

A photograph of a white staircase with a white handrail, leading up to a bright doorway at the top. The scene is brightly lit, creating a clean and open atmosphere.

# Accelerating recovery:

promoting the SME sector's role in rebuilding prosperity in the UK



## ABOUT ACCA

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ACCA is the global body for professional accountants, with over 131,500 members and 362,000 students worldwide. ACCA has its headquarters in London and 144,700 of our members, students and affiliates are based in the UK. 56% of our members in the UK work in or for a small and medium-sized enterprise (SME) and we have over 100 years' experience in understanding and supporting small firms. Independent research shows consistently that accountants are the first choice advisors of small businesses. Given that our members advise their small business clients on a daily basis on tax matters, we are well placed to comment on issues affecting SMEs.

## THE ACCA SME COMMITTEE

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The ACCA SME Committee brings together accounting practitioners, leading academic researchers, financial institutions and entrepreneurs alongside all the main small business representative bodies in the UK (BCC, CBI, FSB, FPB, IoD) and UEAPME, the voice of SMEs in Europe. As the only non-governmental small business interest group that encompasses such a broad membership, the Committee is recognised as a unique voice on small business policy, being able to take a wide perspective on key issues affecting small firms in the UK.

### Policy papers published by the ACCA SME Committee.

- Improving SME Access to Equity Finance (July 2009)
- Supporting Small Business Through the Recession (March 2009)
- Better Regulation – What it Really Means (January 2009)
- Financing SMEs in the Recession (November 2008)
- Small Business in Europe (September 2008)
- Pensions – The Small Business Perspective (May 2008)
- Regulatory Reform – Achieving Real Benefits for Small Business (December 2007)
- Principles for Government Intervention on Small Business Support (July 2007)
- Improving Access to Finance for Smaller Firms (March 2006)
- Private Sector Solutions for Improving Government Business Support Services (November 2005)
- Business Transfer (June 2005)
- Reducing the Administrative Burden of the Tax System on Small Business (June 2005)

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## Chairman's foreword



Few can doubt the importance of the Small and Medium-sized Enterprise (SME) sector to economic recovery in the UK. However, as the professional body most closely aligned to SMEs, ACCA has a particular interest in unlocking the sector's potential.

We are therefore extremely pleased to present the SME Committee's policy recommendations for the next Government. We believe that these represent our best chance of enabling the SME sector to play its full role in accelerating the return to sustained economic growth that we all so badly need.

This report, entitled *Accelerating Recovery*, has been assembled on the basis of the policy debates and expert presentations held in the SME Committee. The evidence informing the Committee's lively discussions has been carefully assembled into a convincing set of arguments about the direction that government policy should take in respect of business support, the development of evidence based policy, access to finance, regulation, skills, taxation and the promotion of exports.

The SME Committee brings a unique perspective to each of these policy areas, as it comprises all of the major SME representative bodies alongside business owners, bankers and of course accounting practitioners, who are acknowledged by SMEs to be their first choice business advisers.

ACCA is grateful to the members of the SME Committee for their time, energy and research in contributing to this document and to Emmanouil Schizas for assembling the arguments into a concise paper.

We believe that this document should be read by every existing and potential Member of Parliament. The economic future of the UK, and the return to economic growth on which we all depend, will depend on the contribution that UK SMEs are enabled and encouraged to make.

**Professor Francis Chittenden MBA, PhD, FCCA, ACIS**

ACCA Professor of Small Business Finance,  
Manchester Business School

## Executive summary

In the aftermath of the worst recession in its post-War history, the UK will need to build new world-beating industries, overcoming the constraints of sluggish demand, poor public finances and slow growth in business and consumer credit. None of this will be possible without solid policies to support SMEs, which account for 99.9% of all enterprises, 59% of all private sector employment, 51% of the UK's economic output, and 73% of net job creation.

To this end, the ACCA SME Committee has prepared recommendations against eight major themes, which we urge all current and prospective MPs to support:

### 1. MAINTAINING THE MOMENTUM

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Although the financial crisis and recession of 2008/9 will not be remembered fondly by the UK's SMEs, the poor economic conditions did focus the thoughts and energies of analysts and politicians on the concerns of the sector. We must build on this unprecedented level of attention and activity, by sustaining it throughout the recovery and embedding it in the machinery of government. To do this, we will need commitment and consistency in the people, the evidence, the tools and the philosophy behind SME and enterprise policies.

### 2. REFORMING BUSINESS SUPPORT

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Despite the billions of pounds invested so far, publicly-funded business support has been unable to address the needs of SMEs. It is unlikely to do any better under the challenging conditions of the recovery. The next government will need to resist the urge to make immediate, sweeping changes and develop instead a medium-term strategy to phase in the resources of proven private sector advisers.

### 3. GETTING THE FACTS RIGHT

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During the recovery and in the subsequent period of growth, SMEs will be served best by a Government with a renewed commitment to evidence-based policy – a Government eager to learn about and understand business. This approach should not disguise the diversity of the sector through aggregated statistics and targets but tackle it head-on, engaging enterprise communities and enriching policy with deep, grass-roots insights.

