

# VAT Increase and Impact on Consumers' Consumption Habit

Masoom Ahmed

Glyndwr University, UK

E-mail: masoomsonia@yahoo.com

Fazluz Zaman

Business Trainer and Curriculum Writer

Australian Business and Retail Academy, Sydney, Australia

E-mail: fazluzzaman@gmail.com

Munshi Samaduzzaman (Corresponding Author)

Accounting Lecturer, KAPLAN Business School, Sydney, Australia

E-mail: samaduzzaman@gmail.com

Received: Jan. 25, 2015    Accepted: Feb. 26, 2015    Published: June 1, 2015

doi:10.5296/ajfa.v7i1.7008    URL: <http://dx.doi.org/10.5296/ajfa.v7i1.7008>

## **Abstract**

The UK government has put new economic policy to increase the Value added tax (VAT) to 20%, which raise widely discussions. This case study aims to find out how increased standard VAT influence customer's satisfaction and consumption habit in North Wales area. There has been lively debate between the government and the opposition party, the government has asserted that it is progressive, as those with higher incomes spend more and will therefore pay more VAT. Opposition claims, however, that as low earners have to spend a much bigger share of their income than high earners in order to meet their basic needs. A total of 80 respondents participated in the survey. sReliability test analysis was used to analyse the reliability of each questions in the questionnaire. Data collected were analysed by using correlation analysis and t-test to determine the relationship between variables and test the hypothesis. The findings reveal that VAT increase has significant impact on consumers' consumption habit. This case study could fill the gap in the literature for consumers'

---

consumption habit on VAT increase. Also the outcomes of this study could add to existing literature and serve as a foundation for further studies.

**Keywords:** Consumers' Consumption, Customer's Behavior, Government, Influence, Value Added Tax

## 1. Introduction

VAT has imitated relationship in daily life, and even it can happen everywhere, every day which has effect on people's daily life. According to Statement of Standard Accounting Practice (SSAP, 1993) which states that "VAT is a tax on the supply of goods and services which is eventually borne by the final consumer but collected at each stages of the production and distribution chain".

In the UK, VAT is charged on the supply of all goods and services made in the course of a business by a taxable person, unless they are specifically exempt. All businesses must register for VAT if their turnover of taxable goods and/or services is above a given threshold – which is £79,000 at present (Budget, 2013). A business pays VAT on its purchases - known as input tax, and charges VAT on its sales - known as output tax, settling up with HM Revenue & Customs for the difference between the two (HM Treasury, 2009/2010).

The original form of VAT started in Germany in 1919. In 1937, France introduced a form of VAT known as pro-duction tax, which has helped replaced with producer's income-based tax in 1948 and consumption tax in 1954. The French VAT system became a condition precedent of becoming a member of European Economic Com- munity (EEC) under the treaty of Rome in 1957. The European community unanimously adopted VAT in 1967 following the reports of the Neumark and Jansen Committees (Oladipupo and Izedonmi, 2013).

VAT was introduced in the UK on 1 April 1973 at two rates: a standard rate of 10%, and a zero rate on selected goods and services (such as food, books, children's clothing, and certain supplies for charities).

The increase in VAT from 17.5% to 20% estimated to raise £12.1bn in 2011/12, rising to £13.5bn by 2014/15 (CRR, 2010). However, VAT increase to 20% would cost each of the UK's 26.2 million households an extra £1.16 per day or £520 a year, reducing spending power by an average 1.25% per annum and increasing the annual VAT bill by 13.9%. Increase Consumer Price inflation by between 0.6% and 0.8%. Hit the poorest one-fifth of the population (who pay the largest proportion of their income as VAT).

There has been lively debate between the government and the opposition party, with opinions from economists and journalists, about whether the rise in VAT is 'progressive' or not. The Government has asserted that it is progressive, as those with higher incomes spend more and will therefore pay more VAT. Opposition claims, however, that as low earners have to spend a much bigger share of their income than high earners in order to meet their basic needs, the tax will actually hit them harder.

## 2. Consumers' satisfaction and consumption habit

Customer satisfaction affects many aspects of the organisation, such as revenue and sales, expenses, especially the bottom line profit Peppard, (2002). Customers' behavior includes recognising what they need, where and which brand they choose and compared shopping to make financial purchasing plan (Solomon, (2004). Hamel (2013) thought the price of goods

and service play importance roles in customer purchasing power. If the price increase, people may reduce purchase it, however, if the price fall, people increase buying it.

Carty (2013) has the similar opinions that if the price increase, the customers would choose a cheaper one to instead. Especially in similar goods or service, consumers often switch the products. If the prices are the same, the impact of price is not obviously.

