



The business people – an extension to your team

Referendum 205 report

The Cost of Doing Business

October 2013

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 4,000 of our members during August and September 2013 to what the true cost of small business inflation was after members reported this as an issue.

Summary of the results

There has been a continued rise in the cost of doing business over the last year with 87% of businesses reporting an increase in energy costs, 83% in transport costs, 78% in marketing costs and 69% in the cost of staff. Businesses report they have had to cut costs simply to keep prices at the same level. There is a reduction in the proportion of businesses reporting an increase compared to last year. However, in context to a longer period of time such percentages remain quite high.

Prices have risen far faster for micro, small and medium-sized employers than for the rest of UK society at 6.0%. 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.

Figure 1 Which of the following costs have increased over the last year compared to 2011

	2013	2012	2011	
Wage inflation	2.5%	3.0%	2.5%	Income Data Services Pay report
Consumer Price Inflation (CPI)	2.7%	2.6%	4.5%	ONS
Annual inflation	3.1%	3.2%	5.2%	ONS/Moneyfacts
Underlying inflation	3.2%	3.2%	5.3%	ONS/Moneyfacts
Small business inflation	6.0%	6.7%	8.5%	Forum of Private Business

Businesses continue to absorb rising prices. Fewer have been able to pass on the costs to their customers this year, with 41% of businesses not feeling able to pass on any costs to their customers. Just 2% were able to pass costs on in full.

There is a significantly lower proportion of businesses concerned by credit restrictions this year, with a higher proportion seeing credit restrictions as irrelevant. Nevertheless, credit restrictions are still apparent with 26% of businesses feeling that they have less leeway than last year.

73% have had cash flow issues as a result and it has had a detrimental effect on 50% of business when looking at investment. 51% reported that it has been detrimental to employment levels and 63% feel that it has inhibited growth ambitions.

16% of businesses expect costs to increase significantly over the next year and 83% believe that prices will continue to increase. Fewer than 2% expected prices to decrease or remain the same.

The most frequently cited exacerbating factors were customers paying late (52%) and competitors offering products below cost price (51%). Excessive administrative demands forced on businesses by government, banks and customers have meant that 35% of businesses have not been able to focus on business activities. Changing payment terms had been a problem for 19% of businesses in dealing with suppliers and 25% in dealing with customers. Bad debt and phoenix companies had affected 16% of businesses.

Policy recommendations

Late payment

- Provide support to the Institute of Credit Management in order to better monitor and therefore strengthen the Prompt Payment Code. No business should be allowed to sign the Code if they have extended payment terms within the previous 12 months. If an existing member extends payment terms a mechanism should allow customers or their business representatives to challenge that change. All contractors for government contracts should have signed up to the ICM's Prompt Payment Code by default.
- Impose a requirement on all PLCs to declare their payment time statistics in annual audits to support better payments.
- Provide departmental support to business intermediaries to mount a challenge of 'grossly unfair' terms as detailed in the EU Late Payment Directive. Organisations like the Forum of Private Business can represent their members anonymously, with no fear that contracts will be lost, but currently lack the resource to instruct barristers in order to do so.

Procurement

- Remove pre-qualification questionnaires for lower value procurements and apply the same contract principles across the public sector. All public bodies - including local authorities - should publish their procurement spend with SMEs in a readily available and easily understood format on the gov.uk website.

Business rates

- The business rate and small business multipliers should be frozen in 2014. The Small Business Rate Relief should be extended to the end of the Parliament. The Government should commit to an independent study of business rates before the end of this parliament.

Fuel duty

- In line with the Chancellor's announcement at the Conservative Conference, savings across government must be identified to ensure fuel duty is not raised again during this Parliament.

Consumer credit licences

- The government should confirm that small businesses which have purchased licences that extend beyond the date of transfer of powers to the FCA should see those payments honoured and be exempt from purchasing new licences. At the very least, the government should use the Autumn Statement to clarify who will benefit from a rebate for previously purchased consumer credit licences and to what level, so that businesses can make an informed decision on whether they can afford to continue offering this service to customers.

National Minimum Wage

- Recent economic figures have indicated early signs of recovery and increasingly there is evidence that business confidence is slowly climbing. Whilst this positive news is most welcome it would be naive to expect businesses to run before they can walk. The Low Pay Commission should consider these issues before making changes to the rate of the National Minimum Wage.

Where business costs have increased

"They are all of similar importance, all extra costs which we could do without. No pay increases for 3 years." Member response

The Forum asked members whether a number of costs had increased over the last year. In some cases costs have decreased through members down-sizing, for instance, by reducing headcount or switching suppliers. In many cases this has minimised cost increases rather than allowing businesses to cut costs.

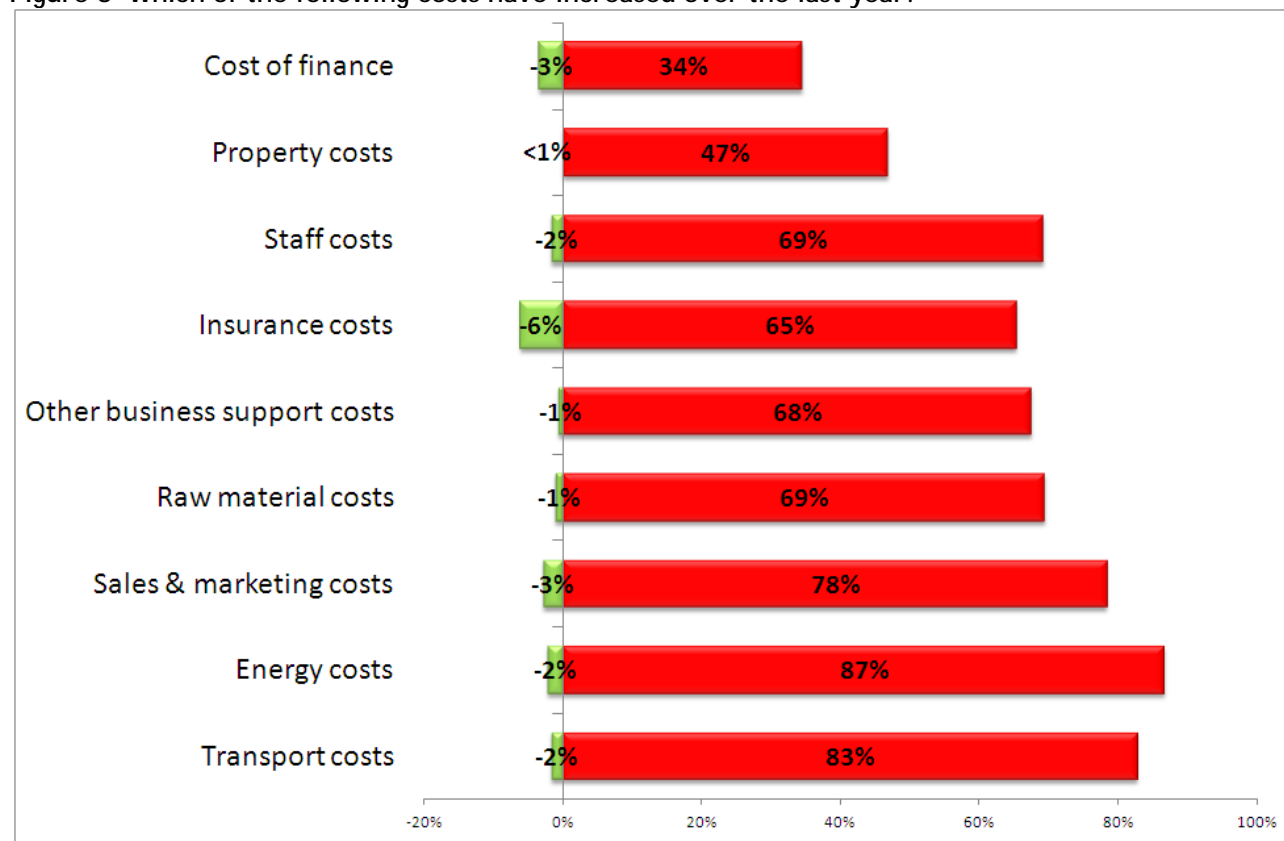
Figure 2 Which of the following costs have increased over the last year