### 4. CREDIT (AND EQUITY) WHERE IT'S DUE

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A great deal has been said about access to finance for SMEs. Now is the time to accept that restoring pre-crisis levels of leverage may not be possible – or indeed desirable – in the short term. Going forward, a more intelligent use of external finance will be a necessity for the success of SMEs. Government needs to help SMEs make the most of the potential of different types of finance but also encourage them to seek appropriate support and advice. Finally, it should not overlook the vast informal market for credit that is both the unsung hero and nameless villain of SME finance.

### 5. REGULATING WITH THE SMALL BUSINESS IN MIND

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The UK's world-class Better Regulation programme can become a key asset during the recovery – or it can become irrelevant. In order to really help SMEs, Government needs to take an outcome-based approach to Better Regulation and take steps to improve the quality of both regulation and regulators. Moreover, Government should focus on stemming the flow, not culling the stock of legislation, and turn its attention in earnest to the sacred cow of regulation – employment law.

### 6. INVESTING IN ENTERPRISE

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The start-ups and fledgling businesses that will help sustain the recovery tomorrow are right now trying to find their feet in an unfamiliar economic environment. In fact, the recession has exposed a gap in enterprise skills and know-how that could be damaging the UK's economic prospects. Yet the mechanisms in place to address this are not effective or efficient, and much of the UK's substantial investment in skills is being misdirected. Government needs to acknowledge enterprise skills as distinct from managerial or sector-specific competencies, and harness the power of enterprise training to tackle unemployment and disadvantage.

### 7. SIMPLE TAX, CLEAR INCENTIVES

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The recovery presents an opportunity for much-needed reform of the UK's complicated and cumbersome tax system. This would be a very welcome development. However, would-be reformers must bear in mind the tax system's crucial role in providing incentives to SMEs and entrepreneurs. No tax regime is without this dimension, and therefore the desired incentives must be carefully considered before any simplifications are carried out.

### 8. SEIZING OPPORTUNITY

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Increasingly, opportunities for the UK's SMEs will lie outside our borders. In line with other countries, Britain needs to develop a strategy for encouraging SME exporters and use SMEs to spearhead deepening trade relationships. Closer to home, the UK must take full advantage of the implementation of the EU Services Directive to open up the European market to UK SMEs and actively resist initiatives that would threaten harmonisation.

## Introduction

Regardless of when the 2010 elections take place and of their outcome, the next Government will come into power in the aftermath of the worst recession in Britain's post-War history.<sup>1</sup> In promoting recovery, Government will have to overcome the constraints of sluggish demand, poor public finances and slow growth in business and consumer credit.<sup>2</sup> Moreover, it will be necessary to encourage new industries to compensate for slower growth in the financial services sector, and the inevitable reductions in public expenditure needed to rebalance the public finances. Finally, Government will have to contain the social implications of the recession<sup>3</sup>, ensuring fair outcomes for the most vulnerable.

The ACCA SME Committee believes that none of this will be possible without solid policies to support enterprise and the small and medium-sized enterprise (SME) sector. SMEs represent 99.9% of enterprises in the UK, account for 59% of all private sector employment<sup>4</sup>, produce 51% of the country's economic output<sup>5</sup>, and were, on the last count, responsible for 73% of net job creation.<sup>6</sup> In addition to economic growth in the strictest sense, entrepreneurs and SMEs contribute to a range of valuable social outcomes, by developing and commercialising innovation<sup>7</sup>, by helping reduce inequality and by providing a way out of disadvantage.<sup>8</sup>

The return of sustainable SME growth is therefore an important pre-requisite for the UK's recovery. Past recessions have seen SMEs lead many of the world's major economies back into growth<sup>9</sup>, and enterprise creation is understood to contribute to economic recovery.<sup>10</sup> During the worst of the current recession, one in every six net jobs lost in the private sector was replaced through self-employment.<sup>11</sup>

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1. ONS, *GDP and Employment – Recessions Compared*, January 2010.

2. *Bank of England Inflation Report*, February 2010.

3. For the most recent review of the evidence on this, see *Monitoring the Impact of the Recession on Various Demographic Groups*, GEO, EHRC and DWP, June 2009.

4. BIS Enterprise Directorate Analytical Unit, *Small and Medium-sized Enterprise Statistics for the UK and the Regions 2008*, October 2009.

5. EIM Business and Policy Research, *2007 Estimate Commissioned for the European Commission's SME Performance Review*, 2008.

6. BIS Enterprise Directorate Analytical Unit, op. cit; and BIS Enterprise Directorate Analytical Unit, *Small and Medium Size Enterprise Statistics for the UK and the Regions 2007*, July 2008. See also J. Kitching, R. Blackburn, D. Smallbone and S. Dixon, *Business Strategies and Performance During Difficult Economic Conditions*, BIS, July 2009.

7. See *Supporting innovation in services*, BIS, August 2008; and F. Patterson, M. Kerrin, G. Gatto-Roissard and P. Coan, *Everyday innovation*, NESTA Research Report, December 2009.