The retail industry employs 3 million people and accounts for 25% of national GDP - a slowdown in the sector could lead to a further 0.5% decline in economic growth over a twelve month period (CRR, 2010).

Labour leader Ed Miliband (BBC, 2010) argued that it was the "wrong tax at the wrong time", because the rise would hit families when they will be under pressure from government spending cuts. Similarly, Wellings (2011) stressed that the increased VAT would distorted the customers' consumption habit.

There are four types of factors can influence the customer shopping behavior: social, cultural, personal and psychological factor. Cultural factor include social calls which is not only depends on the income but also the wealth and occupation. Age plays an import role in personal factors. With the change of age, people may have different opinions about consumption which also includes the marital status. It is very essential to consider the economic situation in personally factor. If the customers get high income or salary they would buy more products and less consider about the price, however if the people get low income or salary, they may buy cheaper products and consider much about the price (Shah, 2013).

Key factors to be researched

H<sub>1</sub>: VAT increase has significant influence on change in consumers' life style.

H<sub>2</sub>: VAT increase has significant influence on change in consumers' purchasing power.

H<sub>3</sub>: The annual income has significant influence customers' buying behavior

H<sub>4</sub>: Age has influence on consumers' buying behavior.

### **3. Methodology**

The research methods include the survey questionnaire design, the sample and methods of data analysis.

Questionnaire Design:

The questionnaire for this study separated into two segments thus section A and B. Section A consists on the demographic profile such as gender, age, marital status, income, races and employment status. Section B is made up with main research questions (figure 1-appendix).

Figure 2 explains about scale measurements. The extent of each variable was based on five-point likert scales which scale points from 1-strongly disagree to 5-strongly agree. Several researchers have used the same measurement in their paper because the reliability of

Likert scales tends to be good and it gives a wide choices answer to respondents (Goldsmith and Flynn, 2004; Houque et al., 2006; Changchit, 2006).

Figure 3 (appendix) presents reliability test for each variables in the questionnaire. Overall reliability of scales adopted in this survey questionnaire was 0.835 which shows very good consistency among the scales (Law and Bai, 2008). However, the reliability of individual variables seems different from each other and varied from 0.884 to 0.782. Then, this survey question can be reliable to examine VAT increase and change in consumers' consumption habit.

Collected data using questionnaire was analysed by SPSS (21) with related diagrams and charts to find the results. And then make correlation and hypotheses testing (t-test).

#### **4. Findings and Conclusion**

From a total 120 questionnaires sent randomly, 80 were returned, which resulted in a response rate of 66%. Brief description of descriptive statistics of the respondents can be found in table 2 (Appendix).

A correlation matrix constructed using the variables in the questionnaire to show the strength of relationship among the variables (table 3-appendix). Correlation analysis was used to analyse the relationship between all variables. This analysis associates variables and discovers if there any variables tend to shift in the same or opposite way when it moves (Saunders et al., 2007), which also can be exposed as positive or negative relationship. If positive value indicates there is positive relation between variables meanwhile, the negative value means vice versa (Hair et al., 2009). On the one hand, values from 0.1 until 0.5 means there is a weak relationship, on the other hand, 0.5 to 1 means there is strong relationship between the variables. However, if the value is negative, it shows there is no direct relationship between the variables.

The correlation matrix indicates that VAT increase highly correlated with consumers' consumption habit. The highest coefficient of correlation in this study was between VAT increase and change in consumers' purchasing power, which 0.36. This study also found positive correlation between VAT increase and change in consumers' life style, annual income and customers' buying behaviour, age and customers' buying behaviour. In other words, the results indicate that the influence variable was VAT increase on consumers' purchasing power.

H<sub>1</sub>: VAT increase has significant influence on change in consumers' life style.

Table 4 indicates that the t-statistic is 1.34 > (0.5), which means VAT increase has influence on change in consumers' life style. There were some similarities between the outcomes of this study and those of previous studies (Jonker et al., 2004; Carare & Danniger, 2008). On the strategic implication, it can be concluded that VAT payments represent 12.1% of the disposable income of the lowest household quintile (the bottom one-fifth of earners) compared to 7.4% by the average household. The VAT increase hit these people hard (CRR, 2010).

H<sub>2</sub>: VAT increase has significant influence on change in consumers' purchasing power.

Table 4 indicates that the t-statistic is  $1.64 > 0.5$  which mean VAT increase has significant influence on change in consumers' purchasing power.

