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BUSINESS INTELLIGENCE

Market insight from Christie + Co

The smoking ban in England - Death of the pub sector or a short term problem?

It is fair to say that the introduction of a ban on smoking in enclosed public spaces has hit the UK pub sector harder than most other parts of the economy and in the process become the subject of considerable speculation, angst and concern.

As we approach the first anniversary of the introduction of a ban in England it is worth reviewing the facts and myths which surround the ban, and examine the experiences of other countries to look for similarities with England, and indications of what the trade is likely to experience going forward.

Background

There has been a general move to reduce smoking throughout the developed world. The driver for this is public health and the demand which smoking related diseases put on health services.

Many countries have introduced bans on smoking in enclosed public spaces;

Country	Date of introduction	Partial exemptions?
Belgium	Jan 07	Yes
England	July 07	
France	Feb 07	
Germany	Jan 08	Yes
Guernsey	July 06	
Iceland	June 07	
Ireland	Mar 04	
Italy	Jan 05	
Jersey	Jan 07	
Netherlands	Jan 04	Yes
North America	Most States	
Norway	June 04	
Portugal	Jan 08	Yes

Scotland	Mar 06	
Spain	Jan 06	Yes
Sweden	May 05	Yes
Wales	Mar 07	

As can be seen most "Western" countries now have bans on smoking in enclosed public spaces and workplaces. There are some exemptions for certain bars/restaurants but these are quite limited in most cases.

In England and Wales the ban was justified on the basis of Health and Safety rules regarding the protection of employees. The Health Act 2006 made it illegal to smoke in an enclosed public space (defined as a space which had a roof and where more than 50% of the sides were walls).

When the ban was first proposed there was an expectation (based on signals from the Labour Government) that there would be an exemption for pubs / clubs which did not serve food, or which were private members clubs. It was clear that this proposed exemption was designed to appease the Government's traditional supporters, working class families, and persuade Labour MPs to support the proposals.

In the end the Government decided against such an exemption, recognising the difficulties it would create and the need to present a "level playing field".

Introduction of the Ban

Smoking in enclosed public spaces in Wales became illegal on 2 March 2007 and in England on 1 July 2007. There had been a period of several months for landlords, licensees and pubcos to make plans to adapt to the ban and, where they felt it appropriate, construct external facilities which offered shelter to customers who wished to smoke.

As well as building so called "smoking shelters" there was a need to provide further investment to;

- Attract new customers
- Prevent lingering smells (which had previously been masked by the smoke) from becoming problematic
- Introduce or upgrade kitchen facilities

Whilst there was, and continues to be, a small number of high profile "rebels" who have flouted the smoking ban, the vast majority of pubs, bars and clubs have complied with the rules, as have their customers.

Post-ban trading

Unfortunately the introduction of the ban in England was followed by one of the wettest summers on record, with widespread flooding across large parts of the country including South Yorkshire and Gloucestershire.

This, combined with the widely reported problems in the financial markets, and accelerating inflation, has led to something of a "perfect storm" for the pub sector.

The Government has not helped the industry by continuing to raise alcohol duty rates and by allowing the supermarkets to continue to sell beer and other alcohol at heavily discounted prices.

As a consequence there has been a seriously negative mood over the last few months with reports of adverse trading conditions from the major pubcos and of pub closures. Quoted companies have generally been reporting falls in beer volumes (down around 10% on a like-for-like basis) and increased numbers of pubs where they are unable to find suitable tenants and are therefore forced to use temporary management companies.

Enterprise Inns' Chief Executive Ted Tuppen has acknowledged that around 25% of his company's tenants are finding life tougher than a year ago, and in April he told analysts that beer volumes were down in the region of 15%

Ralph Findlay of Marston's reported that food is selling well in its managed house division although wet sales are under pressure, and that its tenanted division is feeling the worst of the pressure.

Both of these companies own predominantly community, suburban or rural pubs and have been relatively immune to the effects of the ban unlike the late night / high street bar sector, which has been hit particularly hard by the new legislation. Operators in this part of the market include Sports Café, Massive, Summit Clubs, CanDu Entertainments, Soho Bars & Clubs and Laurel, all of which have gone into liquidation, and Regent Inns which has reported difficult trading conditions.