8. *Beyond the Equality Bill: Embedding Equality and Diversity in Small and Medium-sized Enterprises*, ACCA, March 2010.

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9. P. Davidsson, L. Lindmark and C. Olofsson, 'SMEs and Job Creation During a Recession and Recovery', in Ács, Z. J., Carlsson, B., Karlsson, C. (eds) *Entrepreneurship, Small and Medium-sized Enterprises, and the Macroeconomy*, 1999; M.A. Carree and A.R. Thurik, 'Small Firms and Economic Growth in Europe', *Atlantic Economic Journal*, 26: 2, June 1998; D. Johnson, P. Kenyon and V. Ha, 'Employment Growth by Firm Size Category', *Labour Economics and Productivity*, 7: 1, 49–72, 2005.

10. P. D. Koellinger and A. R. Thurik, *Entrepreneurship and the Business Cycle*, Tinbergen Institute, August 2009.

11. *Labour Market Statistics Statistical Bulletin*, ONS, June 2009. Figures refer to the period between Q4 2008 and Q1 2009.

# 1. Maintaining the momentum

Survey after survey suggests that SMEs do not believe government understands them well enough.<sup>12</sup> Yet throughout the recession, it has been encouraging to see the needs of small businesses rise to the top of the Government's agenda. Although small businesses have reported relatively little satisfaction with individual measures<sup>13</sup>, the amount of attention focused on the SME sector in the recent past has been unprecedented. The next Government should seek to not only maintain this level of focus but also embed it more firmly into the machinery of government.

The Department for Business has, twice in the past three years, been not only rebranded but also substantially restructured. During this time, the average tenure of a minister in charge of the small business portfolio has been less than a year and a half. Moreover, this portfolio coexists with others such as, for instance, that of the Government's Enterprise Champion. Although Government has been able to attract some very notable personalities to the cause of small business, this amount of churn limits the ability of ministers to deliver results and additionally signals that enterprise and SME policy in general are not a priority.

The next Government should guarantee consistent, high-level ownership of the SME agenda, and commit to the *Think Small First* principle throughout its work.<sup>14</sup> This must extend beyond the Department for Business, Innovation and Skills (BIS): most of the policy that is relevant to small businesses is in fact developed by other departments, most notably HM Treasury and the Department for Work and Pensions (DWP). Thinking small first need not be a commitment to subsidising the SME sector at every turn or to exempting smaller businesses from all regulatory burdens. Rather, it should be seen as a duty to design government support, as well as tax, regulation and policy in general so that they are relevant, accessible and effective from the perspective of the smallest businesses.

Similarly, more than a year into the implementation of the EU Small Business Act, the UK Government should state unequivocally what it believes its obligations under the Act to be, and to report on progress against these. Although evidence so far suggests that the UK has performed better than most EU members<sup>15</sup>, this should be no cause for complacency. The evidence here suggests a lag between policy developments and tangible impacts. Rather it should give the UK government more confidence in working closely with Brussels in this area.

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**'However important the support for small businesses has been through the recession, it will be even more critical through the recovery. SMEs will be the foundation on which any recovery is built, so we need to make sure that we get the right balance of freedom, intervention and support for those businesses in particular. The current momentum must translate into certainty about legislation, taxation and public support for the months and years ahead. It is important that the small businesses voice is heard through this election, and that is why the Forum of Private Business supports the Small Business Committee's Manifesto.'**

PHIL ORFORD, CHIEF EXECUTIVE, FORUM OF PRIVATE BUSINESS

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12. NAO, *Complying with Regulation: Business Perceptions Survey 2009*, October 2009. In 2009, only 26% of SMEs said they believed Government understands businesses well enough to regulate. Previous surveys suggest this figure has remained constant over the last three years.

13. See for instance FPB, *Eighth Economic Downturn Panel Report*, September 2009. The survey suggests that a balance of FPB members believed that government support for small firms deteriorated every month between December 2008 and September 2009.

14. For a discussion of the meaning of 'Think Small First', see European Commission, *Think Small First – Considering SME Interests in Policymaking*. Report of the Expert Group, March 2009.

15. *Think Small Test / SBA Implementation Scoreboard 2008: Country Sheet for United Kingdom*, UEAPME Study Unit, May 2009.

## 2. Reforming business support

The next Government will face a very tough challenge in reforming business support. On the one hand, research has shown that, despite billions invested in ca. 3,000 schemes per annum<sup>16</sup>, the public business support system as a whole is not providing adequate services or value for money. Independent surveys consistently find that the appeal of government sources of information to SMEs is very limited.<sup>17</sup> Moreover, the Government's most recent mystery shopping exercise showed that fewer than half of all businesses were satisfied with Business Link following their first contact with the service.<sup>18</sup> Finally, the Government's assessments suggest that co-ordinating the business support system in order to improve delivery will be difficult.<sup>19</sup> We doubt that outcomes will improve under tighter financial constraints or worse economic conditions.

