overall the sector provides employment for 400,000 people. We welcome the commitment that Government will not be introducing the increase in National Insurance Contributions planned for 2011. We also support proposals to exclude new businesses from paying national insurance on their first 50 employees.

National insurance is not however the biggest employment cost pressure on convenience businesses; the planned increase in national minimum wage (NMW) has more of an impact on the economic performance of local shops. 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 % increase in cost of living, whereas the minimum wage increased by 65 %.

Our members have reported the following effects of NMW increases:

Lay offs 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' survey 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 this 'inflation-busting' rate has 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.

The structure for setting the minimum wage is not in need of radical change, but we would support a review of the decision making parameters afforded to the Low Pay Commission. A review could consider setting upper limits on the scale of increases permissible to the rate in any given year. This could be linked to the performance of the economy measured by agreed indicators. The review should also look at a means to ensure business has a longer period between recommendation and implementation to prepare for changes in wage levels.

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

Recommendations:

- **Avoid increases further increases in employment costs until the economy has developed a stable level of growth**
- **Stop 'inflation busting' National Minimum Wage increases**
- **Review the impact of the Low Pay Commission process to increase**

Further information

For further information on the issues raised in this submission or any other matter of fiscal policy please contact Edward Woodall on 01252 515001 or email edward.woodall@acs.org.uk