

Short Inquiry – Impact of Increasing Costs

13 September 2022

Culture, Communications, Welsh Language, Sport and International Relations Committee

Who we are

FSB Wales is the authoritative voice of businesses in Wales. It campaigns for a better social, political, and economic environment in which to work and do business. With a strong grassroots structure, a Wales Policy Unit and dedicated Welsh staff to deal with Welsh institutions, media and politicians, FSB Wales makes its members' voices heard at the heart of the decision-making process.

This consultation response focuses on the impact on SMEs. The cost of living is also a cost of doing business crisis and should be seen as part of that wider challenge, as well as in protecting our economy for growth in the future.

While inflation has spiralled to 10% for consumers, for businesses their inputs have been rising by double to three times that before the immediate current crisis from August 2022. This illustrates that they have been trying to absorb the costs and avoid passing onto the consumer, but that is not sustainable for very long. As such intervention to help business' costs are also a means higher up the supply chain to consumers to address cost of living as well as helping businesses.

SMEs are 99.4% of businesses in Wales, accounting for 63% of employment and 39% of turnover. This is a crucial moment for small businesses in Wales and across the UK, and we expect all governments to step up to meet the needs of this crisis, to work together, and to do their utmost to protect the backbone of the Welsh economy.

- **What impacts has increasing costs living had on your organisation and sector so far?**

Small businesses are particularly vulnerable to external shocks, whether they be in increase input costs through energy and fuel costs, disruptions to supply chains, and dampening consumer demand as costs of living mean households curtail spending.

Some Welsh examples of difficulties faced are:

Café in St. Mellons: Say they are struggling trade wise due to extra business costs and the cost of living impacting on customer spending. They are coming to the end of a fixed contract and is seriously considering whether the business can be viable from October/November on. They have already had to take out an emergency £2,000 loan recently.

Small Penarth café told us that some of their costs have gone up 200%, especially for items like sunflower oil and butter.

Welsh cake shop has told us that the **cost of butter** has gone up so much that it now costs them more than the cost of business rates and rent for three premises in Cardiff city.

Glass manufacturer: say they are currently spending £6,000 a month on diesel on a fixed rate contract, but this is a rate that ends in October and so is a matter of great concern for their future.

In terms of energy costs, we have recently published our report 'Out in the cold' (<https://www.fsb.org.uk/resources-page/out-in-the-cold.html>). Small businesses are in danger of being left out in the cold when it comes to energy bills, with the vast majority excluded from the household energy price cap and other protections designed for domestic household consumers.

Unlike large corporates, small firms cannot hedge costs and negotiate deals with their large energy suppliers. Many of our members note eye-watering energy bills could be the final nail in the coffin as they struggle to get through winter.

The degree to which small business bills for electricity and gas have increased will depend on a range of factors, most importantly whether that business is signed up to a fixed price contract, and when they signed up to that contract. For businesses whose fixed price contracts have ended in recent months, the impacts are typically that the electricity or gas bill will have doubled, trebled, or even increased by as much as four or five-fold.

We've also heard examples of big energy firms refusing to supply small businesses out of concern they could go bankrupt, and some even ask for £10,000 upfront costs as they see them as risky prospects.

It is also worth noting that in our Small Business Index input costs have been a major concern for over a year, alongside skills shortages. The biggest concern had been fuel until Q1 of 2022 and has been energy since then.

Between February 2021 and August 2022, FSB estimates that bills have risen by 349% for electricity, and by 424% for gas over the same period. This is based on an assumption of a 30,000-kWh annual consumption in London. For a business in that situation, it would imply that an electricity bill has increased from just over £4,700 to just over £21,200, and a gas bill has increased from just under £1,350 to just under £7,050 over the period in question.

In terms of effect on business, our survey from May 2022 Energy report found the following

- UK: 96% of small businesses say they are concerned about energy costs
- Wales: 40% of small businesses in Wales are extremely concerned about rising business energy costs, compared to 38% of all SMEs
- 65% of small businesses in Wales report price increases in the last year, with two in five companies (40%) having seen their energy costs double or more.
- UK: 40% of small firms have reduced their energy consumption
- UK: Almost 1 in 5 small businesses have no control over who provides their energy
- UK: 45% of SMEs have raised their prices in response to increasing energy costs
- UK: One in four businesses have cancelled, scaled down plans for investing or expanding the business in response to energy costs

We would expect the figures to have become worse since this data was collected.