Previous research (Carare & Danniger, 2008; Shah, 2013) indicated that wealth and economic situation influence customers' shopping behavior. Due to the VAT increase, most prices of products increase, people have to care the price and their expending. If the customers get high income or salary they would buy more products and less consider about the price, however if the people get low income or salary, they may buy cheaper products and consider much about the price.

H<sub>3</sub>: The annual income has significant influence customers' buying behavior

Table 4 indicates that the t-statistic is  $5.42 > 0.5$  which mean annual income has significant influence customers' buying behaviour. On the strategic implication, it can be concluded that every individual is faced with reviewing their own budget and spending pattern to make future decision so that they can adjust to VAT increase (Carare & Danniger, 2008; Leach, 2012).

H<sub>4</sub>: Age has influence on consumers' buying behavior. Table 4 indicates that the t-statistic is  $3.98 > 0.5$  which means Age has influence on consumers' buying behaviour. There were some similarities between the outcomes of this study and previous studies (Fisher, 1952; Pol, 1991; Swarana, 2012) which also agreed that age as influential predictors of consumers' buying behaviour.

The UK government has put new economic policy to increase the Value added tax (VAT) to 20%, which raise widely discussions. The research highlights the influence of VAT from government, company, and customer, these three aspects. Some people believe that the increase Vat is good policy for the government to get more revenue, to solve economic problem. However, more people thought it has brought more pressure to the companies and customers. Due to the vat increase, the company may suffer recue sales and increase income problem, and customers had to change their life style, such as consumption habit.

Consumers could research prices for essential products to get the best post increase prices. They can also take decision what luxuries item they still can afford, given that most luxury items are subject to VAT.

The study is significant in terms of managerial and theoretical contribution. This study could fill the gap in the literature on VAT increase and change in consumers' consumption habit. For further studies may provide valuable insights students of demographics such as gender, marital status, educational qualifications. Additional tools such as content analysis and Grounded Theory could be employed.

Also the outcomes of this study could add to existing literature and serve as a foundation for further studies. From managerial point of view, this study could assist policy makers to set back VAT at 17.5%, as the Gfk Consumer survey shows a considerable improvement in consumers' confidence since December 2011.

## Reference

- BBC. (2010). Shoppers split over VAT increase. *The Budget*, 22 June, <http://www.bbc.co.uk/news/10381844>. [Electronically accessed 16/12/2013].
- Budget. (2013). HC 1033 March 2013 para 2.179. The threshold was increased in line with inflation for the 2013/14 year with effect from 1 April 2013, by Order (SI 2013/660).
- Carare, A., & S. Danninger. (2008). Inflation smoothing and the modest effect of VAT in Germany. IMF Working Paper, WP/08/175.
- Carty, S. (2013). the Effects of Purchasing Power. Available form: <http://ezinearticles.com/?Factors-Affecting-Consumer-Behavior&id=4602848>[Electronically accessed 14<sup>th</sup> Jan. 2013].
- Changchit, C. (2006). Consumer Perception on Online Shopping. *Issues In Information System*, 4(2), 177-181.
- Field, A. (2006). *Discovering Statistics Using SPSS*, Second Edition, SAGE Publications, London
- Fisher, J. (1952). Income, Spending and Saving Patterns of Consumer Units in Different Age Goups. *Studies in Income and Wealth*, 15.
- Goldsmith, R.E., & Flynn, L.R. (2004). Psychological and behavioral drivers of online clothing purchase. *Journal Fashion Marketing Management*, 8(1), 84-95. <http://dx.doi.org/10.1108/13612020410518718>
- Gujarati, D. N. (2011). *Basic Econometrics*. Palgrave Macmillan, New York.
- Hair, J. F., Black, W. C., Babin, B. J., & Anderson, R. E. (2009). *Multivariate data analysis*. Upper Saddle River, NJ: Prentice Hall.
- Hamel, G. (2012). Factors Influencing Purchasing Power. Available from: [http://www.ehow.com/list\\_7150340\\_factors-influencing-purchasing-power.html](http://www.ehow.com/list_7150340_factors-influencing-purchasing-power.html). [Electronically accessed 14<sup>th</sup> Jan. 2013].
- HM Treasury, (2009/2010), Tax Benefit Reference Manual 2009/10 ed. p88.
- Houque, A. Sadeghzadeh, & J, Khatibi, A (2006). Identifying Potential Online Sales In Malaysia: A Study On Customer Relationships Online Shopping. *Journal Application Business*, 22(4), 119-130.
- Joe Peppard. (2000). *European Management Journal*, 18, 312-327. [http://dx.doi.org/10.1016/S0263-2373\(00\)00013-X](http://dx.doi.org/10.1016/S0263-2373(00)00013-X)
- Jonker, N., C. Folkertsma, & H. Blijenberg, (2004). An empirical analysis of price setting behaviour in the Netherlands in the period 1998-2003 using Micro Data. ECB Working Paper Series, no. 413.
- Law, R., & Bai, B. (2008). How do the preferences of online buyers and browsers differ on

the design and content of travel websites?. *International Journal of Contemporary Hospitality Management*, 20(4), 388. <http://dx.doi.org/10.1108/09596110810873507>

