Access all areas: Finance

The rising cost of doing business:
Five ways the Spring Statement should support start-ups, micro businesses and small firms to get access to finance.

Enterprise Nation | ten THE ENTREPRENEURS NETWORK

Introduction

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In the last 10 years or so, the way the nation sees enterprise has changed for the better. Initiatives like StartUp Britain prompted a shift in culture: the idea of starting and running your own business has become an aspiration for millions.

You can see the change in the data on VC investment – a record £22.2bn was invested in 2021.[1] The best and brightest young people no longer want to work for someone else. Instead, they're building their own businesses and solving some of our most pressing problems, creating high-paid jobs in the process. In a decade, equity investment in start-ups has increased tenfold.[2] But it isn't just the businesses trying to be the next Facebook or Google that the Government should pay attention to. There are also hundreds of thousands of individuals who have taken the step to follow their passion and work for themselves, often operating out of their homes and selling online. They're finding and filling new market niches and giving consumers more choice. Not all will succeed, but when they stumble upon a good idea, it is vital that they can access the finance they need to grow.

To say the last few years have been challenging for small businesses would be an understatement. The combined disruption of Covid-19, Brexit, war in Ukraine and a global energy crisis have hit businesses hard. Many are still paying off debts from Coronavirus Business Interruption Loans. In fact, a survey from accountancy body ACCA finds that 24% of their SME clients believe their growth aspirations are being hampered by existing debt accrued through the Covid loans.[3] As the Chancellor prepares his Spring Statement, three concerning trends show why it is now more important to back enterprise to grow than ever before.

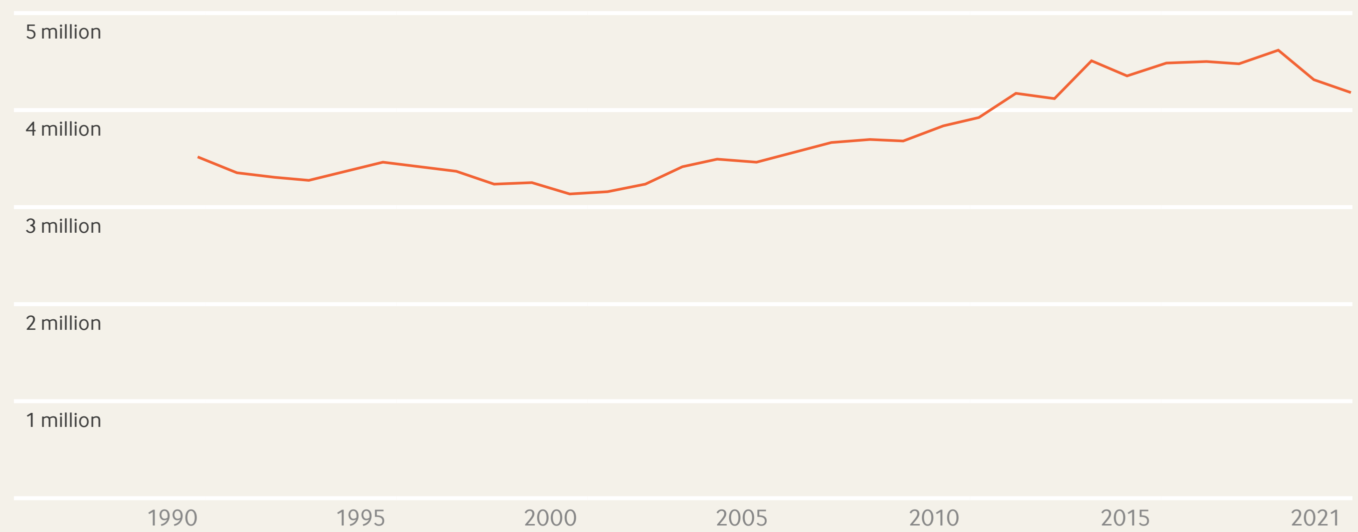
1. Beauhurst, The Deal 2021.
2. Ibid.
3. ACCA (2022) Monthly SME Tracker: March.

Self-employment has fallen to its lowest level since 2011.