	Increased	Decreased	Stayed the same	Do not know	Not relevant
Energy costs	87%	2%	9%	0%	2%
Raw material costs	69%	1%	10%	0%	19%
Transport costs	83%	2%	8%	0%	8%
Property costs	47%	0%	37%	2%	14%
Staff costs	69%	2%	25%	1%	4%
Cost of finance	34%	3%	31%	3%	28%
Insurance costs	65%	6%	27%	1%	1%
Sales and marketing costs	78%	3%	16%	1%	2%
Other business support costs	68%	1%	17%	5%	9%

"Maintenance costs, health and safety costs, energy costs, water charges, fuel costs in a manufacturing business these are difficult to cope with." Member response

Not all costs were relevant for all businesses and as a result the cost of finance was the business cost that was least likely to have increased, with 28% reporting this as not relevant to their business. Raw materials and property costs were also likely to be irrelevant to more than 1 in 7 respondents.

Figure 3 Which of the following costs have increased over the last year?



“Transport, petrol staying high and not reducing.” Member response

83% saw an increase in transport costs as the average price of petrol had increased sharply during the week preceding the fieldwork. Over the last year there has been very little in terms of changes to the price of fuel - oil is at \$111 a barrel - the same price as last September and forecourt prices are very similar. According to the ONS prices on vehicle fuel etc has gone up by around 2% over the last year (September to August) and transport services (insurance, hire and transport services have increased by 4% to 7%). Anecdotal evidence indicates it is the continuing high cost of delivering products and services (sales visits and getting to a client's site) that is causing the difficulty.

“Energy costs - we are a ceramic manufacturer.” Member response

87% saw an increase in energy prices with electricity mentioned by a number of businesses. Gas, water and contractual issues were also reported as reasons why energy prices had increased. Electricity and gas usage has increased at 8% and water by almost 5% over the last 12 months for consumers and business owners have less protection in dealing with the large suppliers than consumers do.

“Raw materials have increased by as much as 15%.” Member response

Another major increase in costs for consumers that was picked up by businesses in some key sectors was the cost of food (hotels, pubs, care homes etc) which has increased by 4% according to the ONS. Other raw material costs have increased, either directly as suppliers put up their prices or indirectly as a reduction in quality has meant more time preparing or sorting through materials that they have bought in.

“Business rates, energy costs, sales and marketing costs, we cannot keep pace with these rising costs.” Member response

78% saw an increase in sales and marketing costs, primarily due to increased postage costs and the impact that this has on their business. Increased costs may also mean, in some cases increased activity.

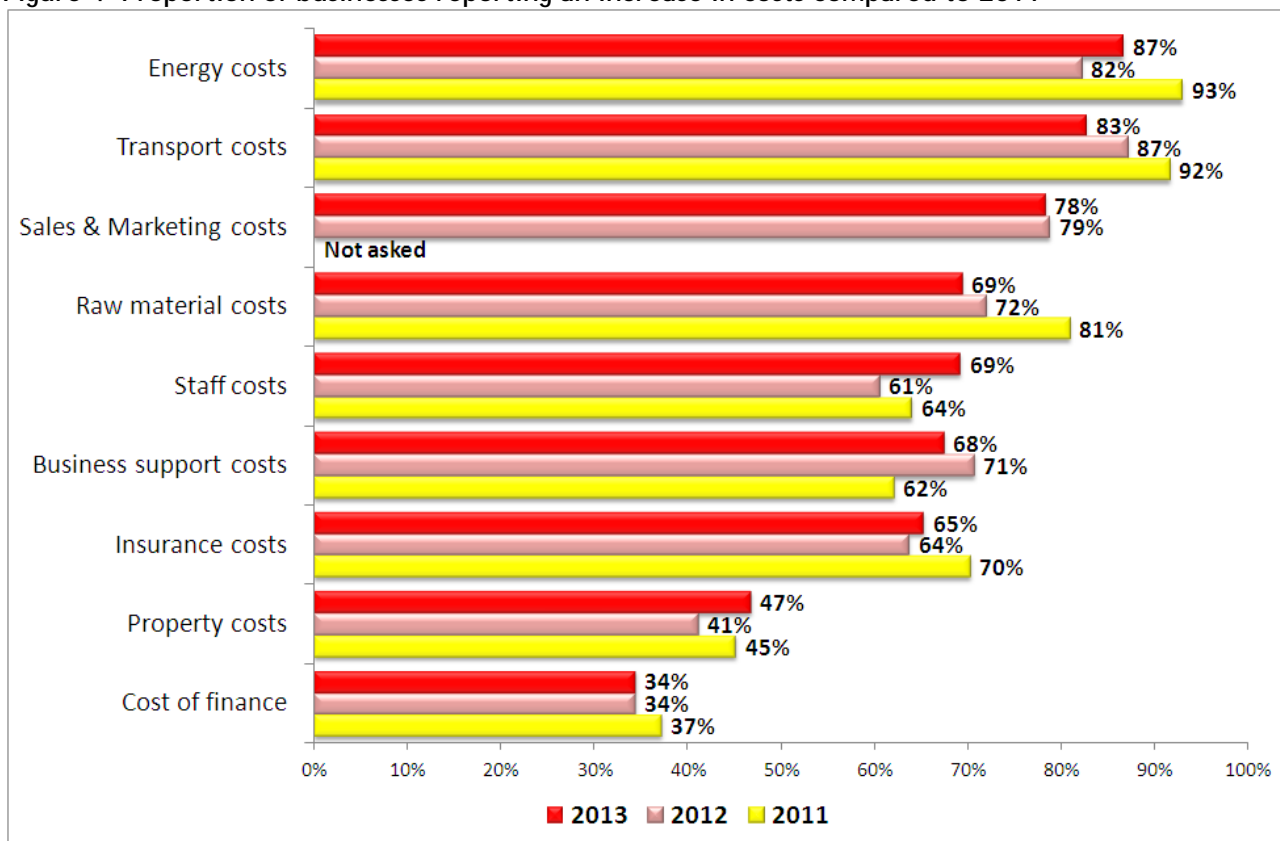
Property costs are the most likely to have stayed at a similar level, although a number of businesses did report that business rates continued to rise. Rent was also an issue for businesses although it was problematic for fewer than in 2011.

“Finance costs, banks bullying small businesses and not listening, fuel costs.” Member response

Cost of finance was the least likely to have increased, although in the last 12 months LIBOR has reduced from 0.7% to 0.5 %⁽⁴⁾. However businesses reported that interest rates had nevertheless increased as had transaction fees and the cost of arranging additional finance (in terms of time and the level of fees).

Insurance was the most likely cost to have decreased over the last year, although this may indicate that businesses have had to reduce their level of cover or increase their excess as a way of reducing their payments.

Figure 4 Proportion of businesses reporting an increase in costs compared to 2011



As in 2011 and 2012, a large proportion of businesses saw an increase in transport, energy and raw material costs as these costs tend to be imported from overseas or have high distribution costs. Compared to last year, a slightly lower proportion of businesses have seen an increase in transport costs than have seen an increase in energy prices.

