



The business people – an extension to your team

Referendum 197 report

The Cost of Doing Business

October 2011

The Forum of Private Business is a proactive, not-for-profit organisation, providing comprehensive support, protection and reassurance to small businesses. We add value to businesses through the collective voice for members in local, central and European government, and the provision of tailored solutions that promote business success.

We conduct research throughout the year and our quarterly *Referendum* newsletter forms part of our regular consultation with a proportion of our members; in it we ask some key questions that help define our campaigning priorities. We use the results to facilitate dialogue between our members and their constituent MPs, MEPs, and Scottish and Welsh representatives.

For the latest quarter's *Referendum*, we surveyed 4,700 of our members during September 2011 to find out the true cost of small business inflation after members reported this as an issue.

Summary of the results

"Indirect costs are harder to control than staff costs so it will be employment that suffers. I feel that we have to grow revenue by 10% a year just to stand still and this is not realistic." Member response

Our members have seen a continued rise in the cost of business over the last year. Overall, 94% of businesses saw an increase in energy costs, 92% in transport costs and 82% a rise in the cost of raw materials/stock. Businesses have had to cut costs simply to keep prices at the same level. More smaller firms are suffering from business inflation than at any time over the last 3 years. An exception is in the area of finance, where the numbers have reduced, with more businesses deciding to become self funding.

The major reasons for increases in prices are predominantly down to the VAT increase and rising energy prices, as well as the weakness of sterling for importers. With wages rising at half the rate of inflation the increase in staff costs reported is down to increased regulatory costs. Excessive administrative demands forced on businesses by government, banks and customers have meant that 45% of businesses have not been able to focus on activities such as cost cutting. In total 97% of businesses have seen an overall increase in the cost of business, with the 1% showing a decrease having to reduce staff levels, change properties or get a more appropriate energy contract.

At 8.5%, prices have risen far faster for micro, small and medium-sized employers than for the rest of UK society. Just under 5% have been unaffected by the rise in the cost of doing business, because they have been able to pass costs on. Around 1 in 3 businesses have, however, not been able to pass on any costs to their customers. Figure 1 shows various inflationary indicators, with wage inflation around that of underlying inflation as reducing staff costs (after reducing their own take-home pay) has been the only way for some businesses to continue trading. Manufacturers and distributive trades have seen the biggest increases in cost due to their higher use of energy and fuel.

Figure 1 Which of the following costs have increased over the last year

Wage inflation	2.5%	Income Data Services Pay report
Consumer Price Inflation (CPI)	4.5%	ONS
Annual inflation	5.2%	ONS
Underlying inflation	5.3%	ONS
Small business inflation	8.5%	Forum of Private Business

88% reported that the changes in costs have had a detrimental impact on their business, 66% have had cash flow issues as a result and 56% say it has discouraged investment. 55% reported that it has been detrimental to employment levels and 74% feel that it has inhibited growth ambitions. Further, 96% of businesses expect costs to increase over the next year, with nearly a third expecting them to do so significantly.

Changing payment terms had been a problem for 31% of businesses in dealing with suppliers and 27% in dealing with customers. Bad debt and phoenix companies had affected 26% of businesses.

There is a realisation that the Government has limited powers to deal with business inflation when finances are difficult. 18% wanted action on red tape to free up business owners' time and 9% wanted a reduction in employment costs so that they can retain staff and business capability more easily. 14%

wanted a reduction in VAT on fuel, as this had a cumulative effect on the supply chain and affected the very businesses that policy makers want to grow to rebalance the UK economy.

Tighter regulation on banks (7%) and utilities companies (4%) were also highlighted as ways in which the Government could support businesses and reduce the impact of business inflation, which is steadily eroding their ability to grow and develop.

Policy recommendations

The general assumption from members is that legislators are unwilling or unable to take concrete action to reduce the cost of doing business in the UK. The Forum recognises the work that has gone into the first phase of the Growth Review but believes more can be done to reduce the cost of doing business.

- The Forum backs some form of fuel price stabiliser, to ensure that when oil prices are higher tax take as a percentage of fuel costs falls. There is also a question of fairness in imposing a tax (VAT) on another tax (fuel duty) and the Government should consider excluding the fuel duty element from VAT charges on fuel. This would reduce the cost of distribution and make UK hauliers more competitive with continental rivals.
- VAT and National insurance are other commonly mentioned taxes that could be reduced. Extending the boundaries of the National Insurance Contributions holiday to micro businesses that take on more employees would be of huge benefit.
- In the longer term the Government should be seeking to integrate income tax and National Insurance. Too many businesses at present outsource tax compliance to specialists. A simpler system with less burdensome compliance procedures would ease the tax process for smaller employers and allow them to consider doing more tax compliance in house.
- Red tape continues to de-motivate business owners. In addition to the deregulatory initiatives announced so far (Red Tape Challenge, One In One Out, Sunset Clauses) the Government should continue to press Whitehall to regulate as a last resort. As an example, the recent consultation on Modern Workplaces suggested the Government is to introduce a compulsion on business owners to consider flexible working arrangements for any employee that requests it. The Forum believes that money would be better spent promoting the benefits of flexible working to businesses, rather than legislating on it.
- Ensure that micro and small businesses are treated fairly by utilities companies. The Forum would like to see a business-focused code of conduct that contains the same protections for businesses that are currently enjoy by domestic users. In particular, it is essential that a cap on backbilling is put in place as soon as possible and strong measures are taken to increase the ease with which businesses can change energy providers.
- Offer smaller employers value through the taxation system. For example, retailers feel that the cost of business rates are excessive for them because they are not able to get value out of their assets (parking, removal of council services) which makes them increasingly uncompetitive compared to out-of-town retailers or internet traders.
- Recent announcements around tribunals - that employees will have to wait two years before claiming unfair dismissal and claimants will need to make a financial contribution towards a claim - are welcome. With full proposals due shortly, we recommend a renewed, expanded emphasis on the benefits of mediation, with the possibility of compulsory attempts at mediation before a case can go before a judge.