The number of people working for themselves has increased massively over the past few decades. Between the financial crisis in 2008 until the start of the pandemic more than a million more people became self-employed.[4] New digital technologies and increasing demands for a flexible work-life balance have led to a seismic shift in the way we work. And for the most part, it is a shift to celebrate. People who work for themselves whether as gig workers, freelancers, or business owners typically find their work more rewarding, more interesting, and better suited to their lives. There are wider economic benefits too. Flexibility has helped keep employment at record levels.

But since the pandemic, self-employment numbers have plummeted. In the last quarter of 2019, almost 4.7 million Brits were self-employed. The latest data shows a fall to 4.1 million, over 500,000 fewer people are self-employed now.[5] This fall in self-employment cannot be explained by a change in the overall number of people working, which has fallen by just 1.3%. Many of the self-employed must have started working for others. While some may have been lured into employment by the prospect of wage rises, the shift might also have been driven by increasing concerns over pandemic-related insecurity and a relative lack of government support when compared with employees. For example, the lack of support for company directors who took their pay in dividends rather than as a salary will likely have made many think twice about starting a business. Legislation such as the wider application of IR35 rules had an impact. Some may be choosing to postpone starting their business until there's more certainty over coronavirus and the economy. For others, it may have been a case of shutting up shop altogether.

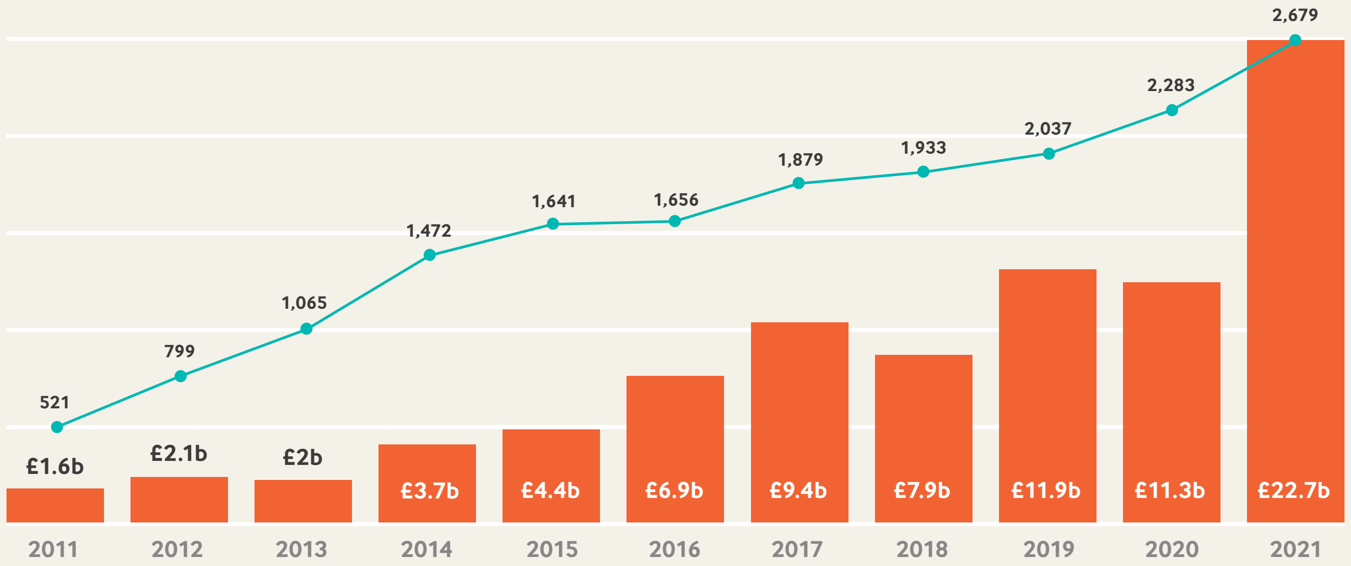
UK self employment has fallen from record highs



Source: ONS.

4. ONS Self-employment statistics.
5. Ibid.

Number of deals and amount raised since 2011, including announced deals only



Source: Beauhurst.

There is an emerging seed-stage funding gap.

The UK can rightly celebrate an equity investment success story. In the space of a decade, VC investment has grown fourteenfold to £22.7 billion. British scale-ups account for a third of all VC investment in Europe.[6] Yet, beneath the surface there is reason to be concerned. Growth in investment has been lowest at the seed stage, and average deal sizes are increasing. Seed-stage deals are worthy of special consideration because these investments are crucial to helping new innovative businesses to get off the ground. The increase in average deal size may well be the result of smart investments at the seed stage, but if companies are finding it harder to secure £100,000 to £250,000 investments, we may see big problems down the line. Behind the positive headline figures may be an emerging pipeline issue.

