

**Small Business Priorities for the New Parliament**

**About the Genesis Initiative**

The Genesis Initiative was formed to improve the quality of the debate on SMEs and create economic reform, driven by SMEs and supported by Parliamentarians. The Genesis Senate meets at least three times during each Parliamentary session, normally in March, June and October. It involves highly professional and qualified representatives of Entrepreneurs, SME Academia, Parliaments and Assemblies and SME Organisations within the UK (some 115 representing some 1 million members across business sectors <https://www.genesis-initiative.org/senate/senate-member-listing/> ). This combination of entrepreneurial zeal, concentrated research and commitment from experts working on behalf of SMEs is linked with All Party Support across the House of Lords and Commons. Their joint efforts contribute to the continued growth of the SME sector within the United Kingdom. This experience and knowledge are shared with international partners who wish to work with or emulate this model.

Small business is the backbone of the British economy and when it does well the whole country does well. The role of Genesis is to act as an umbrella organisation, working on behalf of the SME community to optimise potential growth in the SME sector by fostering a “can do” culture. We aim to participate fully in achieving economic and structural reforms that will enable business to flourish, resulting in higher productivity and a significant increase in the GDP of UK PLC.

**2020 Policy Working Party – Contributions and ideas have come from:**

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Contributions to the working party’s thinking have also been received and shared by individual Genesis Senate participants drawn from sectors representing accountancy, rural and food businesses, chambers of commerce, consultancy, digital, engineering, hospitality, SME financial services, the legal professions, design, fashion, market traders and security, amongst others.

The paper is the view of the Genesis Initiative, for discussion, rather than representing the views of any individual.

**An Agenda for Small Business - Priorities for the new Parliament**

The practical challenges and opportunities facing the SME sector have, as in many other areas of UK life, taken second place to the national debate on Brexit. With nearly 6 million small and self-employed businesses in the UK, the SME sector, will repay policymaker attention.

In this paper, the Genesis initiative begins a process of highlighting key issues that the government should attend to in this Parliament to produce both more immediate results and necessary longer term changes.

The SME sector is anything but homogenous and future work in this program *An Agenda for Small Business* will set up policy analysis, discussion and proposals which examines and respects the differing strengths and opportunities across the SME sector. Genesis leaders usually have the lived experience of founding, leading in or working closely with SME owners and employees. Setting up a small business may provide some with a new freedom, but policy makers, the media and the population at large too often forget that it is also often a difficult choice, or the only option. The SME sector deserves our respect, consideration and support.

**(Signatures, John May and David Harvey x March 2020)**

**Agenda for Small Business: Priorities for the new Parliament**

1. **Summary**

Genesis brings together 115 separate business and professional associations ( <https://www.genesis-initiative.org/senate/senate-member-listing/> ) representing over a million SMEs and self-employed. Discussions with association leaders suggest that priorities across the SME sector include:

* More effective legislation against late payment and related oppressive practices such as prejudicial contract terms.
* Agreeing a BREXIT trade deal with the EU and firming up world-wide free trade deals
* Simpler access to longer term finance
* Online sales, tax fraud and the high street
* The reform of business rates
* Simpler and more effective support for business education.
* Other people -related issues such as good local housing and healthcare
* Introducing new technology and systems
* Tax, business regulation and business support simplification
* Amendment of the governments IR 35 contractor and SME start up taxes

Below, Genesis leaders have discussed in more detail proposals for change in 4 of the above areas which would have major positive impacts and show the sector a leadership that may have been lacking since 2016. These proposals cover late payment, long-term finance, online sales and tax fraud and the IR 35 regime. These areas drew the most immediate and substantial negative reactions and, most positively, suggested answers from the Genesis community. The future work of this Agenda for Small Business programme will look in greater detail sector by sector at a selection of the above issues, both to define sector challenges and to suggest practical answers.

1. **Introduction**

The SME sector is central to the prospects for the UK post Brexit. Here, the Genesis Initiative (henceforth Genesis) sets out in overview the policy challenges facing SMEs. Suggestions from Genesis leaders, led by the 2020 Working Party, set out possible solutions in 4 of the key challenge areas. One thing is for certain, after 3 years of an often fraught national Brexit debate a range of those challenges on the small business community are potentially undermining the opportunity the SME sector offers the UK economy.