Where business costs have increased

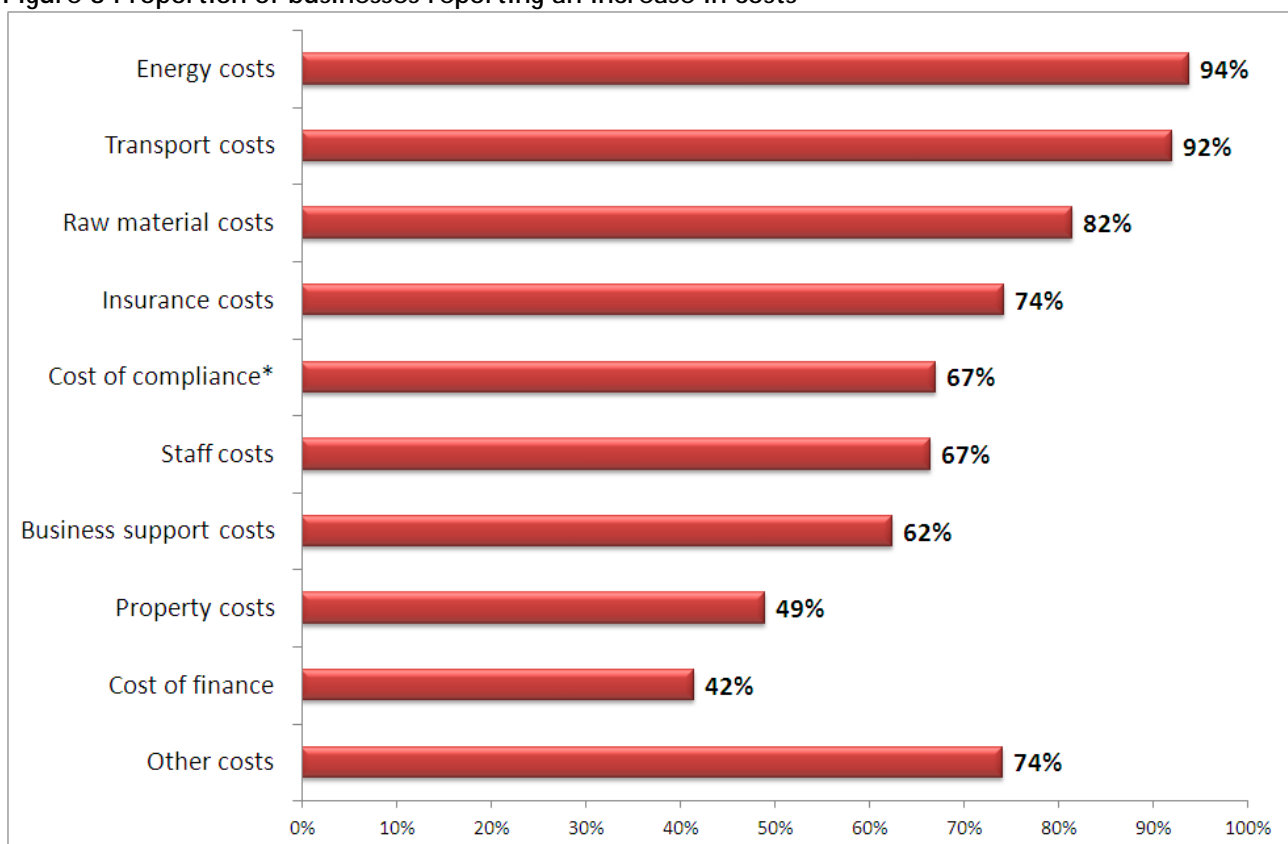
The Forum asked members whether certain costs had increased over the last year. In cases where costs have decreased the Forum found this is due to members cost-cutting, for example through moving to a smaller building or switching suppliers. In many cases this has minimised cost increases rather than allowing businesses to cut costs. To put business costs in perspective, typically over 40% of Forum members routinely report that they are cutting/reviewing costs⁽¹⁾.

Figure 2 Which of the following costs have increased over the last year

	Increased	Decreased	Stayed the same	Do not know	Not relevant
Energy costs	94%	1%	4%	0%	1%
Raw material costs	82%	0%	4%	0%	13%
Transport costs	92%	0%	3%	0%	4%
Property costs	49%	4%	36%	1%	10%
Staff costs	67%	2%	30%	0%	1%
Cost of finance	42%	4%	27%	3%	25%
Insurance costs	74%	4%	22%	0%	0%
Business support costs	62%	0%	19%	6%	12%
Other costs	74%	0%	12%	5%	9%

The three most frequently reported products/services that cost more are interlinked - energy costs are traditionally linked to oil costs and raw materials/stock increasingly require transportation from overseas. As a comparison, figures from *Referendum 196*⁽²⁾ on the 'cost of compliance' have also been added into figure 3 as it indicates the increasing strain on our members.

Figure 3 Proportion of businesses reporting an increase in costs



Insurance costs have continued to rise, particularly on vehicles, property and machinery. Tribunals caused by redundant staff using “no win, no fee lawyers” are also increasing, as are staff costs. Business support costs are mainly due to the cost of marketing and advertising, and the ability of consultants to pass on fees more successfully than some other industry sectors. The gradual winding up of Business Link support services (as opposed to the website) has also meant that some businesses have reported a loss of subsidised support.

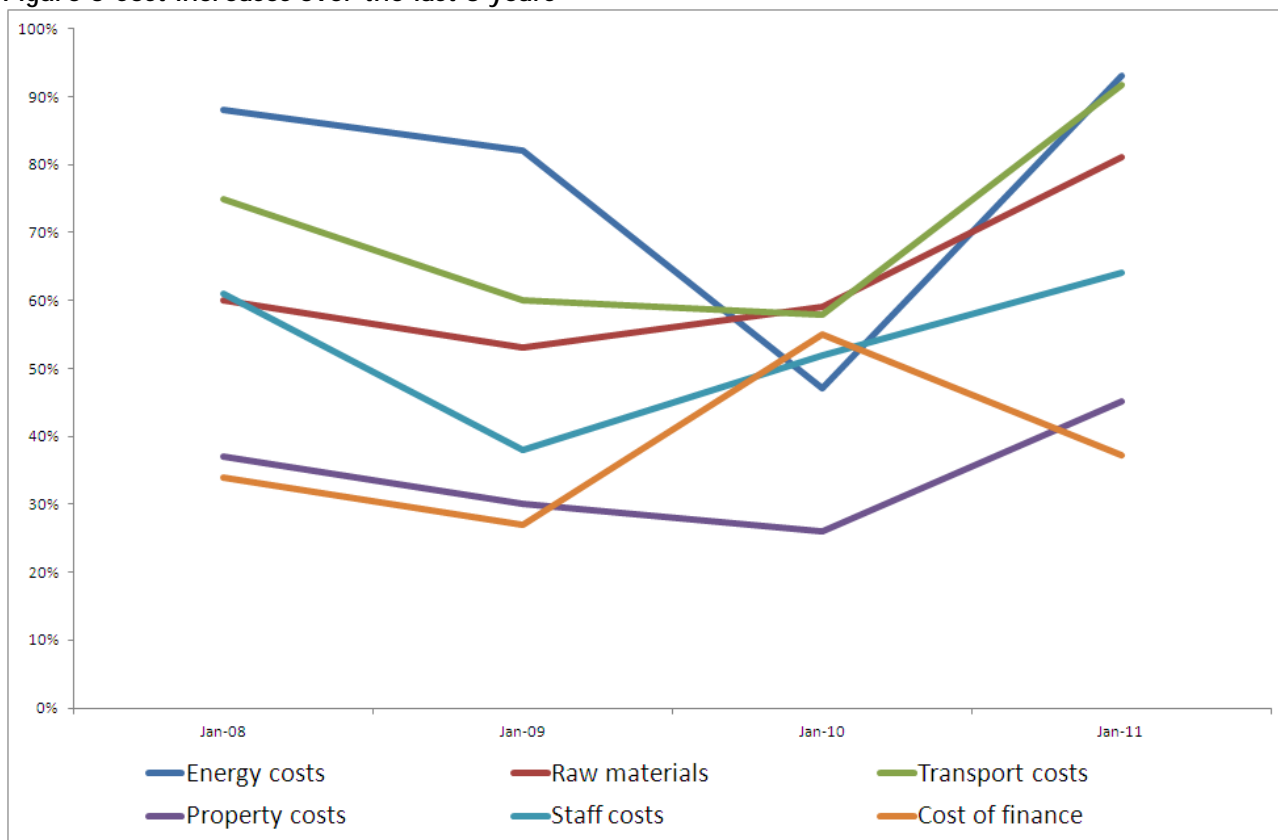
Interestingly LIBOR has increased over the last year from 0.7% to 0.8%⁽³⁾ so the banking industry is not necessarily passing on all the costs to its customers. However, with typical commercial interest rates being over 7%, the margin on such lending is likely to be healthier than those made to smaller firms.