According to data from Beauhurst, the number of first-time seed-stage deals fell from a peak of 2,055 in 2018, to just 1,427 in 2020 – below even the 1,534 seen in 2014.[7] But the decline in initial seed-stage investment is striking because in theory, the demand for such investments should be higher than ever, as the number of companies being registered each year continues to grow. Significantly, the decline in initial seed-stage investment began before the pandemic, suggesting deeper problems.

6. Beauhurst, The Deal 2021.
7. Beauhurst, Seeding to Succeed: The Seed Stage of the Ecosystem.

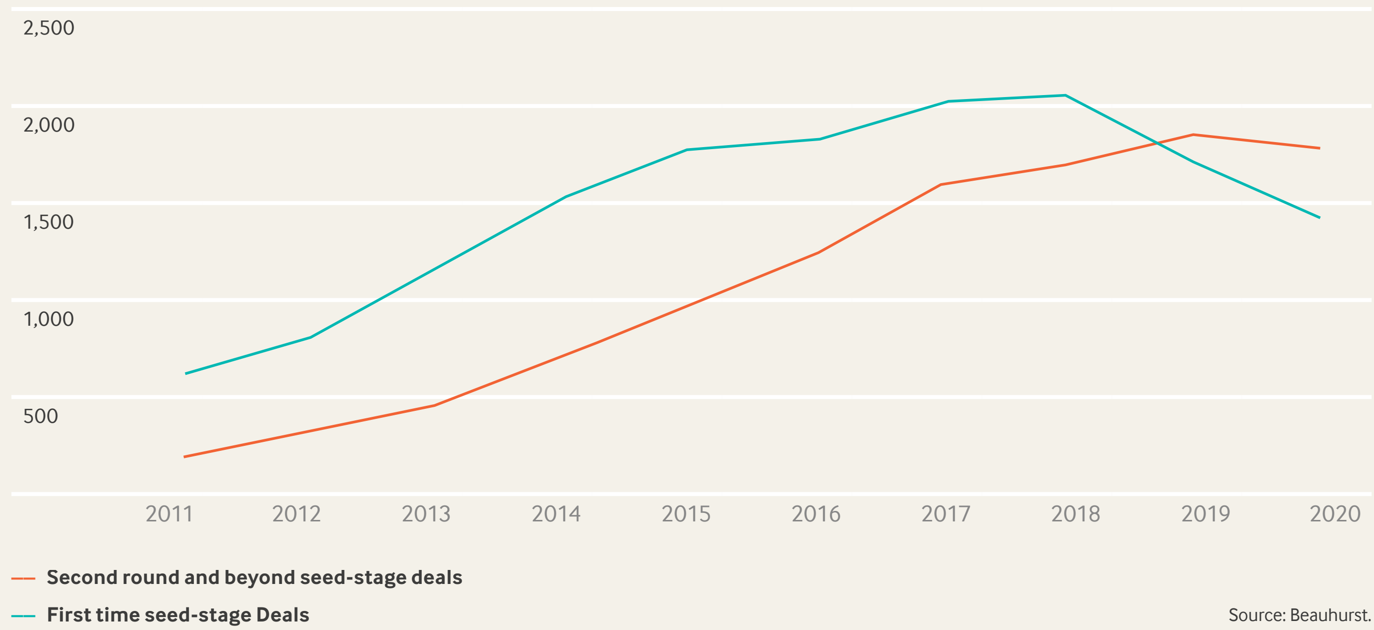
There are multiple explanations for the decline relating to changes. First, regulatory changes to the Seed Investment Enterprise Scheme (SEIS), and its gradual erosion by inflation, have likely played a role. Second, not all investors have the right skill set or risk profile to invest at the seed stage. As Beauhurst points out: "These individuals invest on a discretionary basis which may introduce more volatility into the early-stage investment landscape as changes to schemes like the SEIS and macro events such as the pandemic will be more likely to influence their investment strategies."[8]