Whilst this paper provides a sector overview, the SME community is anything but homogenous. This is the first output of the new Genesis research programme *Agenda for Small Business*. After this initial paper, the objective of the Agenda is to provide sector focussed examination of the UK policy agenda for SMEs, founded on the expertise of Genesis Senate member organisations. The programme will next look in depth, working with academic partners, at how issues introduced in this paper vary sector by sector to optimise understanding and proposals across those major SME sectors in the UK economy. This initial paper has been prepared for discussions amongst Genesis leaders from across business sectors, who have between them a depth of experience in the SME sector.

Central to the Genesis view is the understanding that the idealised road to wealth by entrepreneurship seldom exists. Setting up in business is a tough road, whether aspiring to grow a global enterprise or simply to be a self-actualised citizen through being self-employed. In the national dialogue “unicorns” high-growth firms and Sunday newspaper success stories are the focus of attention. Genesis leaders have lived the small business experience. We know that every small business matters, every SME has the potential to take on its first employee and any SME can contribute to its community’s best future.

1. **Context: The SME opportunity**

Central to the prospect for the UK post Brexit is the work of providing the best environment for the UK SME sector so that is creates wealth and opportunity and SMEs are sufficiently confident to invest in growth and can offer better jobs. The challenge of mobilising this opportunity is seen in what has been described as the last “decade of lost productivity” (Hopley, 2020).

* 1. **The SME sector: where the jobs are**

As demonstrated by the Global Entrepreneurship Monitor (GEM Global Entrepreneurship Monitor, 2019), the UK remains one of the best places to open a business in an economy where 97% of all businesses are small ones (Business population estimates for the UK and regions: 2019 statistical release (HTML) - GOV.UK). Small businesses are “where the jobs are” (Dearie, J., & Geduldig, 2013) and they stand behind the growth in employment of recent years and the economy’s resilient reaction to changes brought about both by the financial crisis of 2008 and by rapidly moving technology.

However, UK small businesses remain less competitive (SME competitiveness - Regional Policy - European Commission, 2020) than some of our strongest international rivals (Abel-Koch, 2014), particularly outside of the service sector. Thus, UK SMEs are less able to cross the growth threshold to become employers and then to grow into that corridor towards being substantial medium-sized enterprises. Those growing businesses make major contributions to local employment and the prosperity of those owning and working in them, as well as supporting overall economic growth and contributing far more to the national tax take than the start-ups from which they originated.

Of course, the geography of challenge for SMEs varies. There is a clear contrast, for instance, between the silver cloud with a stormy lining growth but with accompanying high property prices and business rates of London, for instance, and SMEs in northern towns where poor infrastructure and deficiencies in business education acts as a deadweight on progress. The reasons blocking the growth corridor for many SMEs are many and various, there is no simple fix. Reasons of history, geography, culture and business structure leave legacies that will take time to change.

* 1. **Running a small business - no easy choice**

Whereas larger businesses with a new opportunity will often simply divert existing resources, small businesses in the same situation seize it by creating jobs. There exist though, a range of barriers which make it more challenging for small businesses to reach that point where they take on their first employee and then begin to reach towards growth. There barriers include: regulatory, financial, tax barriers to growth, skills and also in the nature and culture of the SME sector itself. As the BEIS Select Committee has noted *Small businesses and productivity*, 2018):

UK productivity is falling behind its competitors. The Government has acknowledged this in its Industrial Strategy and is considering how it can address the ‘long tail’ of unproductive SMEs. To tackle this, we recommend the Government reduces imbalances between SMEs in different regions and sectors and helps small businesses to better understand what productivity is, how it can be measured and then improved.