Figure 4 Balance of businesses annual change in cost (proportion of those showing a cost increase minus those showing a decrease) over the last 3 years

	National Business Survey ⁽⁴⁾		Forum figures	
	June 2008	June 2009	July 2010 ⁽⁵⁾	Sept 2011
Energy costs	88%	82%	47%	93%
Raw materials	60%	53%	59%	81%
Transport costs	75%	60%	58%	92%
Property costs	37%	30%	26%	45%
Staff costs	61%	38%	52%	64%
Cost of finance	34%	27%	55%	37%
Cost of complying with regulations	n/a	n/a	50%	67%

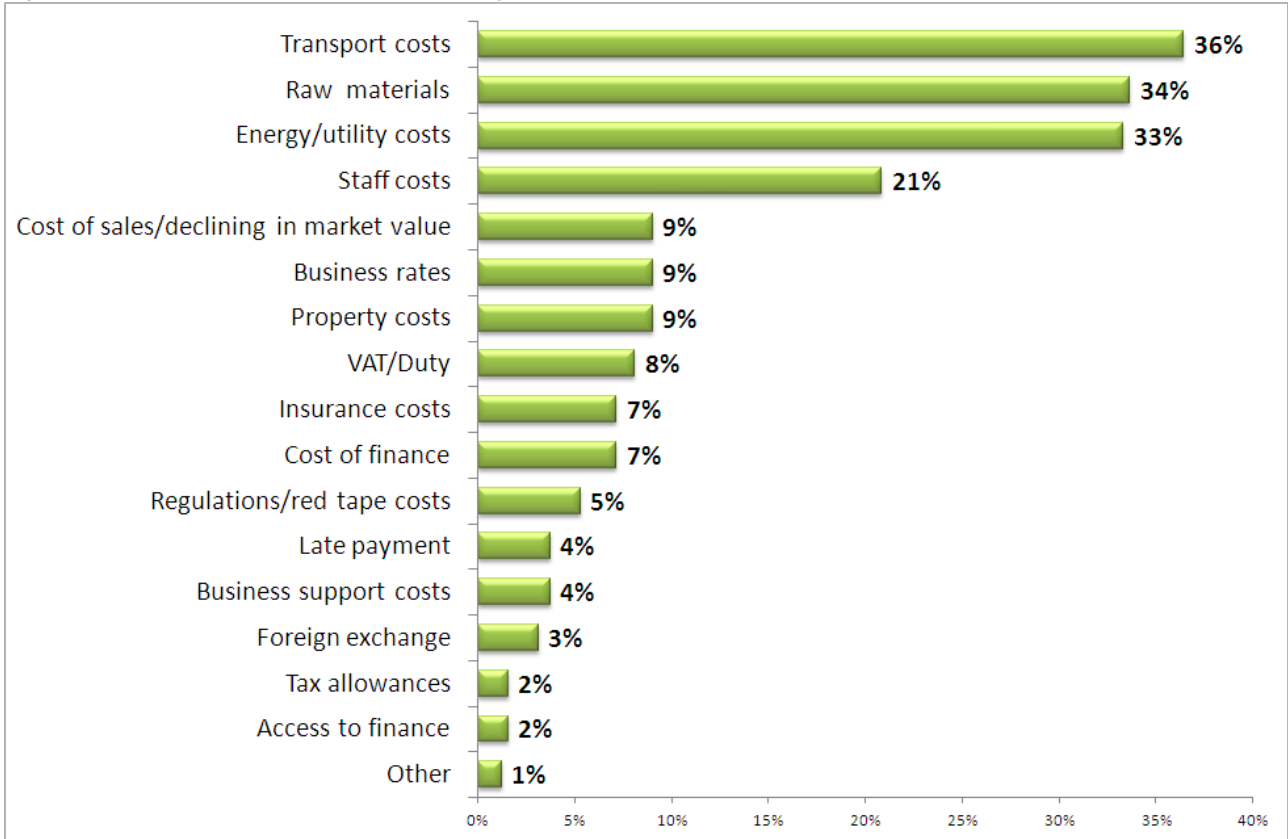
The graph shows the widespread nature of costs in the last year after a slowdown in the number reporting cost increases in 2010. The proportion reporting increases in finance over the last 3 years has reduced from 2010 although the figures are more in line with figures from the National Business Survey.

Figure 5 Cost increases over the last 3 years



We asked businesses in particular what the main cost pressure on their business was at the moment. Responses from business owners are shown in Figure 6.