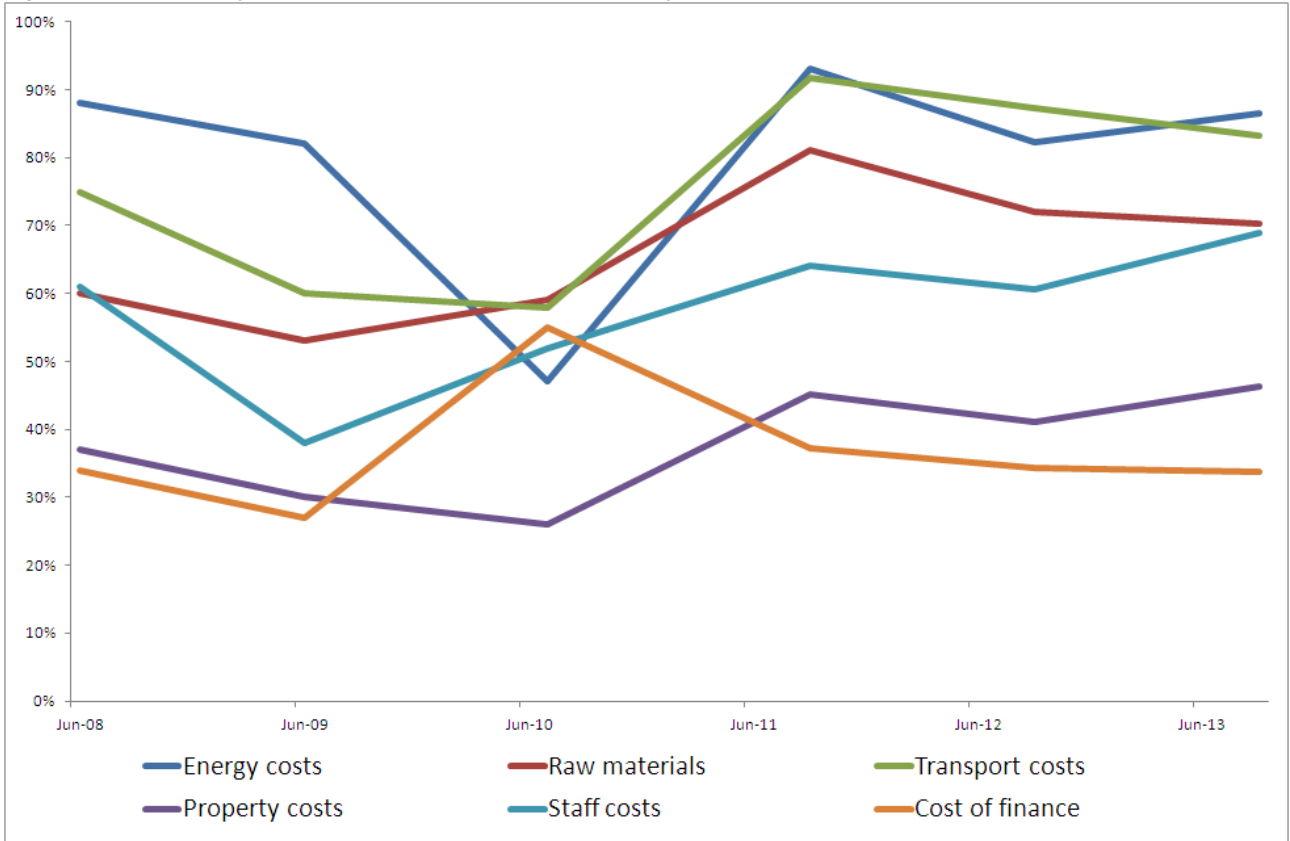
Looking back over a longer time period, these costs have consistently remained high, although the proportion of businesses reporting each area has reduced slightly. Figure 5 looks at the balance of businesses reporting an increase over a decrease in the last four years, using information from the National Business Survey to trace cost changes back to the start of the recession.

Figure 5 Balance of businesses annual change in cost (proportion of those showing a cost increase minus those showing a decrease) over the last 4 years

	National Business Survey ⁽⁵⁾		Forum figures			
	June 2008	June 2009	July 2010 ⁽⁶⁾	Sept 2011	Sept 2012	Sept 2013
Energy costs	88%	82%	47%	93%	82%	85%
Raw materials	60%	53%	59%	81%	72%	68%
Transport costs	75%	60%	58%	92%	87%	81%
Property costs	37%	30%	26%	45%	41%	47%
Staff costs	61%	38%	52%	64%	61%	67%
Cost of finance	34%	27%	55%	37%	34%	31%

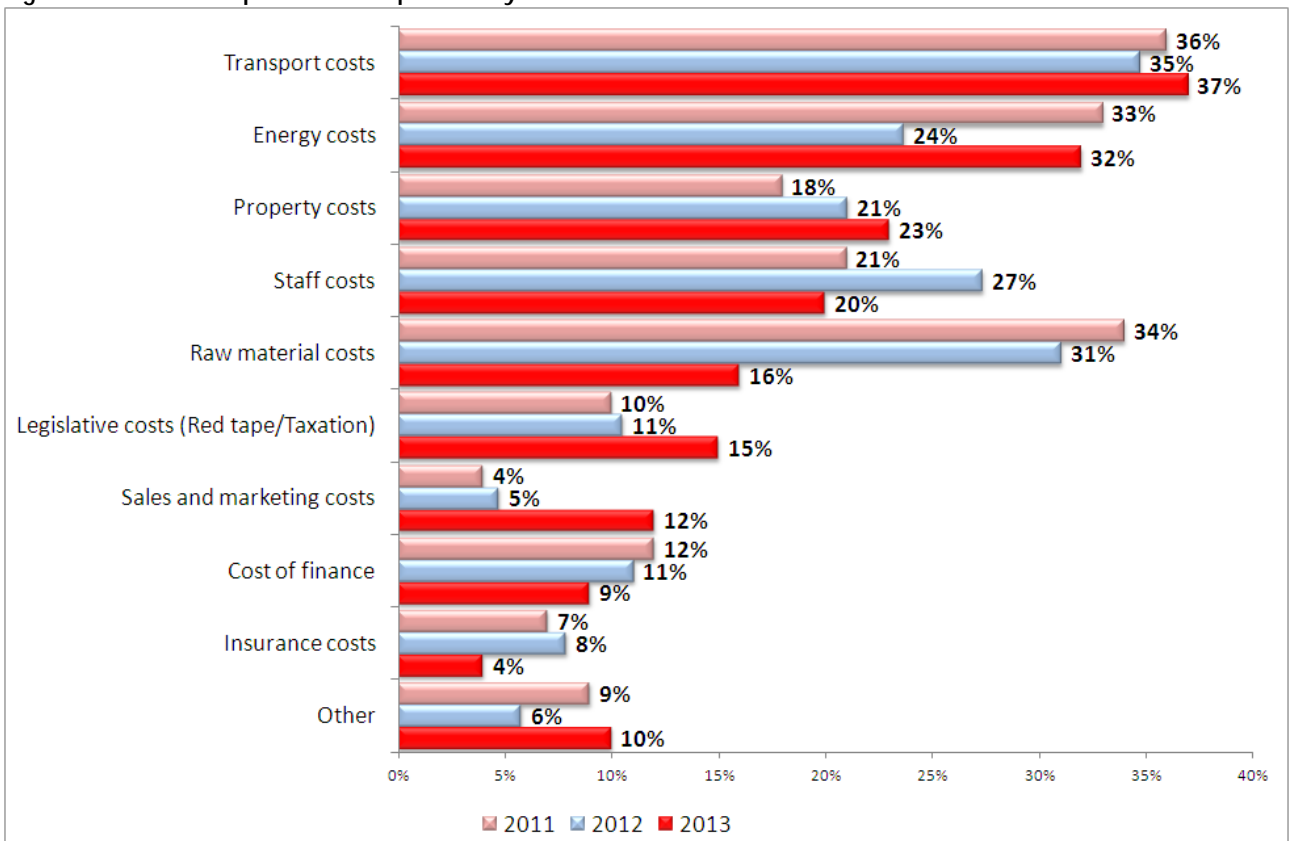
The graph shows the widespread nature of costs in the last year after a slowdown in the number reporting cost increases in 2010. The proportion reporting increases in finance over the last four years has reduced from 2010 although the figures are more in line with figures from the National Business Survey. Increasingly 2010 looks like an anomaly, with a spike in finance costs and a sharp decrease in the number of businesses reporting energy and transport inflation.

