

SEMPORA STUDY: UK VAT INCREASE JANUARY 2010:

NEGATIVE EFFECTS ANTICIPATED BY RETAILERS AND CONSUMERS

Industry snapshot indicates how return to 17.5% standard rate VAT will affect retailers, producers and consumers.

UK consumers could face a double hit when VAT goes back up to 17.5% on 1st January 2009. According to a recent study by SEMPORA Consulting, London, around a third of retailers are looking at using the opportunity to make additional price increases on top of the VAT increase. There is some comfort for shoppers – while 50% of retailers intend to pass on at least the full amount of the VAT increase, 21% said they were planning to pass on only part of the additional cost and 29% indicated that they would hold prices at current levels. As a result, the VAT increase is also likely to put extra pressure on company profits and trading relationships between suppliers and retailers.

While almost 90% of suppliers did not see much scope for price cuts, the majority of retailers are set to maintain strong pressure on net sales prices. In the end, the loser in this game is likely to be the consumer, who is expected to bear the main burden of the VAT increase. Consumers, in turn, can see that the VAT increase will reduce their purchasing power and so said they were planning to bring forward some key purchases. Depending on the product category in question, between 13 and 41% of shoppers were intending to make purchases in 2009 instead of 2010 to save on VAT. And many were planning to reduce their spending in 2010.

As part of this study, SEMPORA surveyed 129 consumers as well as 108 leading companies in retailing and manufacturing.

The forthcoming VAT increase is expected to have a significant effect on UK retailing. Nearly 20% of managers from the sector believe that consumer retail prices will rise by more than the pending VAT increase (Figure 1) and 86% of consumers asked said that they thought the VAT increase would have a negative impact on their personal buying behaviour. 76% expected this negative effect to be bigger than the positive effect of the

original VAT decrease (Figure 2). Interestingly, almost three quarters of consumer respondents believed that the VAT rate will be raised to more than 17.5% in the near future.

As a result, many will attempt to save on VAT by bringing forward purchases to 2009. In particular, consumers see bigger ticket items such as consumer electronics (41%), home appliances (36%) and home furnishings (31%) as the purchases most likely to be brought forward to 2009. Consumers also said these were the items they were most likely to spend less on in 2010 as a result. Cosmetics and non-prescription drugs were least likely to be considered. Overall, two thirds of the consumers indicated that they would become more sensitive to retail prices and 54% said they would be likely to use discount brands more.

The majority of corporate respondents were anticipating these shifts and believed that, compared to a freeze on VAT, turnover will be lower in the first quarter of 2010 (52%). 35% said that they expected an increase in sales in the final quarter of 2009 as a result (Figure 3).

However, it seems unlikely that many retailers will try to cash in on this pull-forward effect by raising prices early. Whilst 9% of respondents said they were already adjusting prices upwards in preparation for the increase, 50% said they would attempt to offset the anticipated drop in demand next year by further delaying price increases from 1st January 2010.

The overall effect indicated by commercial respondents would be negative for their businesses, with 45% anticipating a reduction in net sales turnover and 65% projecting a cut in profits (Figure 4). As a result, almost all of these respondents recognised the need to plan a careful response to the change, with around 90% saying their management teams saw this as an important issue, although only 50% had already prepared or implemented firm measures. More than 70% indicated that they did not know how their customers would react nor what their direct competitors would do.

50% of retailers expected to pass on the full amount of VAT from January and nearly all producers indicated they would seek to do the same. Of the remainder, 21% expected to pass on some of the increase and 29% were planning to keep prices at current levels, suggesting they will absorb the cost of the VAT increase in order to maintain competitive prices. More than 30% of trade respondents indicated they were considering price rises in excess of the VAT increase.

The VAT increase is likely to put extra pressure on trading relationships between supplier and retailer (Figure 5). The trade survey's findings suggest a general consensus that the extra costs of the VAT increase cannot be absorbed entirely by consumers, but with differing views on how the balance of the costs are to be shared by retailers and producers. For example, most producers expected to pass on the full increase to retailers whilst most retail respondents expected some form of accommodation of this rise through more favourable terms. Based on the overall results of the two surveys, Sempora calculates that consumers will directly bear the major burden of the VAT increase (56% of the increase), with some absorption, at least initially, by retailers (30%) and producers (14%).