Leach, A. (2012). how the financial crisis will continued to affect the UK economy, CBI 17 September 2012. Available from: <http://www.cbi.org.uk/media-centre/news-articles/2012/09/the-legacy-of-the-financial-crisis/> [Electronically accessed 30th Oct. 2013].

Lee, H. S. (2005). An Application of a Five-Stage Consumer Behaviour Decision Making Model: An Exploratory Study of Chinese Purchasing of Imported Health Food. Available :<http://summit.sfu.ca/item/4741>. [Electronically accessed 18/12/2013].

Oladipupo, A. O., & Izedonmi, F. P. (2013). Public Perception and Attitude towards Value Added Tax (VAT) in Nigeria. *iBusiness*, 5. <http://dx.doi.org/10.4236/ib.2013.54016>

Oldman, O., & L. V. Woods, (1996). Would Shifting Emphasis to a VAT System Relieve Tax Compliance Problems? In: E. A. Ogundele, Ed., *Value Added Tax: Theory and Practice*, University of Lagos Press, Lagos.

Peppard, J. (2002). *Customer relationship management (CRM) in financial services*.

Pol, L.G. (1991). Demographic contributions to marketing: An assessment. *Journal of the Academy of Marketing Science*, 19(1), 53-59. <http://dx.doi.org/10.1007/BF02723424>

Saunders, M., Lewis, P., & Tornhill, A. (2007). *Research Methods for Business Students*, 4<sup>th</sup> edition, Prentice Hall, England.

Shah, A., (2013). Factors Affecting Consumer Behaviour. Available from: [http://www.ehow.co.uk/list\\_7242892\\_effects-purchasing-power.html](http://www.ehow.co.uk/list_7242892_effects-purchasing-power.html) [Electronically accessed 14<sup>th</sup> Jan. 2013].

Solomon, M. R. (2004). *Consumer Behavior. Buying, Having, and Being* (6th ed.). Upper Saddle River, NJ: Pearson Prentice Hall.

Statement of Standard Accounting Practice. (SSAP). (1993). VAT Decree No. 102, Government Printer.

Swarna, B. (2012). Impact of gender on consumer purchase behavior. *Journal of commerce and management*, 1(9), 10-18.

The Centre for Retail Research. (2010). VAT HIKE TO 20%: Effects on Retailers and Consumers. <http://www.retailresearch.org/vatincrease.php>.

Wellings, R. (2011). why raising VAT destroys wealth, IEA4 January 2011. Available from: <http://www.iea.org.uk/blog/why-raising-vat-destroys-wealth>

## **Appendix**

How Does VAT Work?

A product with a net retail value of, say, £20.00, would cost £23.50 when VAT is applied



(£20.00 + [17.5% x £20.00]) and would increase to £24.00 after January 4 2011 (an increase of 2.1%). That is the theory.

Table 1. The main changes to the VAT structure since the introduction of the tax are:

The standard rate was cut to 8% on 29 July 1974.
A higher rate on selected goods and services was introduced on 18 November 1974, set at 25%. Initially this was applied to petrol only; it was extended to a list of other supplies from 1 May 1975. The higher rate was cut to 12.5% from 12 April 1976.
The standard rate was increased to 15% on 18 June 1979; at this time, the higher rate of VAT was abolished.
The standard rate was increased to 17.5% from 1 April 1991.
Domestic supplies of fuel and power were charged VAT at a reduced rate of 8% from 1 December 1993. This was cut to 5% from 1 September 1997.
The standard rate was cut temporarily to 15% from 1 December 2008 to 31 December 2009.
The rate was set back at 17.5% on 1 January 2010.
The standard rate of VAT increase from 17.5% to 20% from 4 January 2011.