Figure 6 Frequency of cost increases over the last 5 years



We asked businesses the main cost pressure on their business at the moment. Responses from the remaining business owners are shown below and compared to the same answers given in 2012 and 2011.

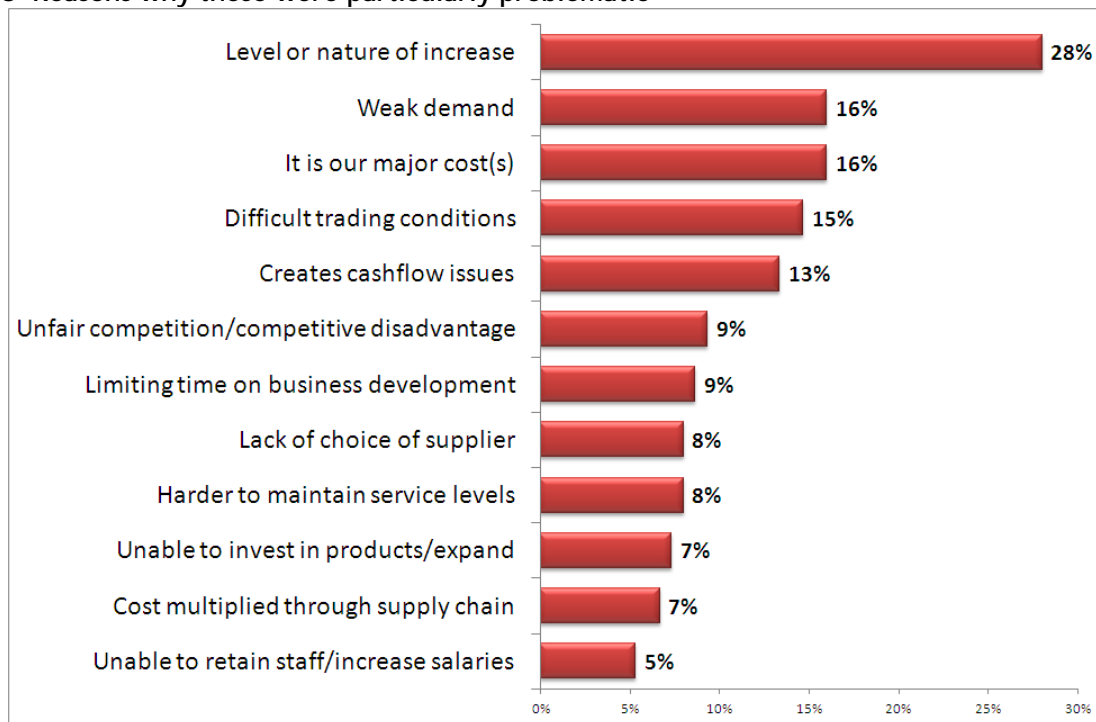
Figure 7 Main cost pressures reported by businesses



Transport costs have remained the same with 37% of businesses who mentioned cost pressures indicating this was an issue. Energy costs have returned to second place while staff costs - typically the biggest cost for the majority of our members - is more a background cost. A number did expect staff costs to rise significantly in the next year as national minimum wage increases impacts indirectly as employees use this to benchmark their own salaries. Legislative and red tape costs went up as a proportion of responses due to the impact of RTI and preparations for pension auto-enrolment as well as industry-specific regulation.

A number of businesses highlighted the reasons why these costs were particularly problematic, with the continued high cost or accumulative impact of continuing increases over the last few years.

Figure 8 Reasons why these were particularly problematic



The level or nature of the increase was the main reason why businesses felt that this was problematic - typically this was that prices of energy, fuel or business rates have been increasing for a number of years and there appears to be no let up in the increases. 28% felt that this was the case and these figure reinforce the latest international inflation indices collated by the ONS. Since 2005 prices have risen by 23% compared to 14% in France, 14% in Germany and 18% in Italy.

“Staffs costs due to lack of work. Transport cost due to cost of fuel.” Member response

16% reported weak demand (the market was contracting or clients were exceptionally price sensitive) or the fact it was a major cost as the main reason why this was an issue. In some cases these two elements are interlinked as businesses were not able to pass on the cost to their customers. With businesses reluctant to increase costs to customers small increases in one or other of the main outgoings of a business can affect it considerably.

“Staff to cover departments’ phone enquiries with a decreasing amount of customers.” Member response

Difficult trading conditions were reported by 15%. In particular, their own low turnover or profitability made it hard for the business to risk increasing prices even though they could not afford a further reduction in their margin in case there was a fall off in sales. Others stated simply that the cost of sales had increased as a result of prices going up and orders have not increased to cover for these increases. 9% reported that competitors (who often do not have to pay VAT, business rates or various licences) were being able to undercut them unfairly as a result of prices increasing. Property taxation was a key way competitors were able to undercut them.

13% felt that it made cash flow issues more critical, in particular late payment, as overdrafts have become scarcer since the last recession. A further 9% felt that it took their time away from developing their

business as they needed to focus on cutting costs, chasing up customers or talking to potential new suppliers/customers.

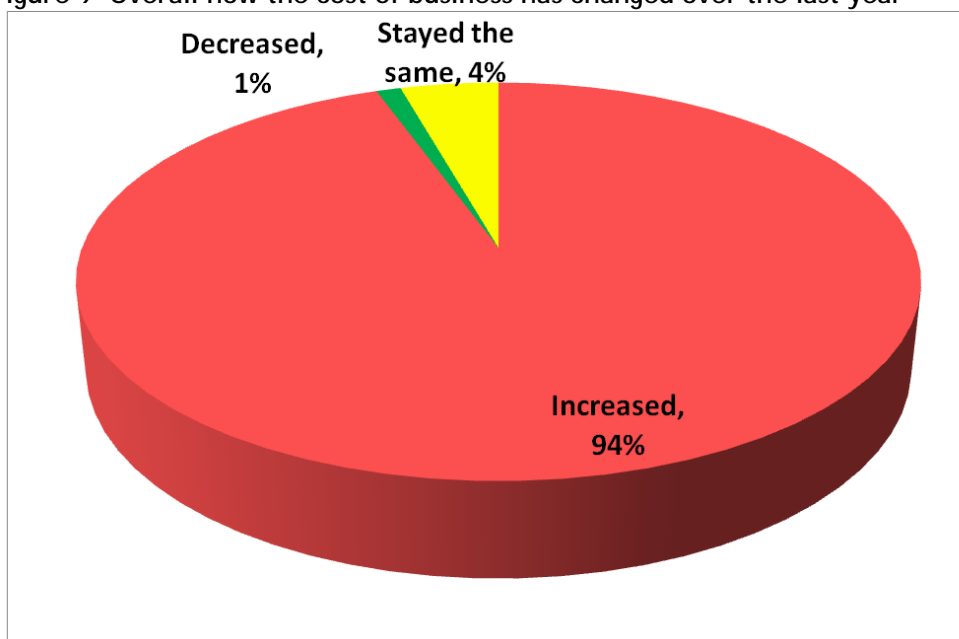
Business inflation

"Cost of sales increasing, but not able to pass on to clients." Member response

94% of businesses have seen an increase in the cost of doing business over the last year, with 1% reporting a decrease and 4% reporting similar levels. The majority of businesses that reported a decrease indicated that this was due to down-sizing and in particular reducing the head count. However Forum research from April indicates that 34% of businesses see cutting costs as a key part of their business development strategy in 2013.