<u>How does this compare to other countries?</u>

The most frequently cited comparable is Ireland where a ban was introduced in March 2004. Notwithstanding certain cultural differences there is no doubt that the pub is a fundamental part of the leisure economy throughout the UK and Ireland. The Central Statistics Office of Ireland has produced data showing that it took exactly one year for the decline in beer volumes to flatten out, and a further six months for sales to show year-on-year growth.

In Scotland the decline in trade does not appear to have been as severe, although there are no official statistics available. After the first year the major operators said;

Greene King	- "Bellhaven' managed pubs saw growth in both sales and margin. Over 25% growth in food sales compensated for a slight decline in beer sales and machine income. "
Mitchells & Butlers	- "like-for-like sales +2.6% March - September 2006, like-for-like sales +1.8% October - May 07"
Punch Taverns	- "managed estate like-for-like sales down 1.6%. Leased estate like-for-like profit down 1.3%"
Wetherspoons	- "sales and margins under severe pressure for first 6 months, recovered strongly in H2"

A year later the same companies reported an improved position;

Greene King	- "managed pub like-for-like sales are above last year

Mitchells & Butlers - "same outlet like-for-like sales +4.4% since October 2007"

Punch Taverns - "like-for-like profit +1.6%in the leased estate since 18 August 2007"

Will England and Wales follow the same pattern?

There is no reason to believe that, all other things being equal, the English and Welsh pub sectors would not see similar patterns emerging - a decline lasting around 12 months and then the start of real growth 6 - 12 months later.

However the pattern will be complicated by the particular set of external influences that the UK pub sector is currently experiencing;

- Global financial conditions - if the credit crunch does not ease, and if the UK banks do not become more willing to lend to the pub sector, then existing operators will struggle to raise the funds necessary to improve their premises. It will then become more difficult to adapt to changing customer demands and expectations, and to reposition businesses to attract new customers.

- UK inflation and employment - if the economy continues to slowdown and inflation continues to exceed income growth then spending on food and drink, which is largely discretionary, will come under pressure. At the same time there are real inflationary pressures on input costs (energy, food and taxation) which impact on the profit margins that an operator can expect to achieve.

- Weather - the UK pub sector needs a good summer. Last year's washout means that like-for-like comparisons should be relatively good and this will enable some "good news" to finally emerge and counteract the negative sentiment that has been in the press over the last few months.

- Increased duty rates.

- "Loss leader" pricing by supermarkets.

Conclusions

There is no doubt that the period since 1 July has seen some of the worst trading conditions in memory. In some respects it is better to have got all the "pain" out of the way in one hit, but several in the trade have been hit financially, with many pubs suffering falls in trade or even closure. Whilst the closure of pubs makes good headlines it should be remembered that this process has been ongoing for several years and includes those which are being sold for alternative use as well as those which have closed for economic reasons.

However, many of those pubs which have been able to adapt to the post ban conditions have been able to maintain or even improve their revenues. The managed sector (away from the late night high street bars) has fared best, with several major operators achieving growth. Tenanted operators have suffered more, and arguably have less room to manoeuvre due to the types of pub they run, and their lack of negotiating powers with suppliers.

The UK pub industry has been, and will remain, resilient and despite the short term issues which are currently being experienced, most commentators believe it has a long term future. The key to the survival of individual pubs will be flexibility in the nature of their trade, an ability to attract new customers and the financial wherewithal to invest in the business.

We may see some changes to the current model under which tenanted / leased pubs are operated although this is likely to be “evolution rather than revolution”. It is more likely that the nature of leases will change slowly, possibly to allow tenants to benefit more from the buying power of their landlords with suppliers such as energy providers, rather than a heavy handed legal challenge to the beer tie.

A reasonable summer, coinciding with the one year anniversary of the introduction of the ban, may well signal a recovery in the fortunes of the sector, but this recovery is likely to remain relatively fragile until general economic conditions improve and the “feel good” factor returns.

Ends

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