	Variables	Questions
Consumer demographic characteristics	Demography	1-7
Consumers' shopping intentions	Attitude	8-10
H <sub>1</sub> : VAT increase has significant influence on change in consumers' life style.	Life Style	11-13
H <sub>2</sub> : VAT increase has significant influence on change in consumers' purchasing power.	Purchasing Power	14-16
H <sub>3</sub> : The annual income has significant influence customers' buying behavior	Income	17-19
H <sub>4</sub> : Age has influence on consumers' buying behavior	Age	20-22

Figure 1. Relationship between variables and hypotheses

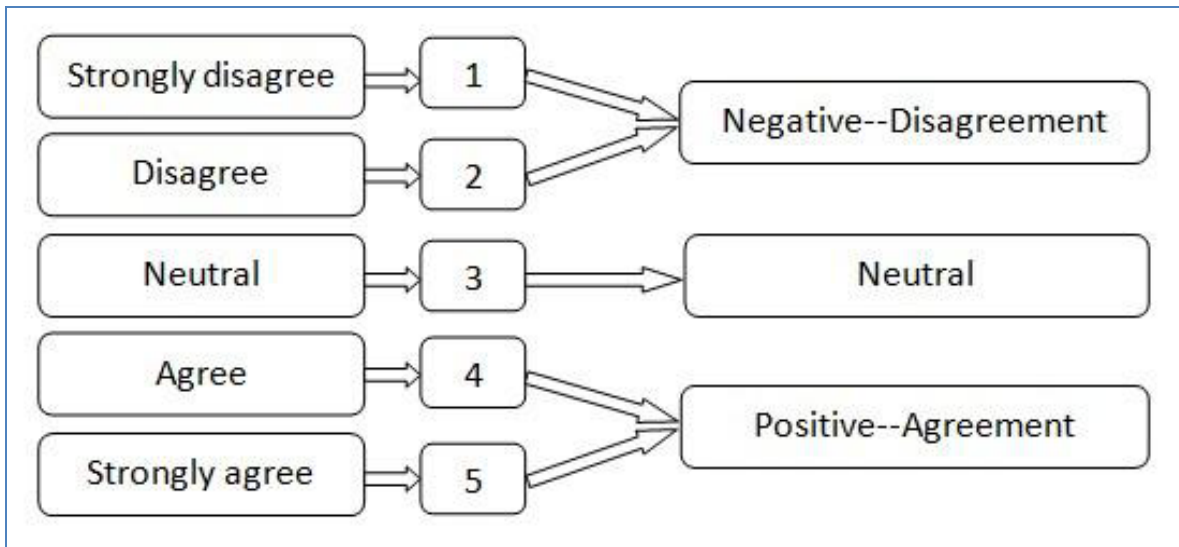


Figure 2. Scale measurement

Component	Cronbach's Alpha
Life Style	.884
Purchasing Power	.865
Income	.810
Age	.782
Average	.835

Figure 3. Adopted from SPSS Reliability Test for Each Variable

Table 2. Descriptive Statistics of the Respondents

Descriptive statistics reveals that the male respondents are accounted for 66% of the total population where male and female respondents 61% and 39%. The largest group of respondents was aged between 21-30 years 41%, with 25% below 20 years, 28 % aged between 31-40 and 6% over 40 years and over. Annual income for the respondents was 46% below £20000, 25% £21000-£30000 and 29% over £31000. It was found that professional, shop workers, businessmen, students participated in the study. The findings imply that majority of respondents work full time.

Table 3. Summary of Correlations among variables

		Gender	Age	Life Style	Purchasing Power	Income
Gender	Pearson Correlation	1	.265**	-.293**	-.252**	-.265**
	Sig. (2-tailed)		.000	.000	.000	.000
	N	80	80	80	80	80
Age	Pearson Correlation	.265**	1	.087	.076	.121
	Sig. (2-tailed)	.000		.163	.225	.054
	N	80	80	80	80	80
Life Style	Pearson Correlation	-.293**	.087	1	.770**	.735**
	Sig. (2-tailed)	.000	.163		.000	.000
	N	80	80	80	80	80
Purchasing Power	Pearson Correlation	-.252**	.076	.770**	1	.646**
	Sig. (2-tailed)	.000	.225	.000		.000
	N	80	80	80	80	80
Income	Pearson Correlation	-.265**	.121	.735**	.646**	1
	Sig. (2-tailed)	.000	.054	.000	.000	
	N	80	80	80	80	80

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Table 4. T-test

Statements	Mean	St. d.	t	sign.	Result
H <sub>1</sub> : VAT increase has significant influence on change in consumers' life style	3,09	1.25	1.34	0,000	Accepted
H <sub>2</sub> : VAT increase has significant influence on change in consumers' purchasing power	2.63	1.28	1.64	0,000	Accepted
H <sub>3</sub> : The annual income has significant influence customers' buying behavior	2.79	1.20	5.42	0,000	Accepted
H <sub>4</sub> : Age has influence on consumers' buying behavior	3.23	1.05	3.90	0,000	Accepted