This description hides a million different stories, circumstances and choices. The national political dialogue around small business is frequently in the language of empowerment, opportunity and wealth creation. All these features are true aspects of SME life, but many of the factors making SMEs “unproductive SMEs” derive from a range of blocking factors which policy needs to remove or at least reduce. In the national dialogue, there is a tendency to point at a lack of competitiveness, rather than to consider the barriers to growth and employment SMEs face. We should not be rosy eyed about the small business sector and the challenges faced by individual small firms. When we are presented with a picture of blossoming entrepreneurship, we should also remember many businesses are set up as “necessity businesses” (Hechavarria and Reynolds, 2009). These are reactions to life circumstances, sometimes positive choices, but often choices based on the necessities imposed by austerity, economic change, redundancy and the ending of traditional employment and business models. Some, necessity businesses whilst required to earn income, also present positive and successful choice about lifestyle, but for many, after much searching, it may be the only viable choice that pays the mortgage. In some instances, running a small business may be a choice of pride and self-respect as against dependency. Even then, given the right climate many of these businesses are capable of creating employment and wealth. More attention, simply has to be directed toward creating that right climate

When between one third and one half of start-ups across the UK will not get through their first two to three years, going into business is a tough choice; “start-ups contribute to both job creation and job destruction” (Roper and Hart, 2018). Many of those who start businesses, at least initially, would rather be back in old-fashioned employment. An example of the barriers placed in the way to such businesses is the IR 35 regulations. The regulation was correctly initially targeted at subcontractors ceasing to be employees and instead becoming subcontractors, whilst doing exactly the same work for the same money, but with the tax advantages of self-employment. However, IR 35 undermines the viability of many more in genuine start-ups or necessity business situations where the business faces the disadvantages of self-employment; having to pick up a range of direct employment taxes and costs that would have been carried by an employer and thus acquiring significant additional risk at the bottom line. Evidence from Genesis recent visit to Washington’s Capitol Hill to meet policymakers and think tanks, is that US policy development focuses on supporting new employment generation as a way of creating new source of national tax revenues.

1. **The Range of Challenges**

Leaders of Genesis have highlighted the following factors requiring action in this new parliament. They are set less in an order of importance, more in an order that balances the immediacy of possible action and a recognition that issues such as the people issues noted as item 7 are long term and require action that may take some years to see tangible results.

1. More effective legislation against late payment and related oppressive practices such as prejudicial contract terms imposed on SMEs.
2. Agreeing a BREXIT trade deal with the EU and firming up world-wide free trade deals.
3. Simpler access to longer term finance.
4. Online sales, tax fraud and the high street.
5. The reform of business rates.
6. Simpler and more effective support for better apprenticeships and business education for both young people and those already in the workplace. The SME sector needs up skilling to become more competitive.
7. Other people related issues such as good local housing and healthcare.
8. Introducing new technology and systems.
9. Tax, business regulation and business support simplification.
10. Amendment of the governments IR 35 contractor and SME start up taxes.

There may be no simple fix, but there are fixes that will make a difference over the term of a government. Short and longer term issues need attention, balancing a combination of more immediate wins and longer term change. Below Genesis Leaders drew out four issues below, which combine shorter and longer term priorities. The following details more extensive discussions. The issues are:

* Work to strengthen the office of the **Small Business Commissioner,** which is already sketched out by government.
* Reviewing of **IR 35**.
* Dealing with **online import fraud**.
* **Access to finance** will take longer to change, but it is crucial to move down the road to change the UK model and to boost confidence in growth.
1. **Case Study 1 – Empowering the Small Business Commissioner**

Genesis leaders have used the support of the Commissioner’s Office to end their own late payment problems and secure payment from customers. Late payment kills the confidence to invest in the future, to buy new plant and equipment to employ new staff or to take risks. Late payment can and does kill suppliers. The scale of late payment and the impact it has is capable of resolution, as Scandinavia with minimal late payment issues demonstrates. Yet, late payment has been and remains a major issue for UK SMEs for as long as anyone can remember. Genesis leaders see it as often the most immediate obstacle to short and medium term investment decisions.

Genesis member organisation observed that circa 25% of businesses which their association members supply are late payers; this headline figure hides variations by sector and frequency but highlights the problem. What is certain is that late payment remains a business killer. Late payment has extremely negative social impacts, as well as economic ones. Intrum set out in their European Payment Report 2019 research (Intrum, 2019) that 3% of UK sales revenues continue to be lost through default or dispute after late payment. Since profit is often made in the last 5% to 10% of turnover, late payment is a significant danger. Previously, Intrum (Intrum, 2019) reported that almost ¼ of UK businesses believe that late payment is a threat to their survival, the highest level in Europe where the norm is around 10%. Research by The Association of Business Recovery Professionals (*Association of Business Recovery Professionals report on late payment*, 2016)shows, similarly to Intrum, that from region to region up to ¼ of businesses may have concerns about survival year-on-year through late payment by suppliers. Hitachi Capital’s recent report (Hitachi, 2019) points out that 57% of SMEs spend nearly one day a week chasing late payments and that 3 in 4 (76%) of freelancers say that late payments have had a detrimental impact on mental health.