Figure 6 Main cost pressures reported by businesses

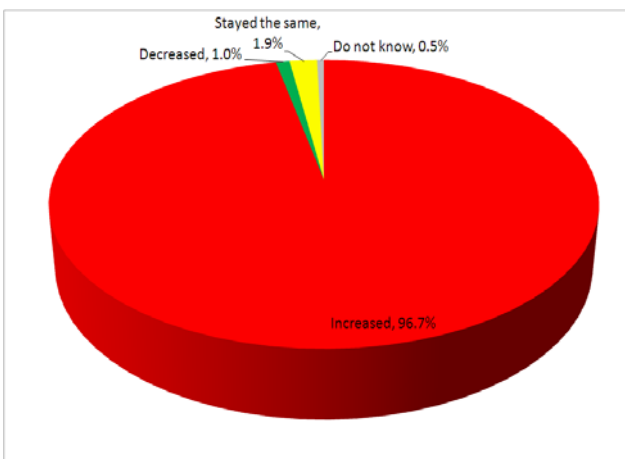


There were three main costs to businesses: transport, raw materials/stock and utility prices. Transport costs were predominantly diesel or petrol, but also the cost of rail and, in the case of travel agents, air travel. Raw materials and stock are also big cost issues as the cost of importing is relatively high. Utility costs (predominantly electricity and gas, although around 5% mentioned the cost of waste disposal) was the other main cost, particularly prevalent in retail and production. 21% reported increased staff costs. The latest wage survey from the IDS Pay Report⁽⁶⁾ puts wages rising at 2.5%, which is lower than the consumer price index at around 4.5%. However staff costs also include tax rises such as National Insurance rises, the costs of complying with employment law and other administrative issues, together with the recent increase in the National Minimum Wage. As the largest single cost for small employers, even a wage increase of 2.5% when the market is poor is difficult.

Cost of doing business

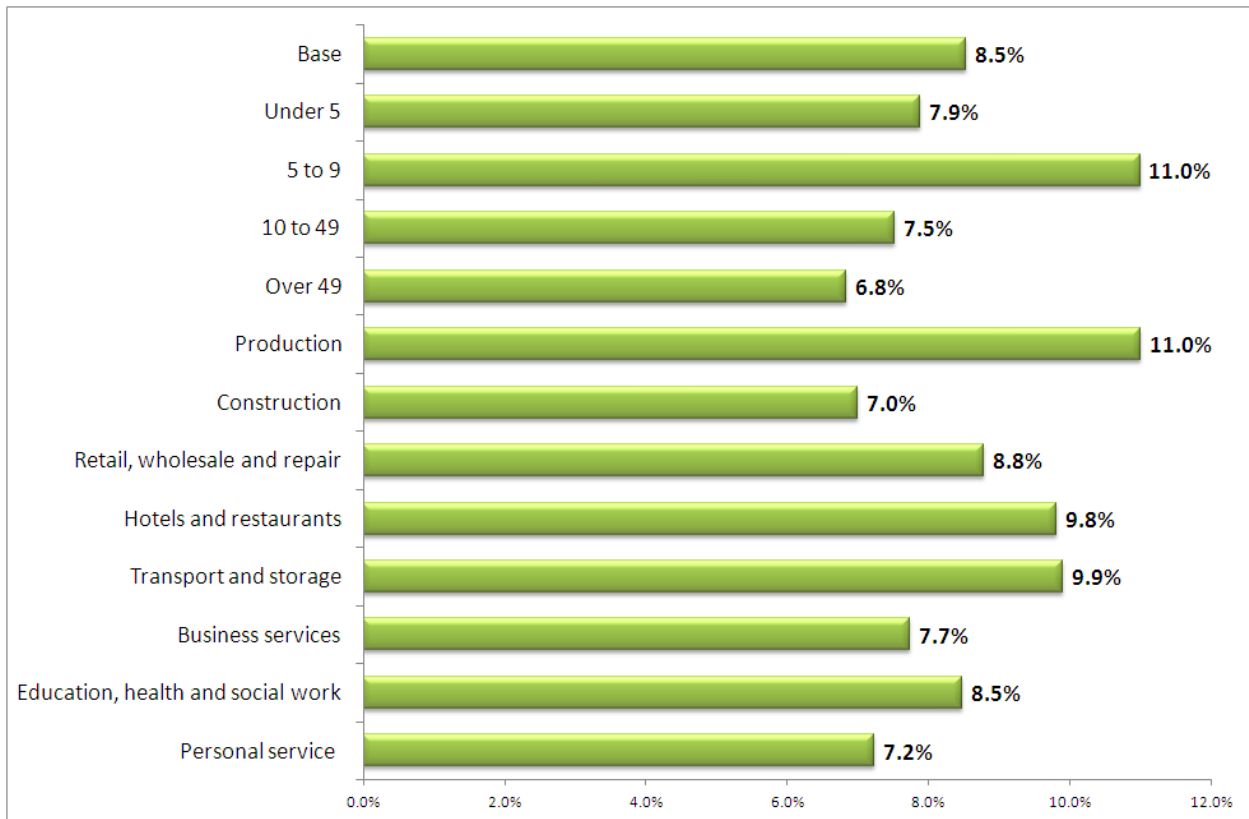
In total 97% of businesses have seen the cost of doing business rise, 1% have seen a decrease and just under 2% have seen levels stay the same.

Figure 7 Overall how the cost of business has changed over the last year



Overall business inflation was reported at 8.5%. Businesses employing 5 to 9 employees saw the biggest rises. Unsurprisingly, businesses with high energy usage (manufacturers), fuel requirements (transport) and labour intensive businesses (hotels, restaurants and care homes) reported higher-than-average increases. Business costs for Wales (8.3%) and Scotland (7.0%) were lower than those for England. Construction and slightly larger companies were least likely to have seen an increase in costs.

Figure 8 Business inflation over the last year



A comparison with the latest More Than Business Inflation Guide⁽⁷⁾ indicates that business inflation has hit manufacturers hardest. The figures also indicate that there has been an acceleration in the cost of doing business in 2011 after a lull in 2010. The latest figures for Q2 of 2011⁽⁸⁾ show a further increase of 2% which increases the Business Inflation guide figures for the last 4 quarters to 7.4%. The first six months of 2011 have seen prices rise by 6.6%, confirming an acceleration in business inflation in 2011.

Figure 9 Comparison with Business Inflation Guide

	Business Inflation Guide					Forum Comparison
	2010 Q2	2010 Q3	2010 q4	2011 Q1	Total*	
Business inflation guide	1.7	-0.1	1.7	3.6	7.0	8.5
Micro business	1.7	-0.2	1.7	3.6	6.9	9.0
Small business	1.5	0.1	1.5	3.5	6.7	7.5
Southern	1.6	-0.1	1.6	3.5	6.7	8.2
Midlands and Wales	1.7	-0.1	1.7	3.4	6.8	9.6
Northern	2.0	-0.3	1.9	4.1	7.9	9.4
Scotland	1.5	-0.2	1.3	3.4	6.1	7.4
Manufacturing	2.0	-0.2	2.1	4.2	8.3	11.0
Services	1.3	-0.1	1.6	3.4	6.3	8.3