In order to protect profits, retailers were considering a range of measures, including: implementing more favourable terms & conditions with producers (55%), intensifying efforts to reduce sourcing costs (64%) and expansion of their own brand / private label product range (41%). As a last resort, 36% of retail managers would consider de-listing products from producers who do not support better prices or terms.

In contrast, most of the producers did not see any room for discounts. 88% were not planning to reduce their net sales prices. Moreover, around one third would consider attempting additional price increases – and risk potential sales losses. “One way out of this dilemma is the development of a coherent value added strategy”, says Francis Prosser, Managing Director at SEMPORA Consulting: “Additional product benefits can reduce customer hesitation, if they are communicated properly. Yet one must also consider the consumers’ price thresholds, which means effective price point management.” Retailers may already have returned to pre-VAT reduction price points and are faced with finding suitable new price points to accommodate the 2.5% price increase. Producers may also look at changing packaging and pack sizes.

ENDS

Note: The trade survey was conducted over several weeks in November 2009 among a broad cross-section of retailers and consumer product producers. A separate consumer survey was conducted in parallel.

The full report can be obtained from SEMPORA Consulting, London at a cost of £250+VAT.

Requests to buy the report or for further information should be made by e-mail to info@sempora.co.uk.

For press representatives, selected results are available at no charge by contacting the contact named below.

About SEMPORA Consulting: SEMPORA is a leading strategy, marketing and sales management consultancy, with offices in London and Bad Homburg (Germany). SEMPORA's sector focus is in Consumer Goods and Services, Retail, Travel/Tourism, Health Care and Industrial products.

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Figure 1: Impact on end consumer prices