On the other hand, although market imperfections are rarer than government policy has often assumed them to be,<sup>20</sup> we do not dispute the need for government support where they are proven to exist (eg in the financing of start-ups or innovative businesses). In particular, we see a role for policy instruments aimed at removing obstacles to the development of innovative, high-growth enterprises.<sup>21</sup> However, we would urge policymakers to be realistic in their expectations. The prevalence of 'lifestyle' enterprises in the SME sector suggests a fairly low ceiling for the potential number of fast-growth firms.<sup>22</sup> More importantly, both the academic literature and the Government's own experience suggest that it is not possible to identify high-growth firms *ex ante* and that many of the stereotypes associated with rapid business growth are inaccurate.<sup>23</sup>

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16. D. Richard, *Small Business and Government: the Richard Report*, submission to the Shadow Cabinet, March 2007.

17. See Ipsos MORI, *Business Perspectives on Government Guidance*, BIS, July 2008; G. Packham, D. Pickernell, and C. Miller, *Putting the Economy Back on Track*, FSB, March 2009; and IFF Research, *SME Business Barometer*, BIS, September 2009.

18. R. Baldock and D. North, *Mystery Shopping the Early Stages of the Business Link Service*, BIS, November 2009. This may overstate actual approval rates. The researchers note that they had difficulty recruiting small businesses to the study because they 'met some antipathy and apathy towards Business Link which was indicative of some misapprehension about the nature and range of the services provided.... In practice, approximately one in fifteen businesses contacted expressed an interest in participating.'

19. R. Moss and S. Wiltshire, *Local Authority Demonstrators*, BIS, March 2009.

20. R. J. Bennett, 'SME Policy Support in Britain Since the 1990s: What Have We Learnt?' *Environment and Planning C: Government and Policy*, 26: 2, 2008.

21. NESTA, *The Vital 6 Per Cent*, October 2009.

22. Open University Business School, *Quarterly Survey of Small Business In Britain Q1 2010*, March 2010; and R. Blackburn, J. Kitching, M. Hart, C. Brush, and D. Ceru, *Growth Challenges for Small and Medium-sized Enterprises: A UK-US Comparative Study*, BIS, December 2008,

23. C.G. Brush, D. J. Ceru and R. Blackburn, 'Pathways to Entrepreneurial Growth: The Influence of Management, Marketing, and Money', *Business Horizons*, 52:5, September–October 2009; and Z. J. Acs, W. Parsons and S. Tracy, *High-impact Firms: Gazelles Revisited*, SBA, June 2008.

Generally, business support can help iron out market imperfections by improving the flow of information and helping businesses overcome capacity constraints. Moreover, because smaller businesses do not always seek out advice or support when they need it, ensuring that the available support is visible and accessible should remain a priority.<sup>24</sup>

We do not believe that a rapid, root-and-branch overhaul of delivery is the way to address these challenges; such exercises have often turned out to be costly and ineffective.<sup>25</sup> The next Government will instead need to deliver at the first instance a medium-term strategy for business support, whereby delivery will be gradually shifted to businesses' preferred advisors, mentors and business networks in the private sector, as well as inspection and information services in the public sector, and the current brokerage model will be abandoned. At the same time, the online presence of [www.businesslink.com](http://www.businesslink.com) should be enhanced, allowing businesses and stakeholders in the private sector to offer feedback and suggest new material easily.

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**'What is now needed is a focus on the current business supports that actually work, of which there are some. The ambition can be narrowed and schemes operated at lower cost, working with partners to provide genuine value added. We do not need the invention of new schemes or new brands that rehash old ideas that we now know don't work.'**

PROF. ROBERT BENNETT, UNIVERSITY OF CAMBRIDGE

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24. E. Schizas and R. Jarvis, 'Determinants of the Demand for Financial Advice Among UK SMEs: Evidence From the 2007 BERR Survey of SME Finances', ISBE Conference, November 2009.

25. For an assessment of past changes in the delivery of business support, see R. J. Bennett and P. Robson 'Changing Use of External Business Advice and Government Support by SMEs in the 1990s', 2003, in *Regional Studies* 37: 8; and R. J. Bennett (2008), op. cit.



### 3. Getting the facts right

Election campaigns are rightly focused on politics. The next Government, however, should commit itself to placing evidence-based policy above ideology when addressing SMEs. Government must seek to continuously learn about the identity, the views and the circumstances of the sector and apply its findings in the design and assessment of policy. In addition to pursuing a robust research programme<sup>26</sup>, it must build more avenues for feedback, not only from major stakeholders but also from businesses at the grassroots level.<sup>27</sup>

Instead of relying on broad descriptive data, the Government needs to accept the diversity of the SME sector if it is to create appropriate policy.<sup>28</sup> The range of dimensions that can be particularly relevant is, in fact, extensive.

- Size
- Industry
- Owner characteristics (age, race and ethnic minority membership, gender, and disability.)
- Location and community characteristics (eg deprivation)
- Business age
- Growth orientation and conceptualisation of growth
- Innovation orientation
- Role in the supply chain
- Level of internationalisation
- Legal structure
- Family involvement
- Home vs. office premises
- Official vs. unofficial status.