Small businesses are seeing their costs rise dramatically

The Bank of England is forecasting inflation to rise to 7% by the Spring. Consumers are facing a 50% rise in energy costs. Businesses that are not protected by OfGem's Price Cap will be hit even harder as their fixed contracts expire. This was true before the Russian invasion of Ukraine and is likely to get even worse as natural gas and oil prices continue to rise. Wage demands are rising too, in part in response to inflation, and in part due to worker shortages. At the same time, supply chain disruption continues to drive up the costs of inputs and Business Rates reliefs that helped businesses weather the impact of the pandemic are decreasing too. Some businesses such as those operating in the hospitality sector will also see temporary VAT reductions to 12.5% expire. To top it off, businesses will have to contend with a 1.25% rise in Employers' National Insurance Contributions.

As a consequence, many small businesses will be struggling. Some might find it harder to export due to energy costs and the increased bureaucracy of new trading rules. What is clear is that any additional costs to businesses will force them to raise prices, cut jobs, or worse, fold altogether. As a consequence, many will be forced to delay their plans for growth and may be reluctant to invest at all. That's why it's key for the Chancellor to back businesses in the Spring Statement and not add to the burden with more new taxes.

The number of seed-stage equity deals is falling



Source: Beauhurst.

8. Ibid.

Recommendations

Rule out a new Online Sales Tax on SMEs

At the last Budget, Chancellor Rishi Sunak announced that the Government would consult on implementing a UK-wide Online Sales Tax, using the revenue to fund reductions in Business Rates. Few would disagree that Business Rates are a badly designed tax. Indeed, there is significant room for improvement. But imposing a new tax on every business that sells things online would hurt millions of businesses and any accompanying Business Rates reduction would be inadequate compensation.

Under an Online Sales Tax, many small and micro-businesses will lose out. At the moment, many small businesses benefit from Small Business Rates relief, which means they pay no rates at all if their rateable value is below £12,000. On top of that, businesses that operate out of their own homes or co-working spaces do not currently pay business rates.

Economic research finds that in the medium-to-long-term the benefits of Business Rates reductions are passed through to commercial landlords, who can adjust to it by increasing rents. One study suggests that between three to five years after a change in business rates, rents adjust to around 75% of the change. This process of adjustment is likely even quicker now that commercial landlords are showing greater willingness to offer shorter leases. The largest beneficiaries of any Business Rates reduction will be large businesses that own their own property, particularly large supermarket chains.[9]

By contrast, all small businesses that sell online will be hit by any Online Sales Tax, regardless of whether or not they have benefitted from any new Rates Relief. Over the last few years, online retail platforms such as Etsy, Amazon, and Faire.com, have reduced the fixed costs of starting a business and reaching customers. Businesses such as Squarespace, Shopify and Stripe have made it much easier to develop an online presence, while digital ads through platforms such as Instagram and Google have eliminated barriers to entry. The SME e-commerce revolution played a vital role during the pandemic by allowing businesses to shift online at a relatively low cost. The lack of a requirement to have a physical premises or any special digital skill-set have dramatically expanded opportunities for retailers. In particular, this has been a boon to entrepreneurs setting up craft businesses, who no longer have to negotiate for shelf-space in physical shops and can instead sell directly to consumers online through easy-to-use platforms.

Any prospective Online Sales Tax also damages the ability of SMEs to raise finance in the short-term by creating a cloud of uncertainty over businesses who plan to sell online.

The reliance of the smallest e-commerce businesses on platforms such as Amazon highlights an additional problem. Any attempt to target an Online Sales Tax at large platforms alone will likely be passed onto smaller traders who use those platforms. Any carve-outs to support high street retailers who also sell online, or size-based exemptions will likely increase complexity and administrative burdens on SMEs as well. For example, any size-based exemption would likely still punish businesses that use online platforms to sell, and it could create a cliff-edge situation for businesses that don't, which could discourage investment and business growth, harming prospects for employment too.

Britain's SMEs have adopted e-commerce at a faster rate than any other economy in Europe.[10] It is something we should be proud of. Businesses that sell goods online should be celebrated and encouraged with support and advice, not punished with a new tax.

9. British Property Federation. The impact of Business Rates on business.
10. Sam Dumitriu. (2020) Upgrade. The Entrepreneurs Network.

