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Bad Rating: Business Rates and the Retail Sector

In this special article, IBISWorld analyst Chris Edwards assesses the state of the retail sector in light of rate rises and online competition.

Rising business rates and online competition has driven a number of retailers off the high street

British high streets have often faced upheaval in the past, from the advent of supermarkets in the 1950s, to the rise of retail parks and out-of-town shopping centres in the 1960s and 70s. Historically, high-street retailers have always found a way to adapt to shifting shopping habits. However, in more recent years the increasing dominance of online retailing combined with weak consumer confidence, a rising National Minimum Wage, and recent changes in business rates may be the last straw for many high-street stores.

The New Economics Foundation, an economic think tank, estimates that 25,000 jobs have been lost on the high street in the first seven months of 2018. A string of retailers have closed in recent months including Toys R Us, Poundworld and Maplin. Others, such as New Look, Mothercare, Marks & Spencer, Homebase and Carpetright, have announced store closures.

High-street retailers have faced increasing competition from online retailers. Online retail has increased at a much faster rate than high-street stores in every year since the genesis of online shopping, with the Office for National Statistics calculating that in 2017 total retail sales increased by 1.4%, in comparison with a 12.1% rise in online sales.

Furthermore, changes in business rates over the past two years have left some high-street retailers struggling with higher tax costs. A major change to the way that business rates are calculated was introduced in 2017. Business rates are calculated based on the value of property, and the 2017 revaluation took into account how property prices had changed since the last revaluation in 2010. Due to the large increases in property prices in some areas in recent years, some businesses were left with much larger business rate bills. Further changes came into effect in April 2018. Some retailers have argued that these changes in how business rates are calculated have resulted in large increases in their tax costs, far in excess of inflation for some. Coupled with a rising National Minimum Wage,

What are business rates?
Business rates are charged on the occupation of non-domestic property. In England and Wales, the amount is based on the rateable value of a property and a multiplier, which is set by the government and differs between small and large businesses. Business rate revaluations generally take place every five years. The most recent revaluation came into effect in England and Wales on 1 April 2017, based on rateable values from 1 April 2015.

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which has increased on average across all age levels by just over 4.5% between 2017-18 and 2018-19, many retailers are struggling to cope with higher costs.

IBISWorld will look at three retail industries and investigate how the current business environment is affecting their operations.

Department stores

The Department Stores industry (IBISWorld report G47.190) has struggled over the past year. The industry's broad product range make it especially susceptible to pressures from online competition. Online-only retailers such as Amazon can often supply a wider range of products at lower prices, due to the removal of the need for physical stores and their associated costs. House of Fraser entered administration in August 2018 before being purchased by Sports Direct owner Mike Ashley. Other department stores such as Debenhams are struggling, with the company releasing its third profit warning in six months in June. Furthermore, Marks & Spencer announced in May that it would cut 100 stores by 2022, and has already closed 22 in recent months, with more closures expected over the remainder of the year. Marks & Spencer has closed its Covent Garden store in response to a rate rise of almost half a million pounds for the outlet, an increase of 41.7%. House of Fraser's business rates bill had increased by 13.6% between 2016-17 and 2018-19.

While online competition has contributed towards department stores' struggles, rising employment costs, weak consumer confidence and high consumer debt have also constrained growth in the industry. The changes in the way that businesses rates are calculated has also had a significant impact on the industry. Business rates in the retail sector increased by 3% in April 2018, which is 0.6% above CPI. However, research by rates adviser Altus Group found that the average rates bill for department stores in England and Wales increased by 26.6% between 2016-17 and 2018-19. This increase is far in excess of the average rate rise for large high-street shops over the same two-year period, which Altus Group estimated as 10.8%.

Weak performance by department stores also has a knock-on effect for concessions and suppliers. For example, the fashion company Mulberry, which has 21 concessions in House of Fraser stores, was owed £2.4 million by House of Fraser prior to it entering administration. Due to the nature of Sports Direct founder Mike Ashley's purchase of House of Fraser, outstanding debts to suppliers will not be settled.

Business rates in England*

Year	Small multiplier**	Standard multiplier***
2016-17	48.4p	49.7p
2017-18	46.6p	47.9p
2018-19	48.0p	49.3p

*Excluding the City of London **For premises with a rateable value of £15,000<£51,000 ***For premises with a rateable value of £51,000 or more

SOURCE: GOVERNMENT

Toy retailers

Toy retailers have struggled in recent years due to increased online competition and falling popularity of traditional toys. Like other high-street retailers, toy retailers have voiced concerns over rising business rates. However, the collapse of Toys R Us, which primarily had stores located away from high streets, has benefited high-street retailers and is expected to continue to do so, especially around the lucrative Christmas period. However, the collapse of Toys R Us also highlights the difficult operating environment that toy retailers are facing.

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Retailers in regions such as London and the East Midlands were particularly affected by the business rates increases. For example, business rates in London increased by 23.7% after the 2017 revaluation, while rates in the East Midlands increased by 7.4% in the same year. This compares with an increase of just 0.9% in the North East. As a result, toy retailers in London have found the business environment particularly difficult to operate in since the revaluation. Due to the large number of small independent retailers in the Toy Retailing industry (IBISWorld report G47.650), typically comprising less fewer five stores and usually in the same geographic region, toy retailers are less likely to see rises in business rates in one geographical region balanced out by falls in another.

Clothing retailing

Like many high-street retailers, clothing shops have faced intense competition from internet retailers. The internet-based clothing retailer ASOS has proven to be a particularly large source of competition for high-street clothing retailers. Changes in the way that business rates are calculated has also affected the Clothing Retailing industry (IBISWorld report G47.710). In March 2018, the clothing retailer New Look entered into a Company Voluntary Arrangement, identifying 60 store closures. Following changes in business rates in 2017, New Look's stores in Banbury, Fitzrovia, Leicester and Oxford Street saw increases in business rates of 87%, 86%, 79% and 72% respectively. In addition, some of New Look's stores that should have seen falling business rates following the 2017 revaluation have been unable to realise the benefits due to the government's policy of phasing in reductions.

Changes in business rates have had a disproportionate negative affect on high-street retailers compared with online-only retailers such as ASOS. As online-only retailers locate warehouses in areas where rateable prices are lower, they have not been anywhere near as affected by the change in business rates.

Conclusion

Clearly, the recent change to business rates has only added to the difficulties faced by high-street retailers, in the face of an online shopping trend that shows no sign of retreat. Numerous department stores have faced financial difficulties, with the rate rises hitting their large premises, and higher rates are a further hurdle to already pressured high-street retailers.

IBISWorld Industry reports used in this special report:

G47.190	Department Stores in the UK
G47.650	Toy Retailing in the UK
G47.710	Clothing Retailing in the UK