An implication of this level of diversity is that target-driven or output-based assessments of government policy can disguise significant variations in their effectiveness and conceal real market imperfections. The catch-all term 'SME', however useful, is itself misleading by bringing together nearly 4.8m extremely diverse businesses<sup>29</sup> and potentially some 2.1m would-be entrepreneurs.<sup>30</sup>

To develop an ad-hoc business support infrastructure for each of these would be extremely inefficient. Instead, the government must make intelligent use of existing community-based resources in order to engage entrepreneurs and smaller businesses through their own peer groups.<sup>31</sup>

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**'A crucial pre-requisite for sound policy making is a robust evidence base. It is imperative that this is sufficiently fine-grain, capturing the diverse activities, contributions and challenges of SMEs operating in a variety of contexts.'**

PROFESSOR ROBERT BLACKBURN, DIRECTOR OF RESEARCH, KINGSTON UNIVERSITY BUSINESS SCHOOL.

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26. *Annual Report on Survey Activity for BERR (Including DECC): 1 April 2008 – 31 March 2009*, BIS, 2009.

27. We have, for instance, called for more extensive use of the Small Business Consultation Database. See *Better Regulation: What it Really Means*, ACCA, January 2009.

28. For a recent assessment of intervention, and the need for segmentation, see K. Mole, M. Hart, and S. Roper, 'Assessing the Effectiveness of Business Support Services in England', *International Small Business Journal*, 27, October 2009, 557–83.

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29. BIS Enterprise Directorate Analytical Unit, op.cit.

30. J. Levie and M. Hart, *Global Entrepreneurship Monitor – United Kingdom 2008 Monitoring Report*, May 2009; ONS, *Population Statistics Statistical Bulletin*, August 2009 (estimates refer to mid-2008). The report estimates that 5.5% of the UK's working-age population were involved in early-stage entrepreneurial activity in the UK.

31. *Financing SMEs in the Recession*, ACCA, November 2008.



## 4. Credit (and equity) where it's due

The financial crisis of 2008–09 led to a tightening of the supply of and demand for external finance that is still evident in the SME sector today.<sup>32</sup> This is a reflection of the state of both the banking sector and the real economy of the UK; both are currently fragile, and because they are recovering in tandem they will both take time to revert to pre-crisis levels.<sup>33</sup> We would stress that the recovery, especially in terms of employment, will depend on new or growing businesses and their access to finance.<sup>34</sup> However, both government support and private sector financial advice have a role in incentivising and facilitating the appropriate use of finance.

The next Government needs to concede, as the Department for Business, Innovation and Skills (BIS) has<sup>35</sup>, that UK businesses were over-reliant on debt prior to the financial crisis, and that, despite the resilience of the SME sector<sup>36</sup>, restoring that level of leverage is not desirable in the short term. This understanding should extend to cases where the Government itself (via HMRC's Business Payments Support Scheme), or other public sector institutions (such as the European Investment Bank), act as creditors, and also to alternative models for raising debt finance for SMEs, for instance through wholesale financial markets.

Bearing this in mind, we welcome the findings of the Rowlands Growth Capital Review<sup>37</sup>, including its emphasis on the role of intermediaries. We call on the next Government to ensure the Review's recommendations are taken forward without delay and that all stakeholders assume their responsibilities as outlined by the Rowlands recommendations.

Although the financial crisis has rightly focused attention on the availability of bank loans, we would welcome a broader debate on the use of finance by SMEs. Both Government and professional advisers should encourage and help build the capacity within SMEs to explore a wider range of credit and asset-based finance products. Small businesses will need to be made aware not only of the existence and advantages/disadvantages of different products, but also of how sensitive the supply of such finance is to the quality and quantity of the information produced by SMEs themselves and the impact of their actions on the business' credit ratings.

Additionally, we believe that equity finance, and especially business angel investment, shows exceptional promise,

especially in supporting the new knowledge-based industries the UK will need to develop.<sup>38</sup> We applaud the efforts of BIS, business organisations and academic researchers to better understand the workings of these markets. We also acknowledge the evidence of market imperfections in this area, on both the supply and the demand side, and will welcome further government intervention to provide appropriate incentives and build capacity among investors and small businesses, as long as it is justified by evidence.<sup>39</sup>

We must stress that the flow of external finance into SMEs is not nearly as large as the flow of informal trade credit between them.<sup>40</sup> Government should bear this in mind in order to avoid exaggerating the importance of bank lending or underestimating the impact of issues such as late payment. We note that, in June 2009, UK SMEs were collectively owed over £30bn in overdue payments alone, up from £18.6bn two years earlier.<sup>41</sup>

In addressing the challenges of access to finance in the recovery, the next Government must not overlook the positive relationship between businesses' stock of knowledge and skills and their ability to access finance.<sup>42</sup> Few business owners or managers have traded through a recession before; moreover, the latest large-scale survey of SME finances found that barely a quarter of SMEs had any managers with financial qualifications and 73% of owner-managers were unaware of programs to develop their understanding of finance.<sup>43</sup> In 2008, we welcomed initiatives to free up funding for higher-level and modular training for smaller businesses, but they should be complemented with funding for financial literacy and credit management training, targeting the smallest and most vulnerable enterprises.<sup>44</sup>

Finally, we note that, at a time when financial advice is desperately needed, the reputational damage sustained by lenders has been such that it could potentially reduce the already low uptake of financial advice among smaller businesses.<sup>45</sup> This effect could be further exacerbated by the large fall in demand for external finance during 2008–09. Financial advisers, including accountants, need to rise to this challenge and the next Government should encourage businesses to find out about and seek out financial advice.