Case Study

Ismay Mummery
Boy Wonder

Boy Wonder is a design-led, sustainable boy's fashion brand made ethically in Britain following circular design principles. After living in Sweden for a year and being inspired by their bright, stereotype free designs, Boy Wonder founder Ismay Mummery was inspired to start a clothing line for boys.

"After coming back to the UK I was frustrated at the lack of choice in boys clothing for my son which revealed a potential gap in the market. Boy Wonder came about from that desire to clothe my son in unique designs that are ethical and sustainable."

After a successful crowdfunding campaign in 2019, she launched an e-commerce website in November 2020 after the pandemic delayed production. She believes that e-commerce is key to her ability to build a sustainable fashion brand.

"Online retailing is crucial for my business. As an ethical, sustainable and British-made brand, my overheads are very high. Wholesaling into bricks and mortar stores is not a viable option until the business has grown. Without an ecommerce website I would have great difficulty in getting my premium products to market."

She is concerned by the proposed Online Sales Tax. "An Online Sales Tax could potentially be a huge blow to my fledgling enterprise. Micro businesses such as mine already have to compete to be noticed against huge global corporations advertising online, ranking at the top in search engines and bidding the highest on specific keywords. We have to work so hard, as it is, to get established and be able to thrive in these difficult times."

Through the pandemic she was unable to claim support or grants.

"An applicant often has to have been trading for a certain amount of time, be a certain age, be able to create jobs, be able to match fund or only need money for capital costs. Better funding therefore needs to be more widely accessible and easy to apply for, without so many stipulations. Investment into more business incubators and accelerators outside London would also be really useful to provide entrepreneurs the vital advice, support and information they need to build their businesses."

If the government can get this right and champion green businesses then she's optimistic for the future.

"British businesses could and should be leading the way in the green revolution, but we need government and policy behind us to get there."

Allow micro businesses to use the new Help to Grow schemes and create a new tax relief to help the self-employed acquire new skills.

Digital technology and management skills are proven ways to support business growth and improve productivity, so it is right that the Government has launched two new Help to Grow initiatives, Management and Digital, to support SME adoption. However, by requiring that businesses must have at least five employees to be eligible, the schemes currently lock out 95% of small businesses.

The Digital scheme in particular also limits businesses by restricting the type of software they can use and the vendors they can receive support to purchase from. It allows eligible businesses to claim a 50% discount on the purchase of digital tools such as accounting software, but choice of software is limited. For example, only three suppliers of Making Tax Digital compliant software are available through the scheme currently, despite many alternatives existing. Although the scheme provides discounts on accounting software, it does not apply to forecasting and planning software, which could drive growth and productivity. Point-of-sale software could also help businesses increase sales growth, while enterprise resource planning (ERP) software could support businesses to identify efficiencies. Both are excluded from the scheme.

The discounts also only apply to the software itself and not to any related training or advice. As a result, software purchased through the scheme might be under-utilised.

By limiting the scheme to only businesses with five or more employees, many of the businesses that could benefit the most from access to management training and digital skills will miss out. If smaller businesses had access to better digital tools and management skills, then they are likely to grow faster and employ more people down the line.

The Sign for Small Campaign estimates that expanding the eligibility of the Digital scheme to all businesses with at least one employee and increasing the types of software available could lead to a £2.95bn boost to GDP.[11] Given the strong evidence linking management skills to productivity, expanding the number of businesses that can qualify for the Help to Grow Management Scheme could have similarly powerful impacts on economic growth.[12]

Both of these measures would, however, still exclude sole traders and the self-employed who have yet to take on their first employee. The UK is relatively unique in offering almost no support through the tax system for training for the self-employed.[13] At the moment, businesses who invest in workforce training can claim tax relief, but the self-employed cannot. To support the self-employed, the Chancellor should explore the creation of a new Self-Employed Training tax credit at the Budget. This would allow the self-employed to benefit from tax relief when they invest in training to develop skills in areas such as management and marketing.

11. Sign for Small Campaign.
12. Sam Dumitriu. (2019) Management Matters. The Entrepreneurs Network.
13. Ibid.

Case Study

Karen Watkins

RowanHR

Having previously spent 15 years building and growing large scale teams for clients, Karen Watkins became frustrated and disillusioned with the corporate environment where the focus was only ever on the bottom line.

"I realised that success starts with your people, it is when you start to focus on the human side of your business that growth really starts to happen, and the results in terms of sustainability speak for themselves."