Amongst Genesis members there were examples of significantly later payment periods than the UK average of 27 days. Observations from Genesis members suggest that perhaps as many as 30% of businesses encounter what they believe to be unnecessarily long payment terms. Government has suggested that the quantum of late payment has fallen by some 50% in recent years (*Creating a responsible payment culture: a call for evidence on tackling late payment - GOV.UK*, 2018) . However, the composition of this change has not been analysed. Genesis suspects that this reduction is primarily in routine late payments, whilst critical late payment threatening business survival remains high.

Shortly before the general election was called Genesis met with Kelly Tolhurst Small Business Minister, and her Labour shadow Bill Esterson, to call for reform of the Office of the Small Business Commissioner’s office (*Small Business Commissioner*, 2020) after the election. The Commissioner’s office was established in late 2017 “to ensure fair payment practices for Britain's small businesses and support them in resolving their payment disputes with larger businesses and bring about culture change”. The criticism of the Commissioner’s office is not that it is unwilling, quite the reverse; it is underpowered and under resourced. It need not have the money, power and resource to police the entire late payment environment; it does need enough to be known and feared; and should have more extensive powers to make very public examples. The re-elected Conservative government has already declared itself willing to build and extend the authority of the Commissioner’s office. Genesis proposes the following:

* Increase the resources available to the Commissioner – around a dozen investigatory staff in total - to enable the investigation and public reporting of more cases.
* As the Minister has suggested, large companies which do not comply with the Payment Practices Reporting Duty – an existing mandatory requirement on large businesses to report payment practice to a national database twice a year – should be prosecuted, with the scheme overseen by the Commissioner.
* The Commissioner needs to be able combine their power to highlight bad practice with the power to fine; this needs to hurt and be proportionate to the size of profits of the offending late payer.
* Technology now allows instant payment, by blockchain and other technologies, such as e-invoicing. The government proposal for a Business Basics Fund competition of up to £1 million in funding to encourage businesses to use technology to simplify invoicing, payment and credit management, should be far more substantial.
* The Commissioner’s powers should also be extended to the investigation of unfair contract terms which effectively institutionalise late payment by allowing the most token of issues to be used to delay payment. In such matters the Commissioner should be able to demand disclosure and to investigate. Such practices rely on the capacity of bigger businesses to bully smaller ones; the Commissioner should have a wider remit to take on some of these instances, with tribunal powers to amend or declare contract void and act against directors behind such policies.
* The US Small Business Administration is a highly effective voice for US SMEs. It provides a simple and effective platform for a range of SME services that combine effectiveness at no cost to the US taxpayer. As noted below it is a highly effective organiser of long term lending which effectively provides long term patient capital for up to 25 years. The Government should explore whether the office of the Commissioner should, in time, come to fulfil a range of the roles similarly carried by the SBA in the United States. Presently, myriad agencies and schemes confuse the UK SME community. There is a case for investigating reducing that myriad through an expanded role for the Commissioner. It is certainly the case that ideas from other countries do not translate directly, but they do often contain the kernel of a good idea.

**Achieving an impact with small business**

By developing the office of the Small Business Commissioner and paying attention to late payment, which is one of the greatest concerns of SMEs, the government can create a track record which the SME sector will notice. Further development of the office of the Commissioner, should initial changes prove positive can create a proven long-term narrative showing that this government wants to put SMEs on a par with big business.

1. **Case study 2 – Digital Platforms and crime online: recouping £1 Bn revenues and protecting UK SMEs**

**Fraud through Online Platforms**

It is child’s play for international firms importing into the UK through third-party online platforms (e.g. Amazon, eBay Alibaba) to ignore the rules to achieve an anti-competitive advantage against UK SMEs:

* Evading the payment of VAT; the platforms act as mere sales facilitators rather than being responsible for the fraud passing through their businesses, importers easily get around VAT.
* Stealing intellectual property and selling cheap imitations in competition.
* Using international postal rules, to import at a fraction of domestic postal costs
* Ignoring the health and safety regulations that protect citizens, selling substandard and sometimes dangerous goods, knowing there is little redress for the customer.
* Ignoring the 3rd party platforms’ own rules e.g. through false reviews of their own and competitor products and offering several platforms on one site, contrary to normal terms of operation.
* Through these anti-competitive practices, undercutting UK businesses, and forcing them out of business.