32. *SME Credit Update Q3 2009*, ACCA, November 2009.

33. For a discussion of the relationship between recovery in output and credit supply, see S. Claessens, M.A. Cose and M.E. Terrones, 'What Happens During Recessions, Crunches and Busts?' IMF Working Paper WP/08/274, December 2008.

34. For a link between finance and SME employment, see *Access to Finance for the Small and Medium-sized Enterprise Sector*, ACCA, CGA-Canada and CPA Australia, October 2009.

35. Comments by Adam Jackson, BIS Enterprise Directorate, to the SME Committee, June 2009.

36. J. Kitching, D. Smallbone and M. Xheneti, 'Have Small Businesses Beaten the Recession?' 32nd Institute for Small Business and Entrepreneurship (ISBE) Conference, November 2009.

37. 'The Provision of Growth Capital to UK Small and Medium-sized Enterprises', BIS, November 2009.

38. 'Improving SME Access to Equity Finance', ACCA, July 2009.

39. See Mason, 'Public Policy Support for the Informal Venture Capital market in Europe: A Critical Review', *International Small Business Journal*, 27, October 2009, 536–56.

40. S. Paul, 'The Secret Life of UK Trade Credit Supply: Setting a New Research Agenda', *British Accounting Review*, September 2008.

41. BACS, November 2009. Fieldwork was carried out by Continental Research.

42. A. Cosh, A. Hughes, A. Bullock and I. Milner, *Financing UK Small and Medium-sized Enterprises – The 2007 Survey*, Centre for Business Research, August 2008.

43. *Ibid.*

44. *Financing SMEs in the Recession*, ACCA, November 2008.

45. *Financial Advice and Smaller Businesses*, FPB and Graydon UK, November 2008.

## 5. Regulating with the small business in mind

The Committee welcomes the renewed emphasis that the 2009 Party Conference season has placed on the Better Regulation agenda. We also welcome the Regulatory Reform Committee's report on Themes and Trends in Regulatory Reform as well as the Government's response, both of which acknowledge that the financial crisis of 2008-09, for all its valuable lessons, does not justify further regulation of the real economy.<sup>46</sup> On the contrary, we believe that, if pursued correctly, the UK's world-class Better Regulation programme will prove to be a substantial asset during the recovery.

The evidence suggests that perceptions of regulation can influence the rate of business start-ups<sup>47</sup> and SMEs' employment decisions<sup>48</sup>, both of which will be central to halting the rise of unemployment. Additionally, reduced regulatory burdens could contribute to higher rates of business survival by reducing the level of distraction faced by SME owner-managers.<sup>49</sup> Finally, the competitive impact of regulation could become more acute in the current adverse credit environment, as any regulation requiring high levels of investment is likely to raise irreversible barriers to entry for small or young firms.<sup>50</sup>

Our advice for Government is that, if pursued purely in terms of nominal outputs, such as the administrative burdens reduction targets, the Better Regulation agenda could become irrelevant. An increasing volume of evidence supports the view that substantial efforts to reduce administrative burdens on business have not improved the perceptions of UK SMEs.<sup>51</sup> We would urge Government to acknowledge this impasse and to shift its focus to the policy costs of regulation. Where possible, we would urge Government to target not notional 'savings' but observable and salient outcomes through better regulation, such as increases in the rate of business creation, employment growth, increased levels of investment and higher rates of innovation.

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46. Commons Regulatory Reform Committee, *Themes and Trends in Regulatory Reform*, July 2009; and Government's response, November 2009.

47. I. Grilo and R. Thurik, 'Determinants of Entrepreneurial Engagement Levels in Europe and the US', *Industrial and Corporate Change*, 17: 6, October 2008.

48. Conservative estimates of jobs lost to employment regulation range from 160,000 to 190,000. FSB, 'The FSB Five-Point Plan for Job Creation and Retention', January 2009 and 'Don't Give Up on Regulatory Reform says ACCA to the New Minister for Communications, Technology and Broadcasting', ACCA Press Release, October 2008. *The Good Guidance Guide: Taking the Uncertainty Out of Regulation*, BIS, January 2008.

49. C. Decker, T. Keyworth, and G. Yarrow, 'Identification of Regulatory Impacts on Scale Economies in Compliance Costs', in *Impact of Regulation on Productivity*, BERR Occasional Paper No. 3, September 2008.