She founded Rowan HR, a HR and organisational design consultancy based in the South West.

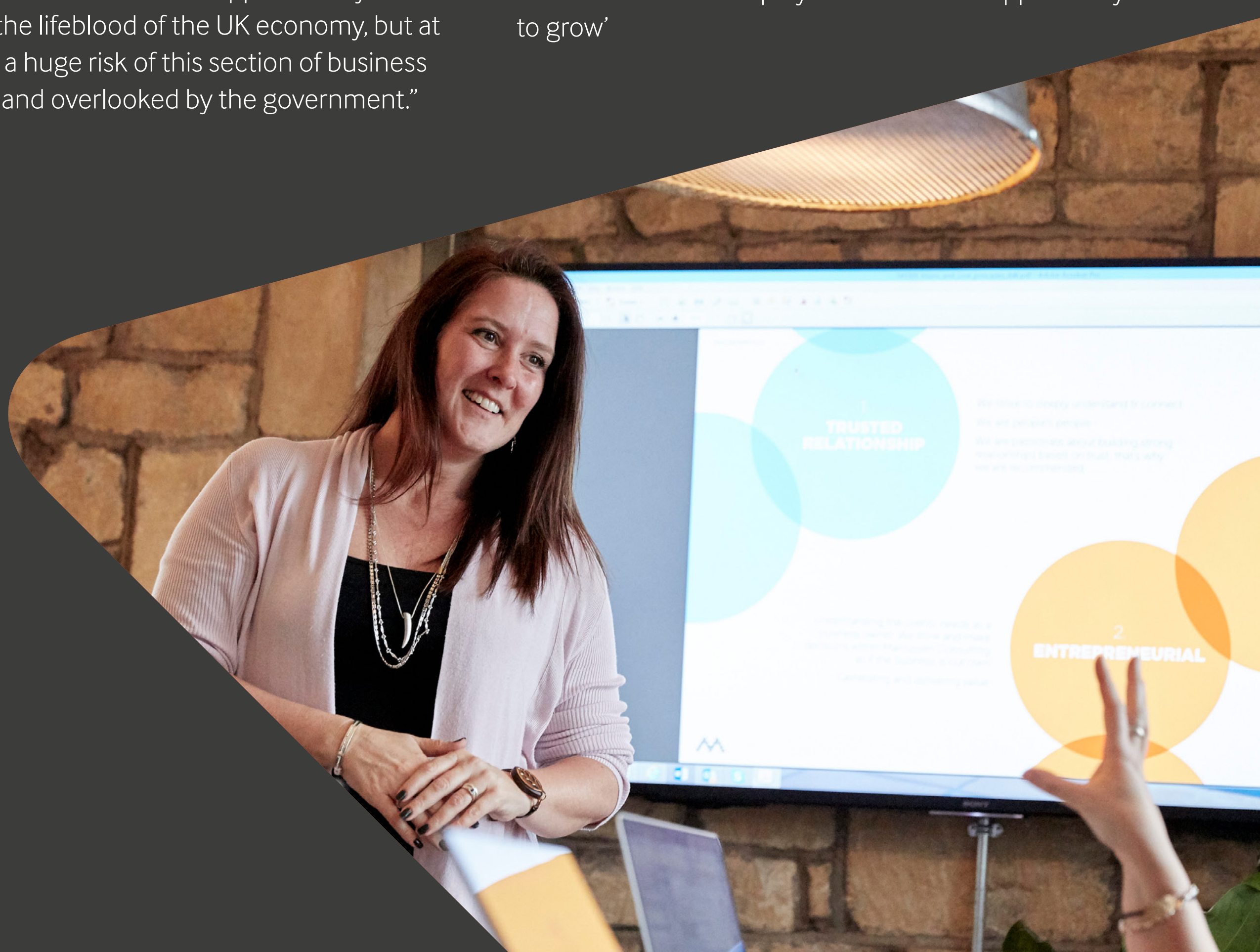
"Micro and SME businesses need support if they are to continue to be the lifeblood of the UK economy, but at present there is a huge risk of this section of business being excluded and overlooked by the government."

She is concerned by the burden of compliance being disproportionate for SMEs while at the same time they are excluded from support schemes.