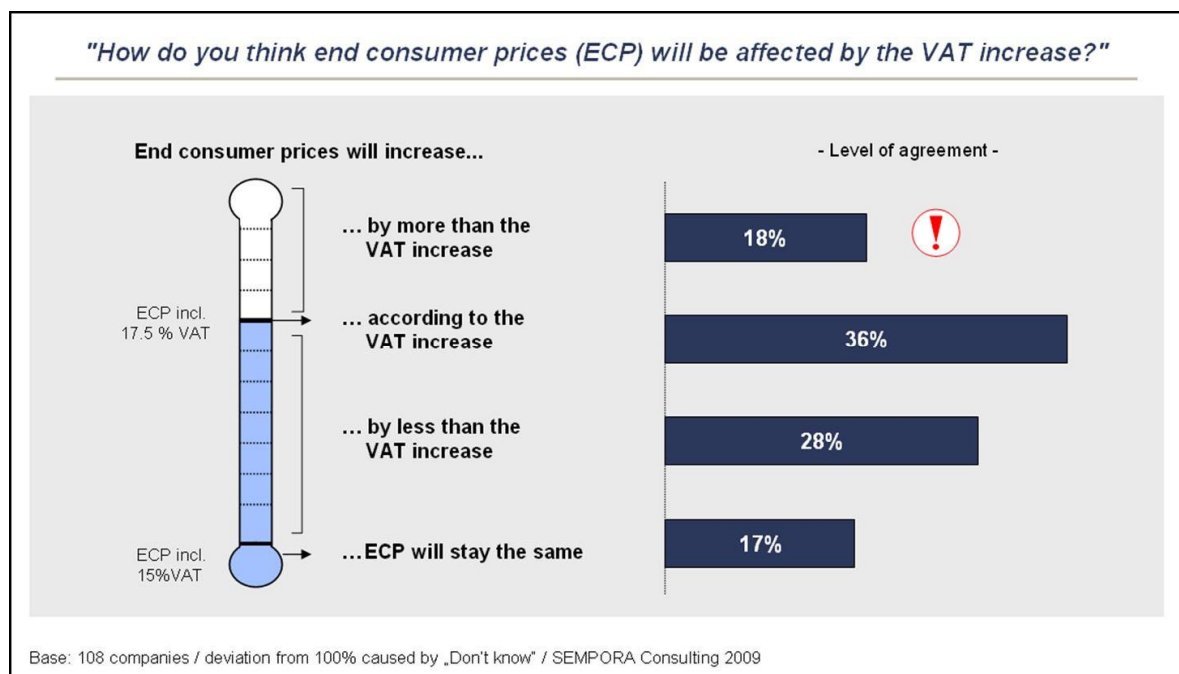


Figure 2: Consumers' buying behaviour

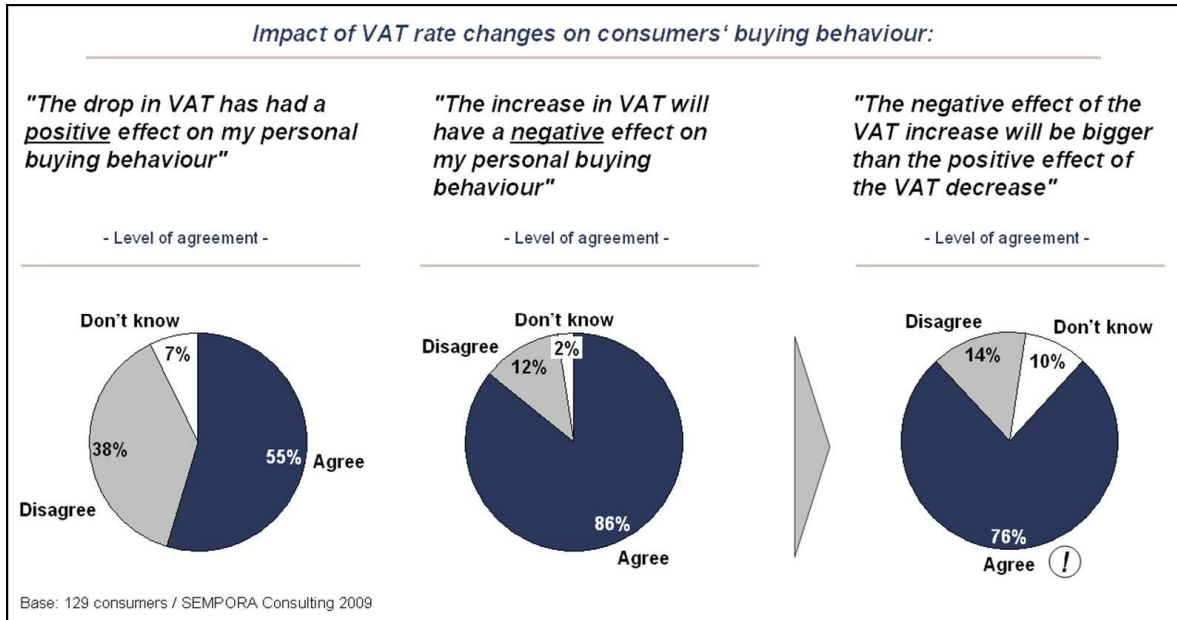


Figure 3: Effect on trade