50. *Impact Assessment of Regulatory Budgets Consultation*, BIS, August 2008.

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51. NAO, op. cit.

The next Government should accept that the flow of new regulation is far more closely related to perceptions of regulatory burdens than the stock of existing rules.<sup>52</sup> It should account for the total burden of new regulations and incentivise government departments to provide better value for money when regulating. We welcome the recently published Forward Regulatory Programme<sup>53</sup> as a step in the right direction and would hope to see such regulatory budgeting tools established in practice after the election. We would expect, however, that employment regulation, currently the least competitive element of the UK's regulatory regime<sup>54</sup>, will once again be addressed by the Better Regulation agenda.

While we would not welcome a reduction of the protection afforded to employees in SMEs, we believe there is scope to review and consolidate large sections of employment regulation and guidance on a thematic basis. We would argue that the Equality Bill, despite its shortcomings, provides a good example of such consolidation. Where this is not possible, we would urge the next Government to ensure continuity in employment regulation and to give smaller employers a chance to catch up with any new initiatives, as recently recommended by the All-Party Parliamentary Small Business Group.<sup>55</sup> Ideally, the next Government should also reaffirm its adherence to the principles of good consultation and to Common Commencement Dates, both of which were recently overlooked in the rush to deliver new employment laws.

Generally speaking, unless the quality of regulation can be improved, the Regulatory Reform agenda could become a zero-sum game, trading off public protection against improvements in the business environment. This is not in the interest of SMEs. In order to improve the quality of regulation, the next Government should commit to all of the following.

- Improving the skills of regulatory staff.
- Timely, high-quality impact assessments and publicly available post-implementation reviews.
- Improving regulators' understanding of SMEs' compliance behaviour.
- Improving the quality of regulatory guidance and enforcement.
- Timely, high-impact engagement with European regulators.
- Improved communication with, and feedback from, SMEs at the grassroots level.<sup>56</sup>

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**'The better regulation agenda is crucial to allowing businesses to grow and drive economic recovery. Addressing regulatory interventions as a whole, rather than just the administrative burdens, is an important contribution towards freeing the private sector to create wealth. This programme must be fully supported by the next Government to realise maximum savings for business.'**

DAVID FROST, DIRECTOR GENERAL, BRITISH CHAMBERS OF COMMERCE

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52. BIS, op. cit.

53. *The Government's Forward Regulatory Programme*, BIS, October 2009.

54. *Doing Business 2010 – United Kingdom*, World Bank, September 2009.

55. All Party Parliamentary Small Business Group, *Flexible working: Challenges for Business*, January 2010.

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56. For a more detailed discussion, see *Better regulation: What it Really Means*, ACCA, January 2009.

## 6. Investing in enterprise

As discussed earlier, the recession has dramatically highlighted existing gaps in the skills and knowledge of entrepreneurs and owner-managers of small businesses. Many of these are now having to re-learn the way they deal with customers, manage cash flow, finance and the marketplace, and the way they do business in general. Meanwhile, the demand for labour elsewhere has fallen rapidly, especially at lower skill levels<sup>57</sup>, to which the bulk of skills funding is directed.<sup>58</sup>

Skills policy, however, has failed to keep up with the rapid pace of change and very little progress has been made since the Leitch Review of Skills in 2006. Where initiatives have been undertaken they have translated for the most part into additional resources for Train to Gain, which despite £1bn of investment per annum is as yet unable to reach the smallest employers, let alone the self-employed. Sector Skills Councils (SSCs) have also met with relatively little success in targeting micro-enterprises.<sup>59</sup> This would suggest that public skills provision for entrepreneurs and micro-enterprises is under-resourced in terms of both quantity and quality; the next Government should carefully consider ways of addressing this.

We would advocate, in particular, a redirection of resources from the current skills and business support budgets towards training for aspiring entrepreneurs, targeting in particular young people in education, the unemployed and people over 50. Evidence suggests that such interventions have the potential to not only create viable businesses, some of whom will go on to become employers, but also to permanently move enterprising people from benefits or unemployment into self-employment; a positive outcome for both the individual and the taxpayer.<sup>60</sup>

To this day, enterprise skills are treated by the UK Commission for Employment and Skills (UKCES) as largely sector-specific.<sup>61</sup> This means that, despite calls for formal recognition of enterprise skills from SFEDI, the FSB and ACCA, among others, existing SSCs are set to become the first port of call for standards in enterprise skills. We would urge UKCES and the next Government to reconsider this state of affairs and allow the smallest enterprises access to their own standard-setting body; it is hard to imagine how engagement will improve otherwise.

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**'Starting and running your own enterprise is not only the best career for many, it is often the only viable option. The 1 in 7 of the adult workforce running their own enterprises can, with the right enterprise skills, know how and appropriate private sector support, drive the economic recovery, the employment rate and social integration. Government has yet to recognise this in its skills and support policies. The lion's share of government skills and support policy and budget goes to corporate/institutional management and 'usual suspect' employers. Working with government we can harness the power of enterprise training and support to ensure growth, tackle unemployment and disadvantage.'**

TONY ROBINSON OBE, FOUNDER/EXECUTIVE DIRECTOR, SFEDI

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57. *Impact of the Recession on the Labour Market*, ONS, May 2009.