- **What impacts do you predict increasing costs will have on your organisation and sector? To what extent will these impacts be irreversible (e.g., venues closing, rather than a temporary restriction in activities)?**

Without substantial intervention, many businesses will close and not reopen. Others will halt investment or will scale down their business. All this will impact on the Welsh economy and aiming at future growth will require that otherwise healthy businesses be supported through this time of dramatic external shocks, so that we have the businesses in place to grow for recovery.

- **What interventions would you like to see from the Welsh and UK Governments?**

At the time of writing, we are still awaiting more detail on the support measures by UK Government. The nature of this support will also influence any consequential for Wales and shape the scale and form of support Welsh Government can provide to Welsh businesses, and where they can fill any gaps.

It is welcome and a huge relief for millions of small businesses to hear confirmation they will be part of the Government's plans to help on energy. Many have been pushed to the brink by crippling energy bills, and so it is welcome that help is on the way.

The toxic combination of uncapped energy hikes, high taxes, inflation, and negative growth have become an existential threat for businesses.

Constricting the scale of energy bills for small businesses is unprecedented, but we now have a high-level commitment in principle to help businesses get through the winter intact. If this policy is successful and meets the scale of the challenge, this will be a lifeline – protecting jobs, communities, and future economic recovery.

However, at the time of writing, the announcement is very high-level and sparse on detail so we will be working with the new Government to clarify what happens next. Small businesses' instant reaction is that this is not enough information, yet, for them to plan.

Last week's statement leaves a number of questions unanswered, including:

- What will be the fixed unit prices (and standing charges) from October 1?
- What practically will now change – will energy retailers suspend high quotes and contract offers and recalculate from October 1?
- Will those who have accepted hugely increased bills in recent weeks be able to renegotiate to bring their bills down to reasonable levels?
- As a small business normally gets quoted for at least 12 months, does that new quote include 6 months at a low rate and 6 months at a high uncapped rate? How does the energy retailer know who to quote extra support to, for the second six-month period?

It is important that this not result in a cliff-edge after six months, with the withdrawal of support to all but 'vulnerable' targeted industries, sectors, or types of business. The definition of who falls in and out of that support will need to be looked at carefully at the three-month review.

Our work on vulnerability of small businesses to energy costs has revealed huge bills causing damage in virtually any sector that uses energy in any meaningful way, just like most households. Any future definition of 'vulnerable industries will need to be broad, realistic, and fair.

The Government should also make good on its commitment for comprehensive help for all small businesses affected. If any have energy circumstances such that, in practice, they turn out not be covered by the measures announced today, the Government must keep an open mind and ensure

policy decisions do not create another group of disenfranchised or excluded small businesses without support, just like it did on income support during COVID.

In general, our position over the last few months has been pushing for feasible policy levers that governments can pull:

- **Direct help for small businesses with bills.** This could be done through the business rates system, accompanied by a discretionary pot of money to be issued by local authorities. It could alternatively be directly applied to energy bills.
- **Temporary reduction of taxes on energy.** For example, the higher-threshold rate of VAT could be reduced from 20% to 5%. The lower threshold and domestic rate of VAT could be reduced from 5% to 0%. A VAT reduction should also help combat inflation.
- **Help to Green Vouchers should be introduced.** Modelled on the Help to Grow Digital scheme, Government should introduce a voucher scheme to support businesses to decarbonise, with £5,000 vouchers that can be spent on environmental goods and services. This would help businesses reduce their need to buy energy from the grid, lower bills, and improve our energy security; and
- **Extend the price cap to smallest businesses.** The smallest businesses need consumer protections in the same way as individuals do. They are more akin to domestic customers when deciding on their energy provider, ranging from lack of expertise in purchasing energy to poor bargaining power.

We have also asked the following of Welsh Government:

- reintroducing business rates holiday of 100% reliefs
- Extending the rates relief cap to £25,000
- identifying funds still available for business support through NDR system left over from Covid.
- Looking to develop long term scheme that support energy efficiency to business premises and replacing old machinery.
- Ensuring the public sector procurement addresses late payments and do not contribute further to cash flow issues of SMEs.

Government should use the mechanisms and learning from Covid-19 response. However, as the situation develops, we should also be mindful of types of businesses that may be hard to reach as was the case for support during Covid-19 (such as the self-employed and freelancers especially those who are not home-based businesses).

It is also important that we have a deeper understanding of what businesses are 'energy intensive' as a proportion of their own costs rather than the definition as set out by sector alone.

We will continue to develop policy responses and identify solutions for SMEs as the situation develops - this will be ongoing work.