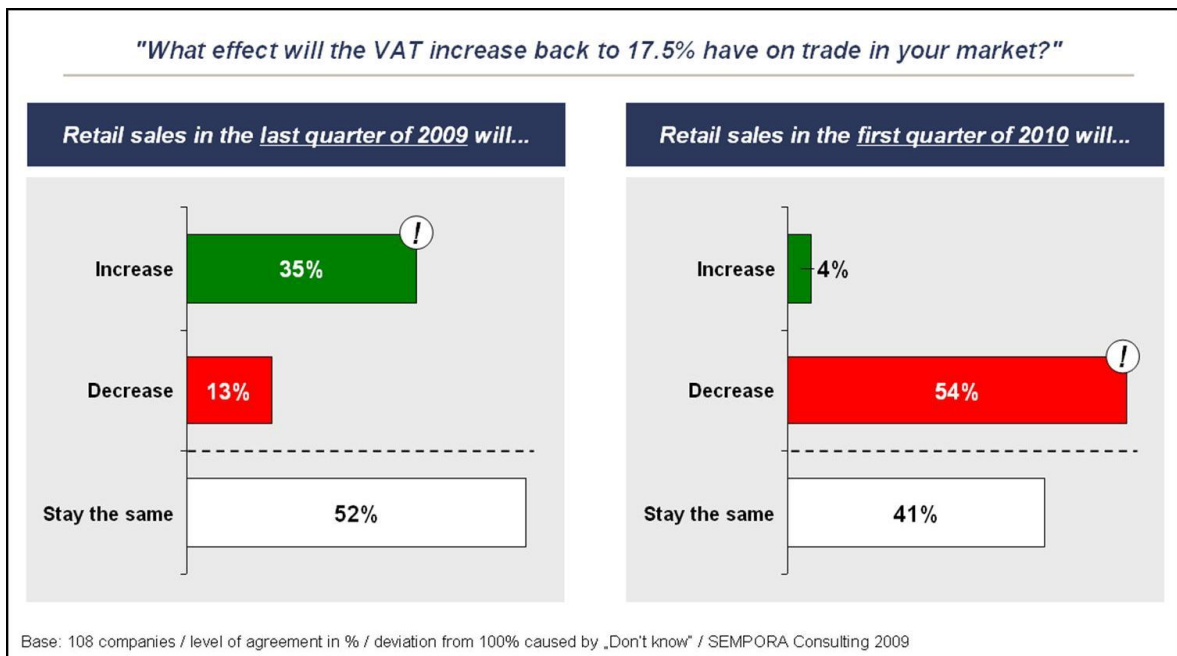


Figure 4: Impact on business success

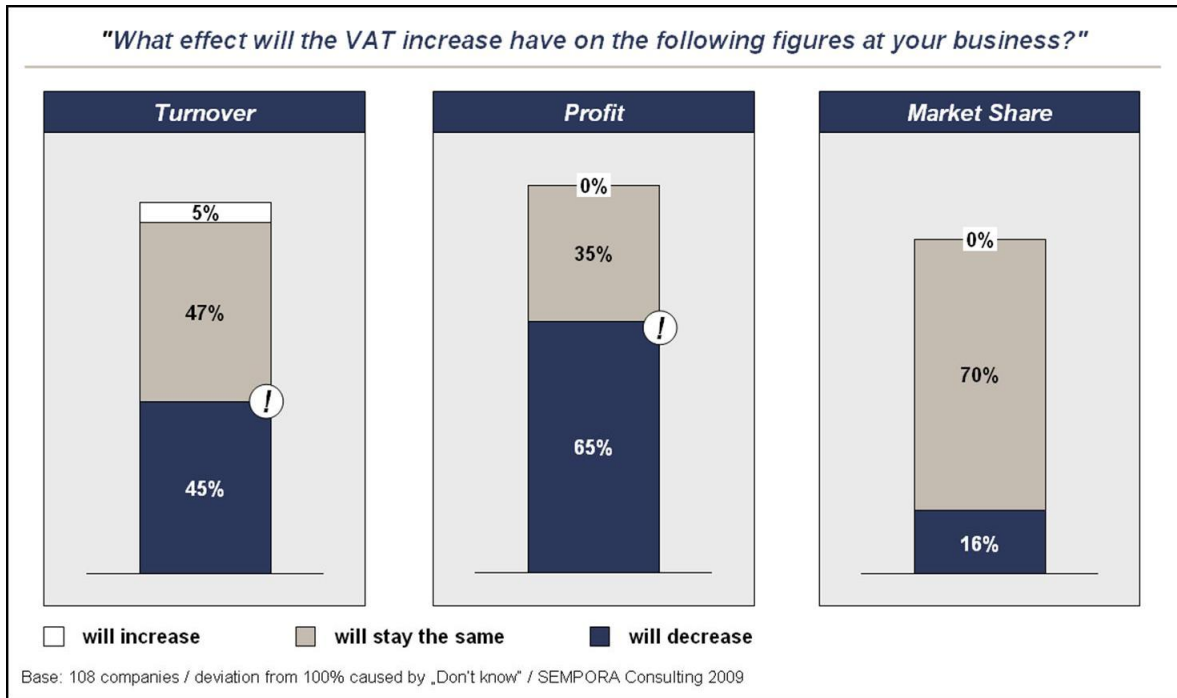


Figure 5: Consequences for trading relationships