HMRC’s estimates and evidence from other countries that are taking legislative action suggests that this issue may be costing the UK economy over £1.5 billion a year in lost taxes and an unquantified amount in failed and damaged UK businesses. Countries as far apart as Italy, individual US states and Australia are acting and recovering revenue.

**A Digital platform Law**

When government looks at digital markets, legislation should include measures to end market abuse and enforce best practice standards of tax compliance, IP law and health and safety regulation and fair competition. This should include:

* Enlisting Online Marketplaces, as the sales facilitator, to collect and pay VAT to HMRC on all goods sold by 3rd Party Sellers trading on their platform. A specialist and resourced HMRC unit should back this up, based on the Australian experience it will much more than cover its costs.
* Placing the obligation of counterfeit and dangerous goods enforcement onto online marketplaces.
* Minimum standards potentially backed up with a licence to operate scheme.
* Taking health, safety and environmental enforcement for digital platforms out of the hands of local authorities and into the hands of the Health and Safety Executive, which should have effective powers of entry, inspection, enforcement and prosecution with respect to digital platform warehouses.
* Legislation to apply joint liability to the supply chain so that platforms, fulfilment houses and categories of logistics operators are responsible for issues arising from imports through them, such as product safety.
* Likewise, all UK Registered Companies in this marketplace owned by Non-EU Residents should appoint a Fiscal Representative and offer a Bank Guarantee.
* Digital platforms use their data about platform users to undercut competition, for instance always presenting favoured suppliers at low prices to users with particular product interests whilst excluding other businesses which are not in a cartel relationship. This abuse of data needs to be reviewed and prevented.
* There have been initial proposals, but there should be further reform of the International Postal Union. For many years, postal charges for importing from China have been cheaper than sending a parcel from London to Leeds. It seems as though changes proposed will still leave loopholes disadvantaging UK SMEs posting in the UK.

**Achieving an impact with small business**

In every trade association whose SME members sell online and have international manufacturing competitors, this issue will be raised. It is one thing for an SME to fail because the competition is better, another when the competition has inherent and unfair advantages. Setting this wrong to rights would merely be to copy competitors in Europe, Australasia and North America for whom we have respect and with whom we have shared values business.

1. **Case study 3 – Access to finance**

**Lenders are from Mars, SMEs are from Venus**

The myth, there is no cash for SMEs to access. In fact, there is plenty, but there is a deficit of trust in both potential lenders and so the propensity for growth; indeed, as if lenders are from Mars, SMEs are from Venus. There is also perceived to be a dearth of patient investment. In late 2018 Genesis reviewed the funding position for the (now) 5.9 million small businesses and self-employed in the UK. The report that resulted (Tyler, 2018)drew on a cross section of some 250,000 businesses and a broad range of Genesis leaders, uniquely combining the experience and views from a wide range of representatives of the business lending and investing community. Collectively British business is significantly less competitive than its peer nations. Post start-up, further job creation and improved competitiveness are often lack lustre. Small businesses create the majority of new jobs, 99.9% of businesses are SMEs, with 60% of employment, but 82% of the businesses created since 2000 are sole traders/self-employed. Circa 50% of these businesses survive to the end of their 4th year. Only 4% of businesses are medium-sized or large.

There is funding out there in abundance when our SME community is searching for investment into their business. The challenge is to match the right business and funder and to do so in a way that makes much longer term options possible so that the business does not feel that to borrow for growth is not also to undermine the business through the threat posed by a perceived demand for short term repayment on long term projects.