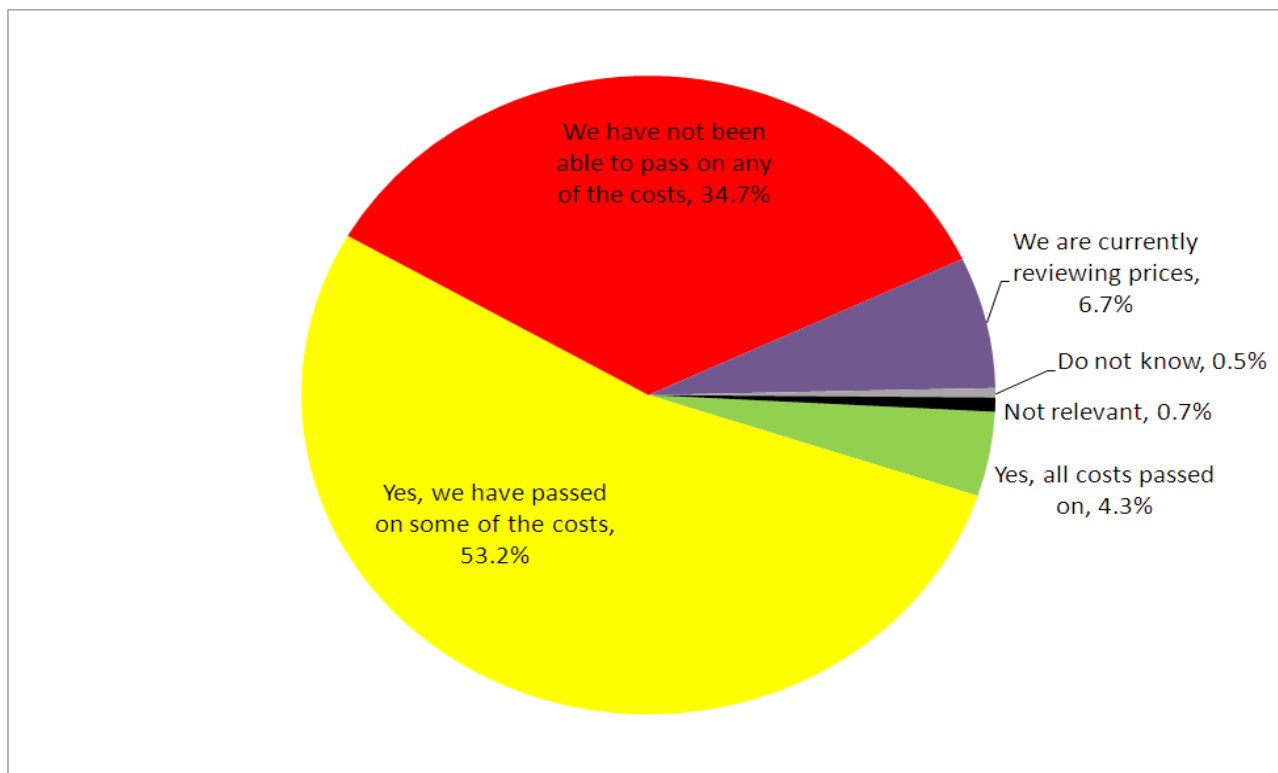
*Figures are cumulative over the four quarters

According to the Business Inflation Guide the sharpest price increases were raw materials and fuel, increasing by 5.29 and 4.68% respectively.

Impact of change to the cost of doing business

Just 4% of businesses have been able to pass on the entire cost of price increases to their clients, with the majority only being able to pass on some of the costs. 1 in 3 businesses have not been able to pass on any costs to their clients.

Figure 10 Ability to pass costs on



Businesses in energy-intensive industries were least likely to be able to pass on all the costs to their clients, with 1% of manufacturers able to pass on all costs. A higher proportion of construction firms (46%), transport/wholesalers (35%) and personal service/care companies (44%) were unable to pass on any costs to their clients. For care companies in particular this was because their clients (local authorities) effectively decided the price. 2% of businesses reported no impact of the change in cost of doing business, with those that had been able to increase prices reporting that this had made them uneasy about their competitiveness, led to reduced sales and vulnerable to customer complaints.

"We have had to review expenditure, staff leaving are not replaced to save money. No investment being made for at least 2 years." Member response

45% of businesses reported that their profitability or margins had reduced as a result of price increases, 14% had seen sales/turnover reduced and 13% had reported that planned investment was unlikely to take place. 3% reported that this was being delayed with the rest reporting simply that it was not taking place for the foreseeable future.

"Significant increase on cash flow cannot compete with large companies when recruiting new staff." Member response

An increase in cash flow pressures were reported by businesses, with 2% reporting that this was responsible for their inability to access finance and several companies reporting that they had to pay in advance or pay a higher price to cover the suppliers' insurance costs. 4% of business owners admitted that higher costs reduced cash flow, meaning when they suffered from late payment they had to pass this on to their suppliers by paying late themselves.

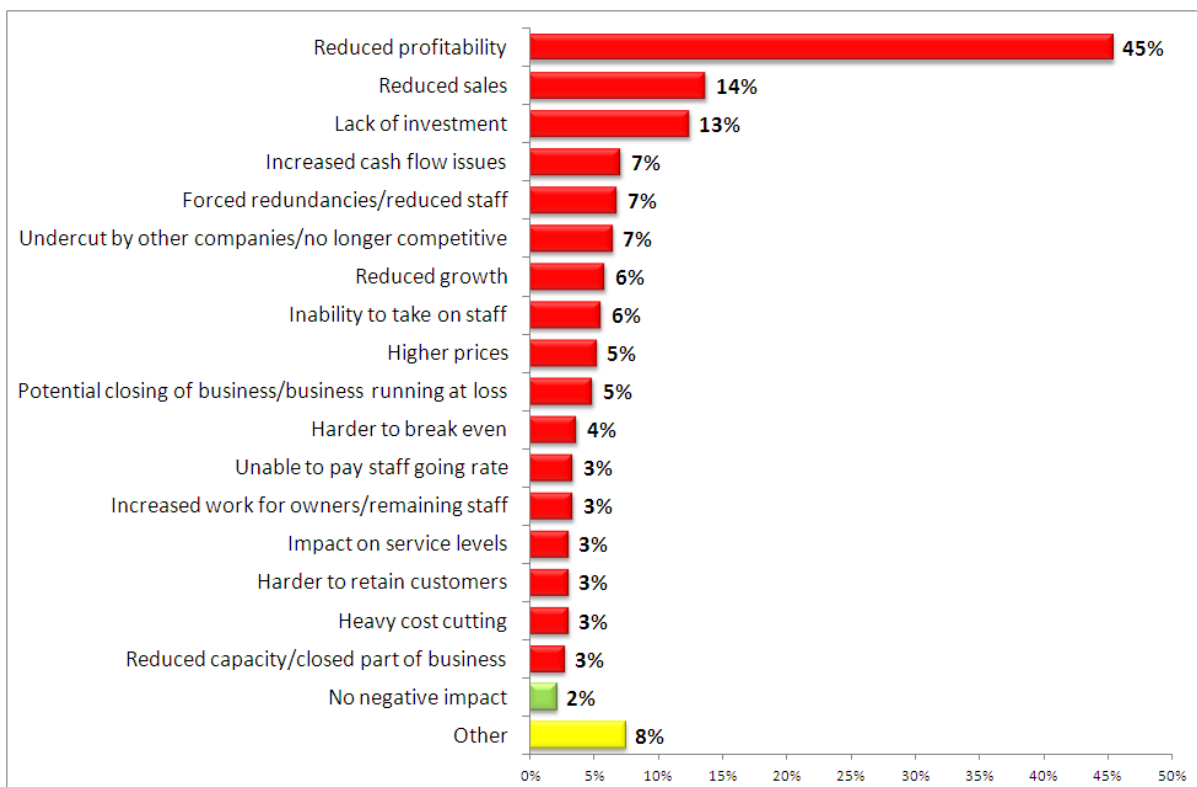
"We have to cut services and staff which has an effect on the quality our customers are used to. Management are required to do more hours. Costs ultimately will have to increase." Member response