58. Qualifications above level 3 (GCSE level) are usually ineligible for government funding.

59. *FSB Research into Sector Skills Councils*, FSB, April 2009.

60. *Inbiz Client Satisfaction and Sustainability Research*, Benchmark Research, April 2004.

61. *A Review of National Occupational Standards for SMEs and Owner Managers of for UKCES*, Pye Tait Consulting, September 2009.

## 7. Simple tax, clear incentives

UK SMEs have long held that the UK tax system is too complex and burdensome, and is in need of reform.<sup>62</sup> Businesses remit about 88% of all of HM Government's tax revenues, at considerable administrative cost,<sup>63</sup> and the management of tax liabilities requires access to costly advice. SMEs can be disproportionately affected by changes in taxation compared to large firms, even if the nominal tax rates imposed on them are less burdensome.

We are aware of proposals to review the plethora of ad-hoc tax breaks, currently valued at £3.6bn<sup>64</sup>, and replace them with a simpler, less burdensome system. We would, in principle, welcome such a step. However, any government so inclined must also remember that the tax system is not simply a fiscal instrument. It is also a very important provider of incentives that can affect decisions on capital structure, investment, innovation and employment.<sup>65</sup> There are incentives associated with any conceivable tax regime, even a flat tax, and they need to be considered carefully.

We note, for instance, the potential of such instruments as Research & Development (R&D) tax credits and the Enterprise Investment Scheme (EIS), but also capital gains tax and National Insurance contributions in promoting innovation, equity investment, and employment respectively.<sup>66</sup>

As pressing as the need for reform may be, we believe that the next government will need to very carefully examine what incentives it wants the tax system to provide *before* deciding how to simplify the system.

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**'All parties have given lip service to tax simplification but little of any great effectiveness has happened since the time of Nigel Lawson. It's time for the talking to stop and for action to be taken to rescue all taxpayers from the tax labyrinth.'**

CHAS ROY-CHOWDHURY, HEAD OF TAXATION, ACCA

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62. F. Chittenden and H. Foster, *Is There a Way Out of the Tax Labyrinth?*, ACCA, March 2009.

63. J. Shaw, J. Slemrod and J. Whiting, 'Administration and compliance' prepared for *Reforming the Tax System for the 21st century: The Mirrlees Review*, April 2008.

64. *Supporting Small Business Through the Recession*, ACCA, March 2009.

65. See for instance *Tax After the Financial Crisis*, ACCA, January 2010.

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66. We discuss the role of the EIS more extensively in *Improving SME Access to Equity Finance*, ACCA, July 2009.

## 8. Seizing opportunity

Whilst the UK has been badly affected by the global economic downturn, it is clear that other markets abroad have been more resilient. It is becoming clear, for instance, that many markets in South East Asia and Africa have managed to sustain economic growth throughout the global recession and are now rebounding sharply, and a great deal of business investment is driven by businesses rushing to exploit opportunities there.<sup>67</sup>

As the depreciation of Sterling prompts UK firms to seek out new and faster growing markets abroad, the next Government should focus on making such opportunities more accessible to SMEs. While the UK has taken steps towards this, most notably by extending trade credit guarantees to firms trading in developing countries, there are other options that have yet to be explored.

We note that a number of countries, including Singapore and the US, have drawn up detailed strategies for increasing export activities among SMEs, while many more, especially in Asia, are engaging bilaterally with their neighbours in order to increase SME export opportunities. It is also clear from the evidence base that growth firms in the UK have no option but to export.<sup>68</sup> We believe that the next Government would do well to consider developing a strategy that brings together business support, financial interventions and other incentives in order to encourage the internationalisation of small businesses.

Closer to home, the implementation of the EU Services Directive provides a first-class opportunity for UK services SMEs to access European markets, and for the Government to test its support infrastructure for small exporters both in Britain and abroad. The UK has so far performed well compared to our peers in implementing the Directive.<sup>69</sup> However, in order to build on this advantage and the opportunities it provides, the next Government will need to engage proactively with Brussels, guarding against any initiatives that could sabotage harmonisation in the EU's internal market.

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**'The UK government has the opportunity to put the great back into the British export market. Entrepreneurs must be allowed to focus on the opportunities export brings, they need the government to provide clear and easy to understand support, financial and other incentives.'**

GLENN COLLINS, HEAD OF ADVISORY SERVICES, ACCA

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67. *Global Economic Conditions Survey Report: Q4 2009*, ACCA, December 2009.

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68. See R. Blackburn, J. Kitching, M. Hart, C. Brush, and D. Ceru, *Growth Challenges for Small and Medium-sized Enterprises: A UK-US Comparative Study*, BIS, December 2008.

69. *Implementation of the Services Directive: Making the Internal Market for Services Work Better*, information note from the Commission, Meeting of the Competitiveness Council, September 2009.





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