**Rebuilding a failed relationship? UK SMEs and the major banks**

How can SMEs be encouraged to take on that next employee? How can they be supported to be more competitive and offer more skilled and better jobs? The lack of patient capital allowing SMEs to grow long term is a significant market failure compared to, for instance, the USA, Germany and Japan. Just 36% of SMEs now use external finance compared to 44% in 2012 and, according to the British Business Bank, over 7 in 10 firms say they would rather forgo growth than take on external finance. Merchant Savvy suggest that 50% cannot get finance when they apply. Under skilled SMEs are part of the explanation, but so is the formulaic “computer says no” approach of lenders, replacing the emotionally intelligent “bank manager” skills of the past.

Mistrusting the high street banks (Genesis, *Access to Finance* 2018), SMEs remain wary about newer alternative providers; for instance, with issues at Metro Bank and peer to peer lender Lendy. Most external UK funding is relatively short term, secured on assets, sometimes family ones. Lending and investing happen in a highly fragmented lending marketplace making knowledge difficult to obtain and trust challenging to create. The Bank of England noted (2003) “it is hard for businesses (and their advisers) to review what is available and find the best scheme”; this remains the case. Attracting new customers is a major problem; Capital Economics points to business wanting technology for better marketing, but longer-term funding is not available on reasonable patient terms.

Small businesses were hit especially hard by the recession. Around 85 per cent of business current accounts and 90 per cent of loans to SME’s in England and Wales are with the largest banks. Three plus years of general economic uncertainty alongside the concerns over the treatment of some SME’s in the past, for instance in the events of the HBOS/Lloyds business lending scandal (Lloyds fined £45 million by the Financial Conduct Authority for HBOS failures over Reading scandal | London Evening Standard, 2019) has helped to add to their reluctance to borrow. We can look at many other current reasons for that caution, but the statistics tell us that almost two thirds of UK SMEs are not willing to fund expansion through borrowing; there has always been a reluctance to take external equity. Family businesses in particular can be, additionally, reluctant to involve equity partners because of the dilution of family control, perceived short termism and its clash with the long-term view of the family interest that such businesses often take.

**New entrants to the finance market**

As the research carried out by Genesis in 2018 demonstrated, new lenders in the market are often unknown to the SME community, thus opportunities to grow trust, relationships and lending are limited. However, it is undeniable that since the recession of 2008 we have seen an unprecedented number of new lenders entering the UK business market with numbers of available lenders at a high. They are funded in a number of different ways and this has become more sophisticated over time. The competition for customers, coupled with a low interest rate environment, has meant that the end user, the business owner, should be able to find good value and readily available borrowing. Innovative British finance firms have brought a new financial lending ecosystem of next-generation facilities. There is no lack of funding options, which can be tailored to avoid a “one size fits all” offering.

In addition, the once-in-a-lifetime distribution through the Capability and Innovation Fund remedies package over 2018 and 2019 should have kick-started even more innovation in business borrowing and banking. The Government can build upon work already carried out by, for instance, the British Business Bank’s Small Business Group’s Business Finance operation where an expanded remit can further grow awareness, provide education and stimulate accessibility to the new business lending community.

The danger is that unless business and the lending/investing sector becomes better matched, UK businesses could still become relatively underfunded at the time when they should be pushing ahead, identifying and chasing down opportunities post Brexit. Whilst the business world has not taken full advantage of open banking and the opportunities that can provide, to exchange data, to find the right matches, this appears to be changing. Finance providers are cooperating to link their data. Such partnerships can help to ensure that educated providers can match with educated businesses through the knowledge open banking can allow. From a small business perspective, it has to be said that a general lack of knowledge of how these lenders work has led to many questioning their integrity and trustworthiness.

Joe Harrison, Chief Executive of the National Federation of Market Traders, (a Genesis member)comments “NMTF believe that, as a trade association with a membership of in excess of 20,000 micro and small businesses, the Government’s help in assuring the respectability and standing of the specialist lenders, raising awareness, combined with work between the two parties, would go a long way towards improving the growth of small business in many UK sectors, eminently more suitable than a ‘one size fits all’ offering that we were all used to in the past”.

Britain’s business owners deserve to be satisfied and confident not frustrated and concerned, with help to improve their confidence in seeking investment for expansion Thus, Genesis, for example, is examining a partnership with technologically savvy and longer term orientated finance providers to support women entrepreneurs, many of whom feel very disadvantaged as against their male counterparts.