As the main costs were often outside the remit of the business (utilities, imported goods etc) it meant that tougher cost cutting was required on the costs they could control; 7% had to reduce staff levels, 3% had to reduce service levels and 3% had been forced to undertake more rigorous cost cutting programmes.

"Restricting opportunities because all growth will have to be self funded because of bank situation." Member response

6% reported they had reduced their growth plans with a similar number reporting that they were unable to take on staff or pay current staff the going rate. As well as staff retention, customer retention was a key problem for businesses with 3% reporting that they had lost loyal customers as a result. Worryingly in one case, a business owner reported that he could no longer afford to use local UK merchants.

Figure 11 Impact of price changes on the business



"It is getting to the point when we have to decide whether or not to remain open - a business that has been going for 21 years." Member response

3% of businesses reported that they had to reduce capacity or close part of the business to keep afloat, and 5% foresee a potential closing of the business as rising costs continue to have a demotivational effect. With 1% of business owners reporting significantly reduced pay and 2% reporting that they had to increase the time and effort spent on the business just to keep it going, keeping business owners motivated is increasingly important for the future of the UK economy.

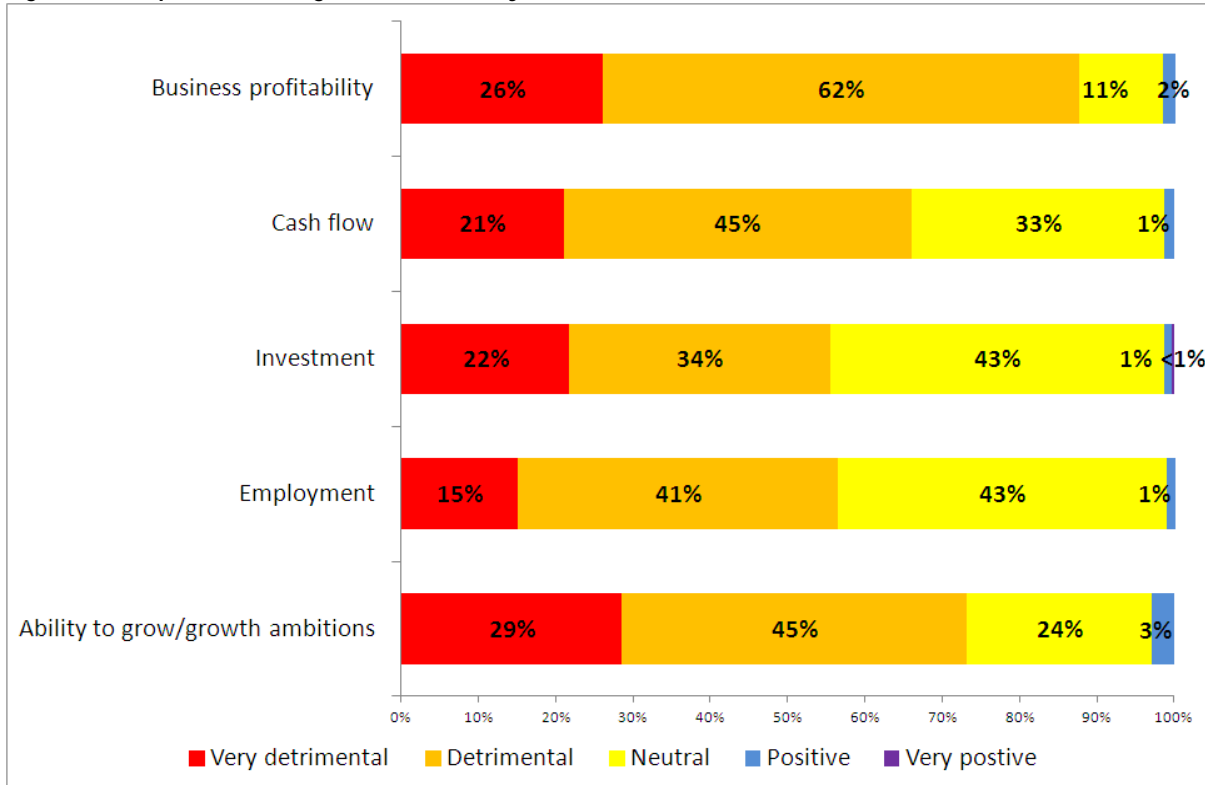
"We have to strip out costs unfortunately this is usually staff costs. The Government must work harder to help reduce direct and indirect cost to businesses." Member response

Business owners felt the impact of indirect costs from government legislation most keenly and reported its impact on their business. For some businesses this cost was attributable whilst others felt that it was the general cost of taxation and increasing unpredictability of it that was harming their ability to grow and was increasing their cash flow issues.