Figures have changed little over the last two years. In 2011 97% of businesses saw the cost of doing business rise, 1% saw a decrease and just under 2% saw levels stay the same.

Figure 9 Overall how the cost of business has changed over the last year



Overall the average (mean) price increase was 6% although the weighted median was 4.4% with 54% reporting an increase of 2-5%.

Inflation was higher amongst care homes, hotels and restaurants (by 0.4%) and in London and the South East (+1%) and the Midlands (+0.7%). Costs were lower amongst companies in Scotland and the North, office-based services and engineering businesses.

ONS figures are lower as employers, particularly those with fewer than 30 employees, do not benefit from the economies of scale or larger employers but have higher fixed price costs than non-employers.

- Producer prices input costs 3.1% (August 2012 to August 2013)
- Accountancy services 3.2%
- Legal services 2.7%
- Architecture services 3.2%
- Engineering services 1.5%
- Cargo handling services 4.6%

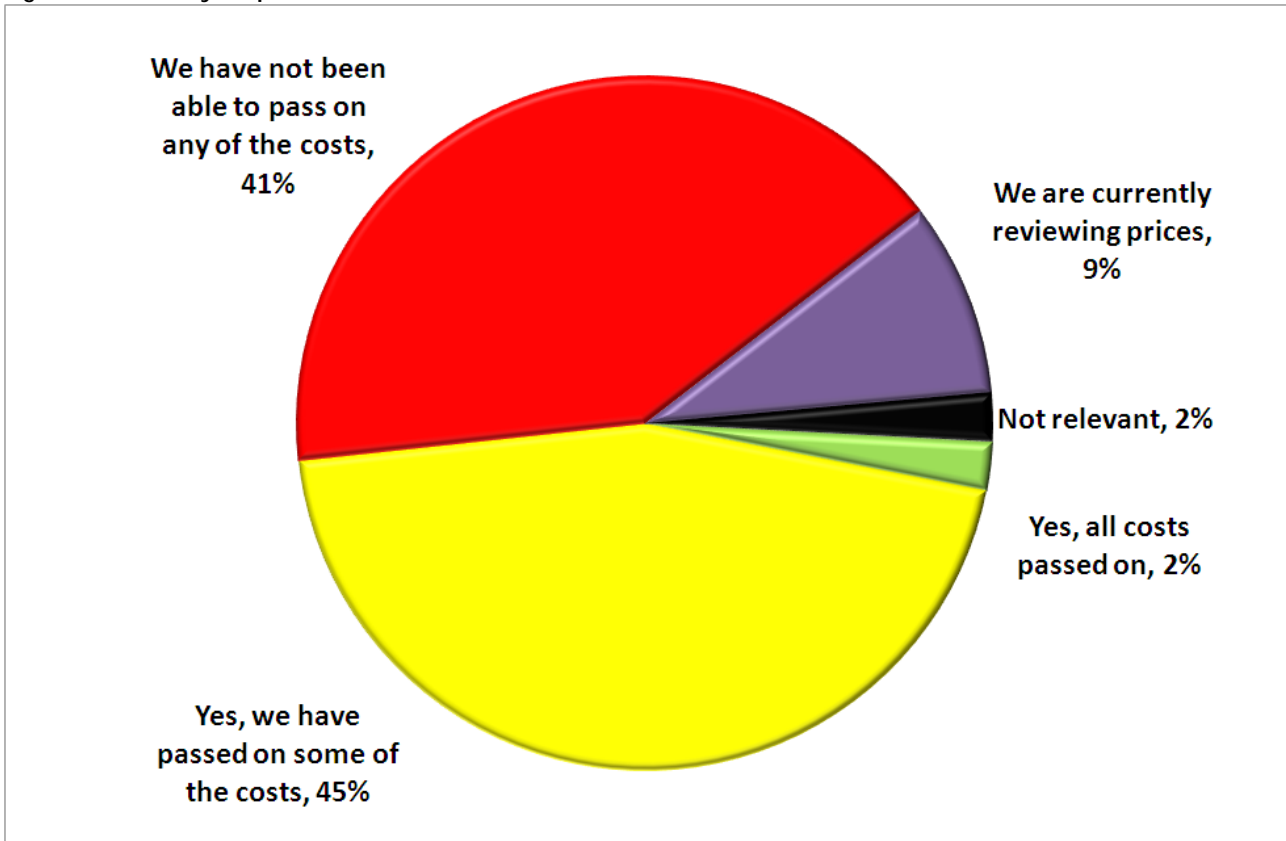
Impact of change to the cost of doing business

"Increasing bank charges or postage not recoverable from sales." Member response

Business inflation is however relative provided that businesses can pass on the cost to their customers, thereby retaining their margins. Just 2% have however been able to pass on all costs to their customers and 45% have been able to pass on some of their costs with almost 1 in 10 currently reviewing prices.

Overall 41% of businesses have not been able to pass on any of the costs of doing business.

Figure 10 Ability to pass costs on



Compared to last year, there is no real change in terms of the proportion of businesses who have been able to pass on all of their costs to their customers. 45% have been able to pass on some of their costs compared to 40% in 2012 and 53% in 2011. The other major change was that a very high proportion of businesses are currently reviewing prices and some businesses reported that imported goods and the cost of delivering goods are constantly changing.

Figure 11 Historical ability to pass on costs

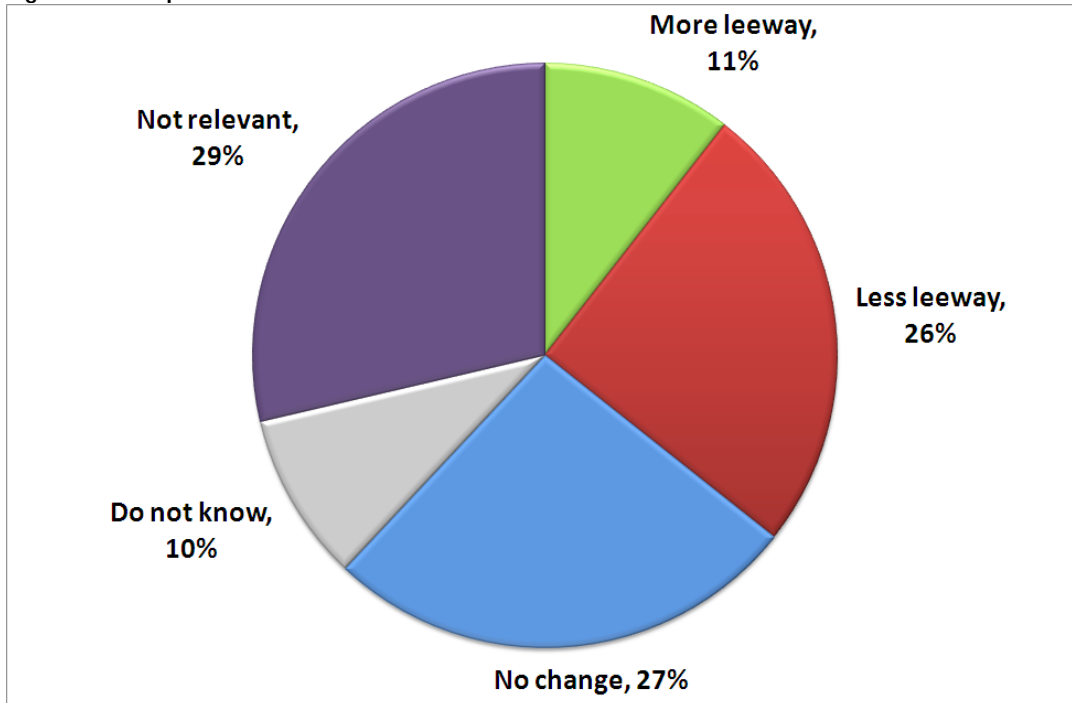
	2013	2012	2011	Change 2012-3
All of the costs have been passed on	2%	4%	4%	-2%
We have passed on some of the costs	45%	40%	53%	5%
We have not been able to pass on any of the costs	41%	36%	35%	5%
We are currently reviewing prices	9%	18%	7%	-9%
Not relevant	0%	1%	1%	-1%
Do not know	2%	0%	<1%	2%