**An answer - The British *Small* Business Bank (BSBB)**

Building trust and knowledge requires both a major simplification of the current offer and mechanisms that are long term and can come to be understood and trusted by SMEs. Government should consider a high street and virtual national brand of the British Business Bank, fulfilling a mission of patient capital, lender/investor/business education and mentoring to give small businesses the confidence and skills to grow and so create jobs. While operating through local providers, the BSBB should, like the US Small Business Administration or Germany’s similarly state owned KfW Mittelstandsbank, be the UK’s primary SME finance brand, offering long term patient lending.

Working through existing financial institutions, the BSBB, as a new division of the British Business Bank, should partner regionally and operate teams of local mentors/assessors to lead the necessary cultural change. A myriad of brands and schemes should be replaced by a more limited range of partner distributors funding to one model.

SMEs need patient capital for anything up to 25 years. The BSBB should provide guarantees to local partners, including new banks and finance providers, over these periods of 75%, sometimes 90% or more, with the borrower normally taking a risk on the rest. As in the US a small fee would cover the costs of the BSBB and its partners. This is an intervention to end market failure. It will be important to grow a brand and so grow awareness of what should be a powerful presence to support small business. As well as monitoring borrowing performance, BSBB mentors would focus on competitive skills and training and on promoting particular government initiative e.g. ethical and green practices. The major SME member organisations could act in an advisory role to such a BSBB initiative.

**Achieving an impact with small business**

Enough small businesses need to be persuaded that growth is worth the risk and that a borrowing or investment partner can be just that, a partner. If we get this right, it will provide substantial benefits for the UK economy in terms of overall growth and competitiveness, development of trade, more skilled jobs, strong tax revenues and healthier communities.

1. **Case study 4 – IR 35, destroying flexible British SME expertise**

For almost three decades, the UK has enjoyed a competitive advantage through its businesses being able to access vital flexible expertise they need to deliver projects and drive the economy forward. The intermediaries’ legislation colloquially referred to as the IR35 tax rules (IR35) presently may undergo another major overhaul after April 2020. The impact of the changes is likely to be highly detrimental, particularly at a time when the UK economy needs to be nimble on its feet to deal with the potential opportunities and threats posed by Brexit.

Freelancing is a valued business tool. At the top end, areas such as Interim management revolves around the provision of specialist resources and skills for a defined project or period. Clients can turn to Interim practitioners and consultants for their most complex and top-heavy roles, using a proven heavyweight Interim executive for a short-term assignment to manage a period of growth, transition, crisis or change within an organisation, including start-ups. Similarly, Contractors skilled in a variety of disciplines across all business sectors can be engaged for defined projects to meet a particular need.

Freelancers are businesses on their own account and the vast majority operate through their own personal service companies (PSC). This structure currently enables Clients to engage and disengage a Freelancer at little or no notice. The PSC is an intermediary so, depending on circumstance, IR35 may apply; until April 2020 the Freelancer is primarily responsible for any tax liability if within IR35. It is proposed from April 2020 the Client is responsible for issuing a status determination statement (SDS) to say if IR35 applies. If it judges incorrectly that the rules do not apply, it becomes primarily responsible for any IR35 tax liability. Human nature suggests that Clients will be risk averse and likely to decide that most assignments will be inside IR35. The Freelancer may continue to work through their PSC and incur the same tax liability as if they were directly on the Client’s payroll but without any entitlement to employment benefits. Alternatively, they can decide not to use their PSC and go direct on the client’s payroll with employment benefits, but the Client has to change the nature of the contract to an employment contract.

Either way, the SDSs issued are likely to put the Freelancer within IR35 even where there is no need, and, in essence, a “worker” tax is applied to a situation where there is a business, not a worker. The Freelancer will suffer a significant unnecessary additional tax burden, which is unlikely to be offset by increased day rates. Many situations will be unclear. A probable outcome is for more Freelancers to return to employment, resulting in a much less flexible workforce[[1]](#footnote-2). Two major high street banks have already announced that, going forward, they will only take on Freelancers working through their PSCs on the basis that the assignments are treated as within IR35. This blanket determination is a direct contravention of the rules to be applied after April 2020.