"We paid the Reach registration fees last year but another £50,000 [is] due this year which makes our business unsustainable." Member response

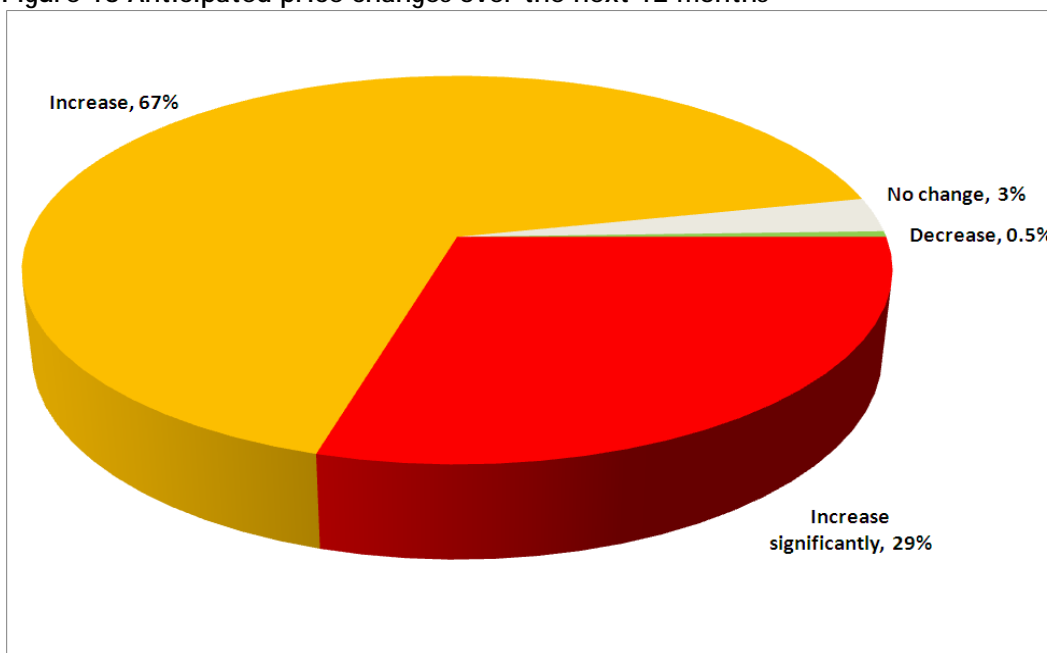
Few businesses reported an improvement to their main financial indicators. Those that did see an improvement had undertaken a cost reduction programme or had switched suppliers, particularly financial. Rising costs were particularly detrimental to growth ambitions, although a reduction in profits was more widespread. For just under half of businesses the rising cost of doing business had no effect on employment or investment, although it may have inhibited longer-term increases in these sectors.

Figure 12 Impact of change in cost on key business indicators



Practically all business owners expect the price of doing business to continue with 29% expecting significant rises and 67% expecting an increase. Less than 1% expected a decrease and 3% reported that they expected prices to remain at a similar level.

Figure 13 Anticipated price changes over the next 12 months

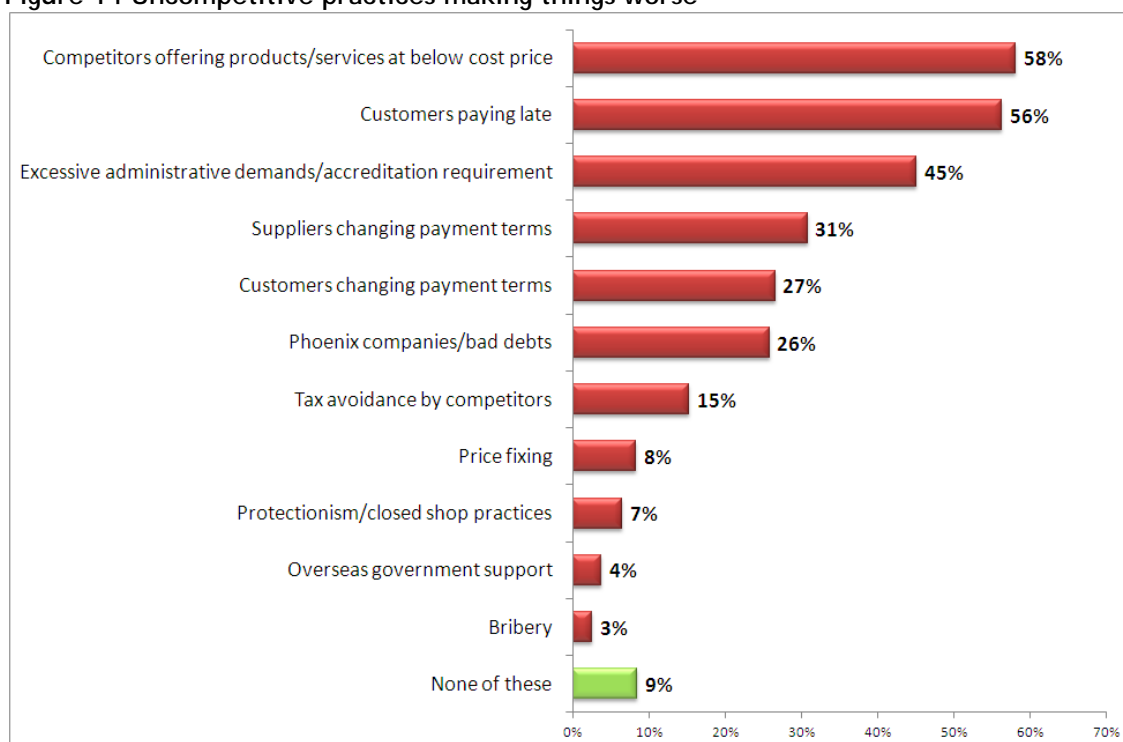


Practices making cash flow issues worse

"Customers can take longer to pay knowing that we live with it or they will go elsewhere. Big companies extend their terms at their own discretion." Member response

We asked businesses what practices were making cash flow issues worse. Over half of respondents reported that customers paying late and competitors offering services below cost price were making their ability to charge a fair price harder. Businesses with over 10 employees were most likely to suffer from cut price competition with 63% citing this as an issue with companies in the South (South East, South West, East of England). Those in distributive trades (haulage, wholesale, retail) were most likely to cite this as an issue. These businesses are likely to suffer from high property costs and competition from overseas, with businesses able to access lower fuel costs. Businesses in the construction trade were the most likely to be suffering from customers paying late.

Figure 14 Uncompetitive practices making things worse



45% of business owners felt that excessive administration was hitting their business by adding cost through payment of accreditation bodies (this was particularly an issue for construction firms and businesses in the health and social work sector) and took time away from business operations.

Smaller employers also form the 'squeezed middle' in the supply chain, with 30% of suppliers and a similar proportion of customers changing their payment terms. 1 in 4 businesses also had lost anticipated revenue from phoenix companies.

Tax avoidance by competitors is an issue for 15% of businesses. This includes the self employed who slip under HMRC's radar, such as 'bedroom sellers' who make their money through eBay and larger organisations and who use taxation loopholes to give themselves a competitive advantage over smaller employers.