Few of those that saw a decrease in costs passed on these cost savings to customers as a majority of these businesses were in industries where customers were themselves cutting costs.

Impact of credit in mitigating cost inflation

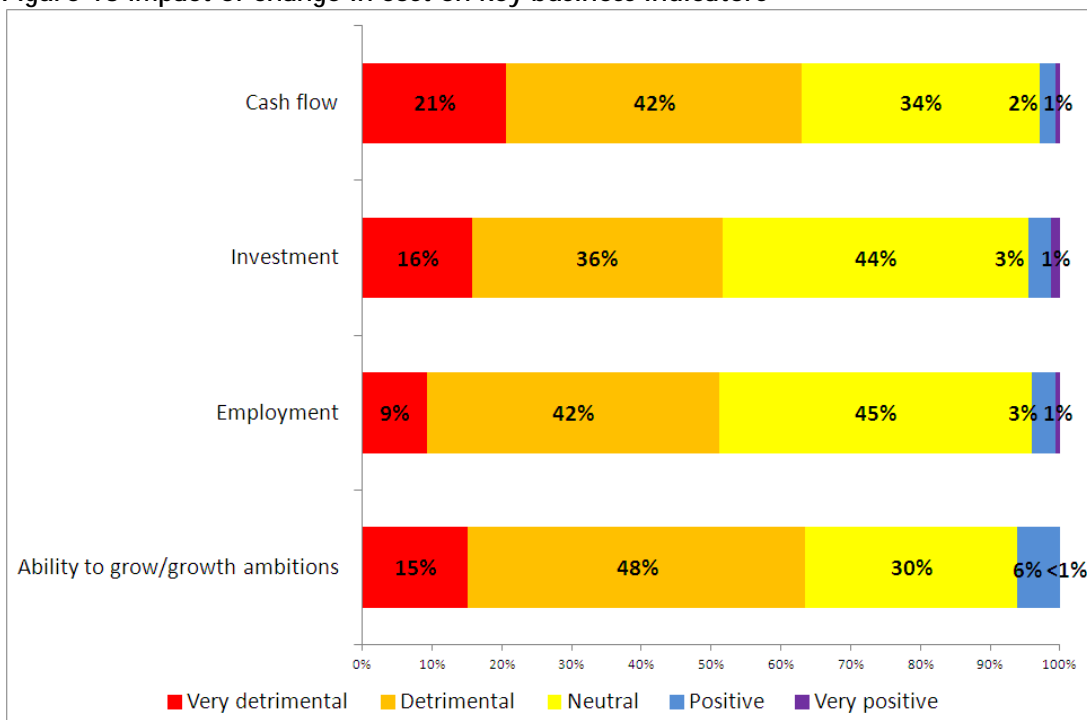
The cost of finance is in itself a key constituent in the cost of inflation for businesses, however the availability of credit facilities such as overdrafts can minimise the impact of cash flow issues caused by rising prices.

Figure 12 Impact of access to finance on business costs



Looking at some of the indicators it is clear that the rising cost of doing business has had a considerable negative influence on the business. The impact on the business has been greatest in terms of cash flow and growth ambitions. Overall around three quarters of businesses reported some negative impact of business inflation whereas just 8% of businesses saw some positive impacts of increased costs.

Figure 13 Impact of change in cost on key business indicators



The figures for 2013 were very similar to 2012, with a continuing trend towards fewer businesses reporting they were 'very detrimental' or 'detrimental.'

Figure 14 Impact of change in cost on key business indicators

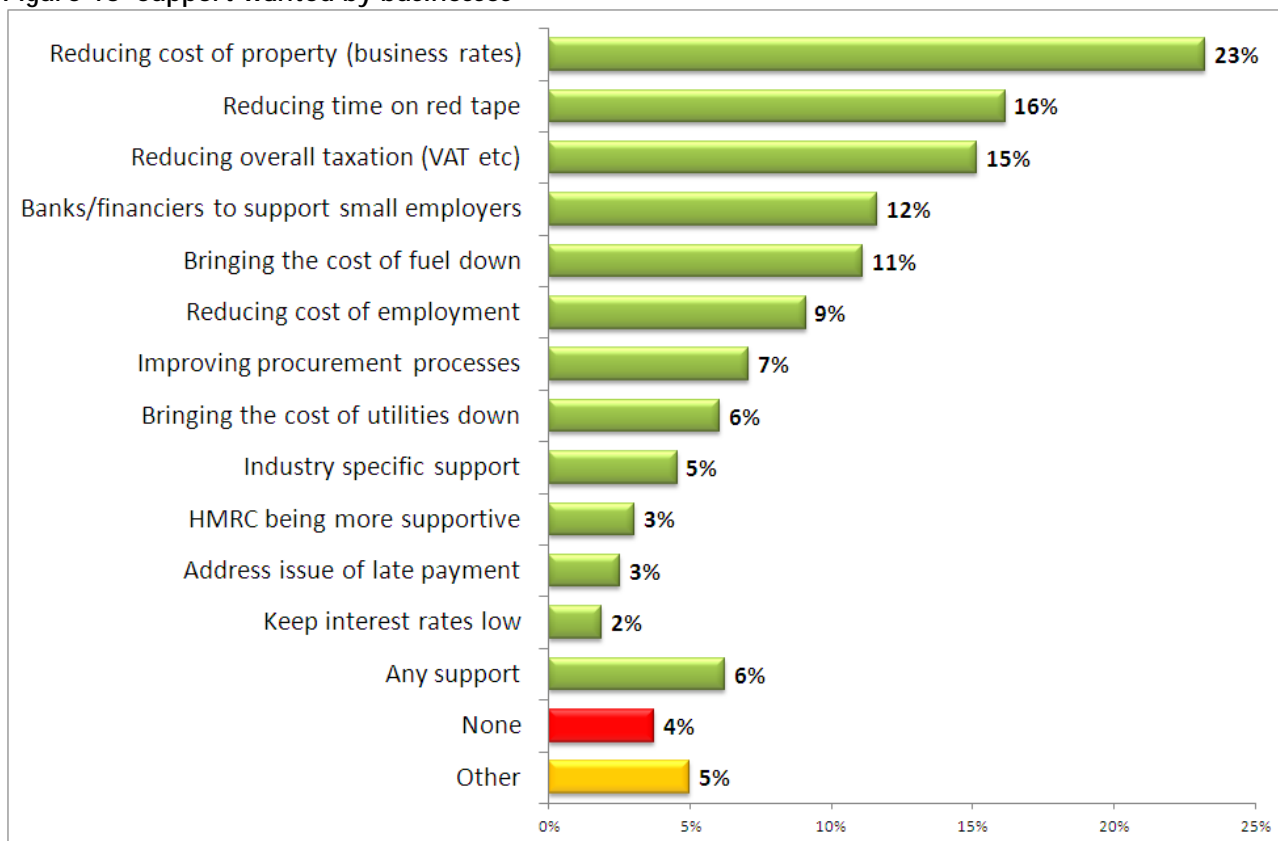
	Year	Very detrimental	Detrimental	Neutral	Positive	Very Positive	Impact
Cash flow	2013	21%	42%	34%	2%	1%	-60%
	2012	16%	50%	31%	2%	<1%	-64%
	2011	21%	45%	33%	1%	0%	-65%
Investment	2013	16%	36%	44%	3%	1%	-47%
	2012	15%	38%	46%	1%	<1%	-52%
	2011	22%	34%	43%	1%	<1%	-55%
Employment	2013	9%	42%	45%	3%	1%	-47%
	2012	14%	42%	41%	3%	0%	-53%
	2011	15%	41%	43%	1%	0%	-55%
Ability to grow	2013	15%	48%	30%	6%	0%	-57%
	2012	18%	51%	27%	3%	<1%	-66%
	2011	29%	45%	24%	3%	0%	-71%