It is undoubtedly the case that some subcontractors were using personal service companies to avoid employment tax situations when they effectively remained employees in all but name. This was particularly the case with a certain number of NHS consultancy contracts and the BBC. Equally, the situation of consultants dealing with single clients one at a time or in start-ups with a first client, either by the nature of the start-up, the nature of the work or because of issues of necessity, is highly different. These individuals can be forced by IR 35 to carry the tax costs of employment as both effectively employee and employer, whilst having none of the benefits.

**An answer**

This is not a straightforward matter, but it is an extremely controversial one in the SME sector. As is suggested above, this is in part because the revised regulation proposed covers both situations of abuse and equally situations with the SME community will be massively disadvantaged by the change. The review of IR 35 by the House of Lords Economic Affairs Committee should put the government on notice about the consequences of applying a simple answer to a complex problem; it may simply be a wrong and damaging answer.

As part of post Brexit planning, further implementation of the above changes to IR 35 should be suspended for at least 3 years (one year deferral has just been agreed) to ensure flexible SME contracting expertise is available competitively to the UK economy. At the same time a research-based review should compare the costs and benefits of employment as against contracting. We suspect that this could lead government to create a level playing field by giving contracting businesses within IR 35 an initial start-up exemption to recognise the initial risks of contracting and to encourage the progression that would lead to job creation. The review is required to deal objectively with the issue of fairness, since it was the unfair abuse of contracting relationships by some former public sector employees, which provoked IR 35. The situation in the private sector is different.

**Achieving an impact with small business**

Making concessions here is about building trust and is also about showing a measured, balanced and two-way approach to ending abuse but also recognising the challenges of running a small enterprise in different situations and different sectors, is part of making a compact with the SME sector.

1. **Small Business Priorities for the New Parliament – Next Steps**

In the week to 9 February, the Financial Times mentioned small business six times, two of the stories were about the efforts of Goldman Sachs to enter small business lending. This says something about the place of the small business sector in the national debate, even in the U.K.’s outstanding business newspaper. Yet SMEs are all around us. Before the introduction of Fordian industrialisation, SMEs were not specifically mentioned because every business, pretty much, was an SME. Now, at a time of significant national change of direction, of finding new places in the international business world and of looking to improve the opportunity and the quality of life of many of the UK population who have been left behind, providing a level playing field of opportunity for the SME sector is more important than ever.

Genesis leaders have always encountered the lobbying firepower of big business. Even where professional and trade bodies have a significant secretariat, the SME sector is seldom able to direct the targeted voice that it sees across the way in the big business sector. The nature of dialogue at party conferences, at major industrial gatherings, in the media, tends to think big business.

It is not that small business asks preference, rather it looks for fairness and equality of opportunity. The sector looks to support our country’s future and the future of our communities, as well as meeting the personal aspirations of entrepreneurs, employers and their families, whether that is a growth business or simple security in life.

The small business sector needs to know that government has an ambition to see the sector successful and contributing its full potential to the U.K.’s prosperity. Where the ambitions of small businesses are humbler or shaped by necessity, SME owners and employees at least want an equal chance to contribute to the prosperity of those who work with them and rely on them.

A systematic programme of policy to support the SME sector is overdue. Here Genesis has set out work that could be explored medium-term or where more immediate action can be taken to show that support. Taking forward its Agenda for Small Business programme and using its business and academic links, over the next 12 months Genesis will explore challenges facing the SME sector. Genesis will suggest a range of solutions and opportunities in some of the U.K.’s major SME sectors, represented in the membership of the Genesis initiative.

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1. HMRC has developed the ‘Check Employment Status for Tax’ online tool ​(CEST) to help determine whether someone is self-employed or an employee for tax purposes. There are several problems with this tool:

When tested against the facts of a number of cases decided as outside IR35 by the appeal courts, in a significant number of instances the tool did not give the same result.

The tool is testing working practices but has to be used before work starts. As a result, many questions are “what ifs” to be answered without reference to reality

A person who is an “Officer” of a Client company is automatically defined as an employee. Interims in particular require suitably senior authority to manage growth/transition/crisis/change and are unlikely to be able to achieve this if not a Director.

Contractors become Directors of their Clients not as an end in itself but as something incidental to the task they have to complete. Where the appointment as a Director is not in the normal course of business but is for an alternative purpose, the Interim should not automatically be defined as an employee. [↑](#footnote-ref-2)