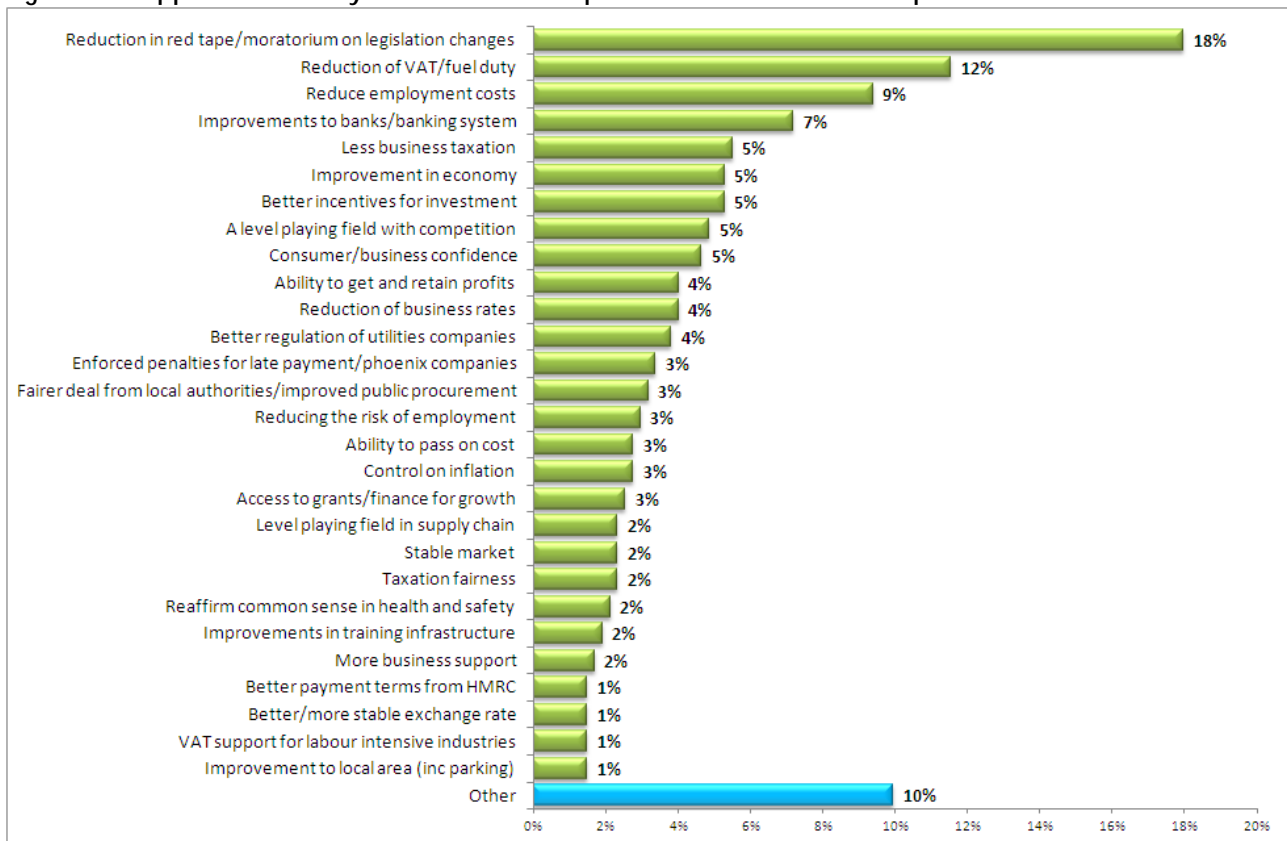
Price fixing, bribery and support for indigenous companies by overseas governments were also mentioned by a minority of respondents.

Support wanted to help future development

"Sweep away red tape as promised before last election. It seems there is now much more red tape." Member response

The support businesses wanted to combat the increases was quite varied as most of the cost increases are due to an unstable international market for commodities. Businesses feel that reducing the cost of red tape would allow them to save money on compliance issues and devote more time to running the business.

Figure 15 Support wanted by businesses to help them with future development



"Changes in employment law. A proper fuel stabiliser as promised by the Government. A level playing field for all businesses including internet companies who avoid many costs e.g. business rates in some cases." Member response

"Increased fuel costs have knock-on effects to everything. Our costs rise, staff need more money to pay for their living costs, costs rise = increased cost of supplies etc., fuel prices need controlling." Member response

Businesses would also like to see a reduction to taxation on diesel in the UK to reduce the cost of distribution and bring hauliers' costs more into line with continental rivals.

"Freeze on minimum wage and NIC reduction during recessional economy." Member response

Reducing the cost of employment would also mean that businesses were able to retain staff and minimise the requirement to reduce staff when faced with increasing costs to the business. Businesses were also concerned about the future as few felt that costs were likely to reduce in the foreseeable future.

"We are concerned about the pension legislation coming in the next year pushing employment costs up further especially after raise in NI employer contributions, extra holiday legislation and minimum wage being raised." Member response

VAT and National Insurance increases were the most commonly mentioned tax increases that could be reduced to help smaller firms cope with some of their larger costs, although 5% simply wanted reduced business taxation.

"For companies to pay on time and for government to realise that small businesses cannot survive with high VAT increased bills + increased National Insurance. This is killing small businesses." Member response

7% wanted an improvement in the banking system as short-term bridging loans are costly; some reported increased charges and felt that the cost of finance was one of the few areas that could be better controlled. Other areas where greater support could be provided were from utility companies (4%) and from local authorities (3%).

"A fair market with local authorities. They are the biggest employers, we pay our rates to them but they restrict access to the potential business to local suppliers and in general pay more from preferred suppliers." Member response

The lack of support given to local firms by councils (for instance companies now have to pay for waste handling in some part of the UK) and the continued rise of internet sales have meant that businesses feel that business rates increases are unfair and increasingly anachronistic in the market. These should be by reducing rather than being used as an increasingly important form of revenue.

Information sources

- (1) Forum of Private Business reports including Referendum 189 (48% cutting costs), Economy Watch February 2010 (46% cutting or reviewing costs) and Economy Watch October 2010 (39% reviewing or cutting costs)
- (2) Forum of Private Business, Referendum 196, Cost of Compliance www.fpb.org/page/104/Referendum.htm
- (3) BBA LIBOR rates, available from their website, www.bbalibor.com/rates
- (4) Ipsos Mori, National Business Survey Wave 2 June 2009
www.ipsos-mori.com/researchpublications/publications/publication.aspx?oltemId=1340
- (5) Forum of Private Business, Economy watch July 2010, www.fpb.org/research
- (6) Income Data Services, Pay report August 2011, www.incomesdata.co.uk
- (7) More than Business, Business Inflation Guide Report Q1 July 2011, available from the More than Press Office
<http://newsroom.morethan.com/contacts>
- (8) More than Business, Press Release for Business Inflation Guide Q2 September 2011
<http://newsroom.morethan.com/contacts>

Forum of Private Business
Ruskin Chambers
Drury Lane
Knutsford
Cheshire
WA16 6HA

Telephone: 01565 634467
Email: info@fpb.org
Web: www.fpb.org