Support wanted by businesses

"Business rates were due to be reviewed, government has now delayed this process for another 2 years."
Member response

We asked what support was wanted by businesses in helping them to deal with rising costs and the cash flow issues that it can cause.

Figure 15 Support wanted by businesses



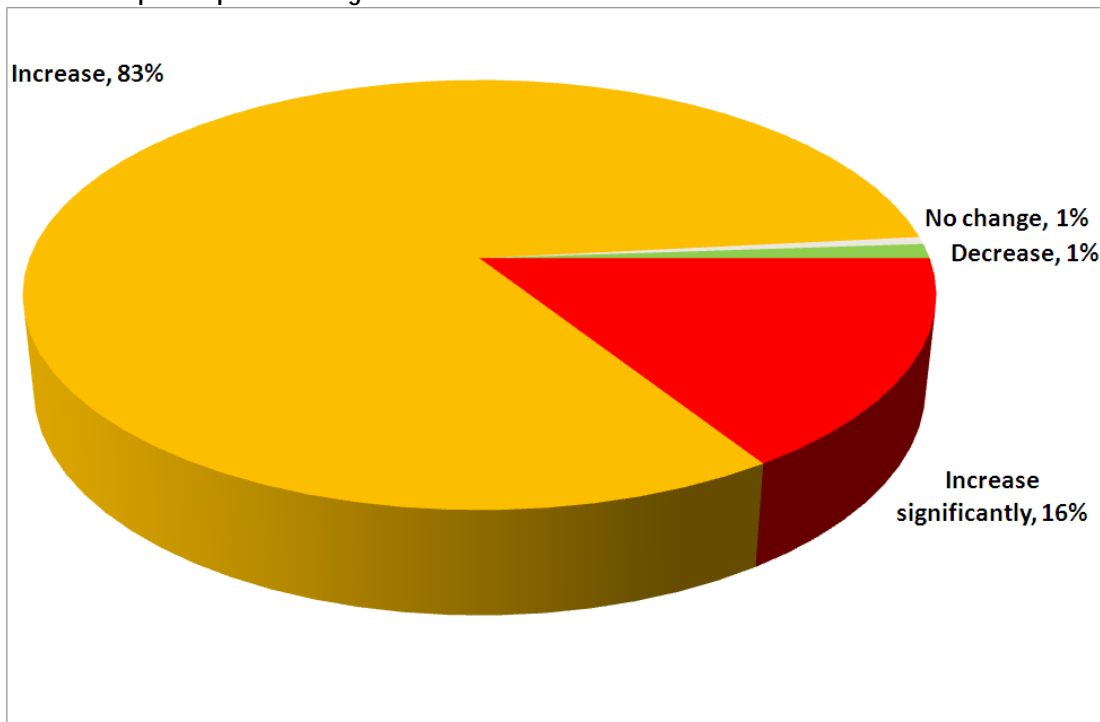
“More support with business rates, more support from HMRC in understanding cash flow problems especially VAT.” Member response

23% wanted support in reducing the cost of commercial property - although rents were mentioned by some business, particularly upwards only rent reviews. For some businesses it was the constant increase in business rates. One business felt that £1,000 for a small shop was excessive and there was a general feeling that they received limited support for what they paid.

Impact of change to the cost of doing business

Practically all business owners expect the price of doing business to continue with 16% expecting significant rises and 83% expecting increases. Less than 2% expected a decrease and only 1% reported that they expected prices to remain at a similar level.

Figure 16 Anticipated price changes over the next 12 months



2013 again saw a slowing in the rate of business inflation, however businesses are much more expectant that price increases are around the corner. A number mentioned wages and finance as areas where there was likely to be an increase next year, whilst fuel, utilities and business rates seemed to be continually increasing and there was widespread scepticism as to whether this would change in the next year.

Figure 17 Expectation change in last 12 months

	2013	2012	2011	Change
Increase significantly	16%	14%	29%	+2%
Increase	83%	79%	67%	+2%
No change	1%	5%	3%	-4%
Decrease / decrease significantly	1.2%	1.8%	0.5%	-0.4%
Balance	+97%	+90%	+95%	-5%

Only a small minority of businesses expect prices to remain the same in the next year, whilst few reporting a decrease next year suggested this would be due to switching one or more suppliers. More likely was that businesses had switched suppliers to minimise increases.

Practices making cash flow issues worse

The Forum looked at a number of uncompetitive practices that have been making things worse for smaller firms throughout the UK. There has been a significant decrease in the number of customers paying late, suppliers changing payment terms, phoenix companies and red tape demands from customers. Otherwise there was little change from the uncompetitive practices reported by our members last year, indicating that although such practices were not becoming more widespread, they are still not tackled effectively.

Figure 18 Uncompetitive practices making things worse

	2013	2012	2011	Difference
Customers paying late	52%	59%	45%	-7%
Competitors offering products/services below cost price	51%	55%	58%	-4%
Excessive red tape demands by customers or procurement teams*	35%	40%	45%	-5%
Customers changing payment terms	25%	26%	27%	-1%
Suppliers changing payment terms	19%	24%	31%	-5%
Tax avoidance by competitors	17%	13%	15%	4%
Phoenix companies/bad debts	16%	21%	26%	-5%
Overseas government support for competitors	9%	7%	4%	2%
Price fixing	6%	8%	8%	-2%
Protectionism/closed shop practices	6%	7%	7%	-1%
Bribery	4%	4%	3%	0%
None of these	12%	8%	9%	4%

* Wording changed in 2012 from "excessive administrative demands, accreditation requirements" so that there is greater focus on customers "gold-plating" administration rather than policy makers.

The main uncompetitive practice reported changed from competitors offering products or service below cost price to customers paying late. The top three uncompetitive practices remained the same for the second year running.

Regulatory changes that would help businesses control costs

"More vigilance by customs when customers purchase high value jewellery items when visiting Dubai. They avoid the VAT and then ask us to value these items. Adverts on TV encourage people to buy - unfair trading." Member response

We asked businesses specifically what regulatory changes could be made to help businesses control costs. Just over 1 in 5 focussed on cutting red tape, 12% in resolving regulatory unfairness within their market sector, 9% in dealing with late payment and 7% wanting more effective regulation on the energy market.