"Time is money, and the compliance and regulations that surround running a small business place a huge constraint and burden on micro businesses. We are expected to comply with the same level of regulations that bigger businesses do but on a fraction of the budget, we pay the same financial obligations, yet we are regularly excluded from schemes that could mean the difference between surviving or thriving."

She believes schemes, such as Help to Grow, should be expanded to support micro businesses.

"Most current schemes could offer micro businesses a real lifeline but are needlessly excluding them based on the number of employees rather than opportunity to grow'



Help entrepreneurs to scale and innovate by scrapping the sunset clause for EIS, SEIS, & VCTs and simplifying the process for Advanced Assurance.

The Enterprise Investment Scheme (EIS), Seed EIS (SEIS), and Venture Capital Trusts (VCTs) are powerful tools for driving investment in early-stage ventures. By offering generous tax relief, they can fill a gap in the market for businesses seeking investment without the revenue or trading history needed to acquire traditional bank loans.

The introduction of SEIS in 2012 has played a vital role in driving investment in businesses at the seed stage. As an indication of the response, average investment sizes and times now hover just below the SEIS threshold of £150,000 and less than two years' trading.[14] It is such a vital scheme, yet awareness among politicians has been remarkably low. One poll suggested that fewer than half of MPs had even heard of it.[15] When rules changed in 2018 to require that any applications for Advanced Assurance (pre-approval for the relief) needed to name investors, the number of first-time seed stage deals fell. This was designed to curb speculative investments to reduce wait-times, but had the unintended consequence of creating a chicken-and-egg scenario where Advanced Assurance was necessary to get investors, but to get Advanced Assurance you need to have investors attached. The inability for a business to be pre-approved without a named investor is a barrier, in particular, to businesses trying to raise finance through crowdfunding platforms such as Crowdcube or Seedrs. This is likely to be a particularly big problem in regions where angel investment networks are smaller.

There are a range of reforms to the scheme that would support more investment into early-stage businesses at a low cost. First, the long-term future for all of the venture capital tax relief schemes should be secured by abolishing the sunset clause which would cause the reliefs to expire in 2025. Second, the SEIS threshold of £150,000 per company should be raised to £250,000. This would help more investors to back seed-stage businesses and reflect a long-term trend for increasingly valuable first-time deals. Third, the Advanced Assurance scheme should be reformed so businesses can apply for pre-approval before they have an investor attached. To further improve Advanced Assurance, more resources should be invested in HMRC to shorten wait times for approval.

14. Beauhurst, Seeding to Succeed: The Seed Stage of the Ecosystem.
15. Parliamentary Snapshot 2017. The Entrepreneurs Network.

Case Study

Matthew Walker
Savora Drinks

Matthew Walker is the co-founder of Savora Drinks, a maker of Great Taste Award winning mixers expertly crafted for pairing with Tequila. Savora was born out of the idea that every spirit has a mixer with which it is commonly served, such as Gin & Tonic and Rum & Coke; yet Tequila is all too often written off as just a shot.

With a background as a Chartered Accountant, Matthew has always kept a keen eye on different methods of raising finance. Savora have benefitted from two rounds of SEIS investment, as well as grant funding such as through the Government's Kickstart Scheme and Innovate UK's Young Innovators Programme. He expects to use EIS down the line.

"SEIS is a great way for SMEs to raise investment and there are plenty of investors out there looking to invest through the SEIS and EIS schemes. However, there is often a mismatch. Unless you have personal connections within your network who are looking to invest, it is difficult to find the investors (and equally difficult for the investors to find the SMEs to invest in)!"

Reinstate and expand the New Enterprise Allowance to £100 per week for up to a year, allow recipients to access more of it upfront, and expand the eligibility of the scheme to all 23-year-olds earning less than the National Living Wage.

The New Enterprise Allowance (NEA) had a muted impact on entrepreneurship, unlike its predecessor from the 1980s, the Enterprise Allowance Scheme (EAS), which at its peak had over 100,000 people enrolled.