"Government promised to reduce red tape, it seems to have increased." Member response

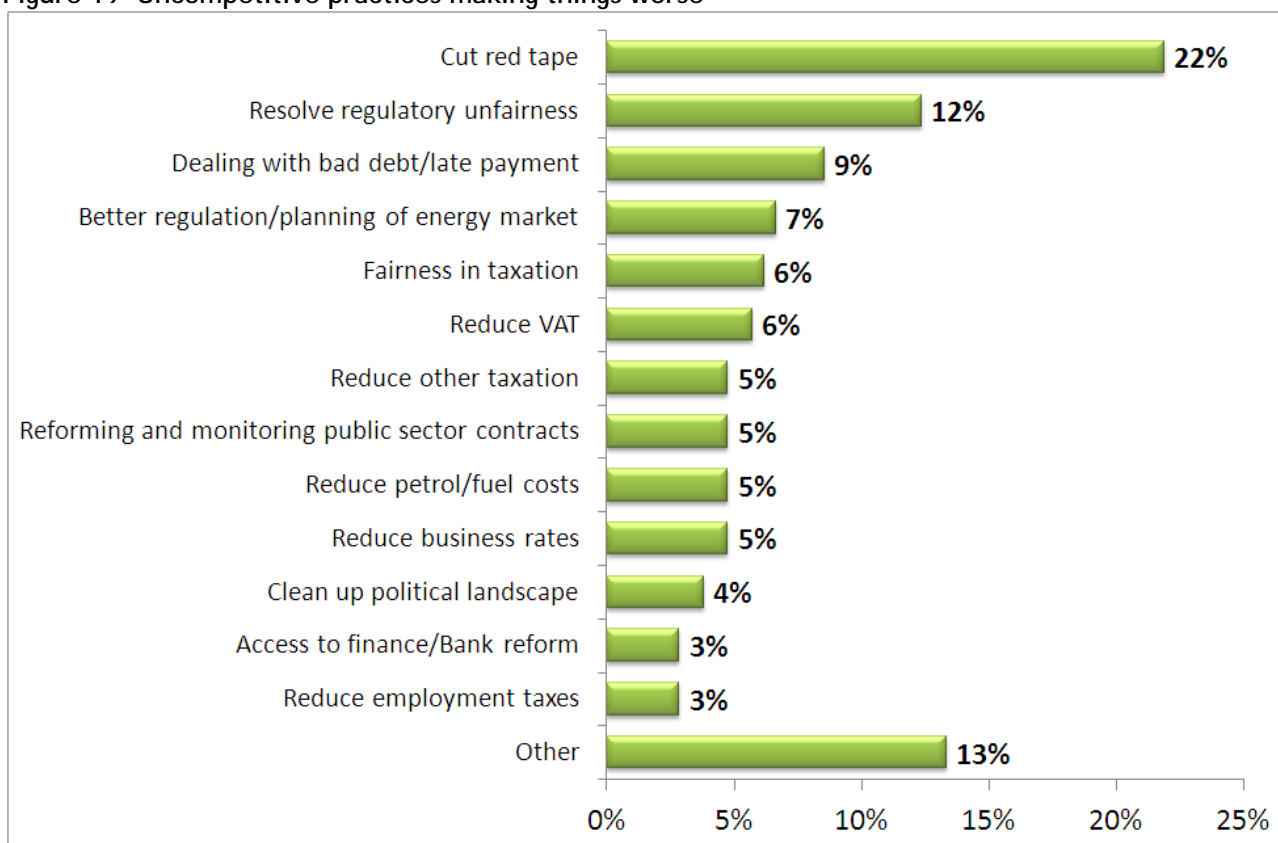
22% wanted the government to reduce the red tape that they had to comply with, this rose to 24% if minimising the need for external contractors (accountants and solicitors were included). Some businesses felt that the government should leave prices to market forces, but freeing up business development time would be something that regulators could do.

"As a retailer we find a difference between retail law and distance selling regulations which disadvantages the retailer - returns periods, rights etc." Member response

12% had issues that they felt compounded regulatory unfairness - with retailers feeling that regulations on traditional shops (consumer rights, licences such as PRS etc) compared to the requirements on bedroom retailers and international suppliers. Others felt that they were at a disadvantage over the costs put on UK businesses that businesses outside the UK had to comply with.

"Fair trading in the UK. Limit trading from abroad some countries do not have to comply with legislation particularly Health & Safety and cost of wages" Member response

Figure 19 Uncompetitive practices making things worse



Others felt that they were disadvantaged by regulation that may benefit larger organisations but were simply not relevant for businesses with less than a certain number of employees or where everyone was based in one location.

"We have had to go to court to get what is owed to us. Although settlement in our favour, there is little action we can take to enforce payment, we still lose and are out of pocket." Member response

9% of businesses wanted tougher action to incentivise prompt payment either through enforced payment terms (typically 30 days) or tougher penalties for those who delay. This was more important than bank reform and access to finance as businesses prefer to be in control of their own finances rather than rely on expensive bridging loans or finance packages to sort out cash flow problems.

"A sensible energy plan, huge subsidies to foreign companies to build inefficient wind farms, being dilatory over nuclear power and not being honest/open. Common sense for the long term please." Member response

7% wanted a reduction in energy prices, but in a sustainable way, in contrast to fuel taxation there was a feeling that taxation could not be used further to depress prices, but businesses wanted to be certain that they were not being limited internationally by high energy prices. Green energy, environmental taxation and lack of choice in the marketplace were seen as the key issues. The fieldwork took place before the concept of capping energy prices was mentioned in the political arena.

Another recent suggestion from the conference season was the capping of taxation from fuel duty, in total 5% wanted the government to look at the cost of petrol - with double taxation in the form of VAT on fuel duty a particular issue.

"Enforcement of quality control for public sector contracts (i.e. I am being constantly undercut by other contractors who then perform below standard)." Member response

5% also wanted public sector procurement to be reviewed so that local suppliers do not feel at a disadvantage compared to national providers and that contractors are reviewed. A number of businesses felt that they lost out in terms of price or other 'added value' service and then were frustrated when the

preferred supplier underperformed and retained the contract. A review of procurement was already expected in the next year.

“Ensure the application of CASC rules is being operated strictly in accordance with the rules by all golf clubs benefitting from the substantial reduction to their business rates.” Member response

In total 15% wanted improvements to the taxation policy - 2% mentioned tax simplification, 6% mentioned fairness in taxation, 6% wanted to see a reduction in VAT and 5% wanted to see a reduction in corporation tax, industry specific levies and various other taxes. In some cases businesses mentioned more than one of these issues, either due to unfairness in VAT regulation or the desire for businesses of all sizes to pay broadly the same levels of tax (especially corporation tax).

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) and Get Britain Trading February 2012 (29% reviewing costs), Business Support Survey May 2013
- (2) AA/Experian, Fuel Price report, available from the AA website www.theaa.com
- (3) BBA LIBOR rates, available from their website, www.bbalibor.com/rates
- (4) ONS Consumer Price Indices, September available from www.ons.gov.uk
- (5) Ipsos Mori, National Business Survey Wave 2 June 2009 <http://www.ipsos-mori.com/researchpublications/publications/publication.aspx?oltemId=1340>
- (6) Forum of Private Business, Economy watch July 2010, www.fpb.org/research
- (7) Income Data Services, Pay report August 2012, www.incomesdata.co.uk
- (8) More than Business, Business Inflation Guide Report Q4 April 2011, available from the More than Press Office <http://newsroom.morethan.com/contacts>

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