The original EAS was tremendous value-for-money. It paid unemployed people a weekly allowance to start and run a business. The World Bank estimated that it created one job for every £5,000 spent and many famous names attribute their business careers to it, including SuperDry's Julian Dunkerton and Creation Records' Alan McGee.[16]

The follow-up, the New Enterprise Allowance, was launched in 2013 to try to replicate this success. But it failed and was closed to new applicants this January. The key difference between the schemes was their relative generosity. In the 1980s, the EAS offered the unemployed more than they received on Jobseeker's Allowance at the time. By contrast, the NEA offered only £1,274 over six months, which was 25% less than Jobseeker's Allowance. There was a further problem in that the newer NEA, unlike the old EAS, interacted with the Universal Credit (UC) taper rate, thereby creating a disincentive to work.[17]

This failure was a huge missed opportunity. Research from The Entrepreneurs Network identified high levels of entrepreneurial ambition in deprived communities around Britain. Almost half of the 1,000 people polled as part of that research had business ideas, but most were held back by concerns around finance.[18] Yet SME owners, when polled as well, said that £5,000 was often enough to start their business.[19]

A revamped, more generous, and better-funded NEA could make a real difference, kickstarting the entrepreneurial journeys of thousands across the country. Three key changes are needed to make the scheme work. First, as recommended by both The Entrepreneurs Network and Policy Exchange, the scheme should be expanded to £100 per week, and the way it interacts with the UC taper should be reformed. Second, it should last for a year, not just six months. Third, it should be more flexible. Conditional on a credible business plan, recipients should have the additional opportunity to access 50% of their last six months' worth of entitlement upfront.

16. Sam Dumitriu. (2021). Knocking Down Barriers: Empowering business builders in the UK's most deprived communities. The Entrepreneurs Network.
17. Ibid.
18. Ibid.
19. Ibid.

Use data to make it easier for small businesses to learn about the wide array of support schemes available.

Even when there is support and guidance for SMEs available, too many fall through the cracks as they do not know where to start. This has prompted countless calls for a 'one-stop shop', to which Enterprise Nation is responding.

The company is building a smart platform that matches a small business to relevant support in the form of content, events, training, local programmes and trusted advisers. The vision is to learn enough about the business so that instead of busy business owners actively searching for support, the platform will utilise user insight to deliver a tailored service. This data driven approach will lead to saved time and increased productivity for the business owner who will be served the right support programme at the right time, and more effective public spend as HM Treasury can apply taxpayer money to support programmes that are rated by the business owners for whom they are designed, and the Enterprise Nation platform can pre-filter eligible businesses so time is not wasted in lengthy applications.

Just as Netflix and Spotify recommend subscribers TV shows and music, Enterprise Nation seeks to provide businesses with personalised information on all of the relevant schemes available to them – prioritising the schemes that would benefit them the most. By recognising that small business owners rarely have the spare time to search and apply for support, the platform continues to iterate to be as frictionless as possible.

The Government can heed this through learning from nations that have adopted the 'once only principle', which means that the government can only ask once for a piece of information. It is estimated that this joined-up approach to government in Estonia saved over 1,000 years' worth of work for entrepreneurs.[20]

For example, in the case of the UK's Help to Grow scheme, businesses must answer a five-minute long questionnaire to gauge their eligibility for support. A better scheme would eliminate any question where the government already possesses data. The Government could go even further and anticipate needs too. For example, when HMRC learns that a business has gained their fifth employee, the business owner should immediately be informed that schemes like Help to Grow are now open to them.

Change is necessary to make this vision a reality. First, businesses need a single digital identity for interacting with the government. The recent commitment to "One Login For Government" is a welcome step, but implementation is key. Second, departments need to be much better at sharing data between one another. This sounds simple in principle, but requires real leadership in practice. Creating opt-outs to protect privacy and having a clear framework for how data can and can't be used will be vital.

A smarter approach to business support will save businesses time and ensure that business support reaches its intended targets, saving money for the Government too.

20. Kirsty Innes & Philip Salter (2021). A Digital State: Upgrading Ambitions From A One-Stop-Shop To A No-Stop-Shop. The Entrepreneurs Network and The Tony Blair Institute.

Conclusions

The Chancellor recently set out his vision for "a future economy built on a new culture of enterprise". To make that vision a reality will require policies that halt the decline in self-employment, that fills the emerging seed-stage funding gap, and that supports small businesses at a time of sharply rising input costs.

We've set out five recommendations to support enterprise:

1. Rule out a new Online Sales Tax on SMEs

2. Allow micro businesses to use the new Help to Grow schemes and create a new tax relief to help the self-employed acquire new skills.

3. Help entrepreneurs to scale and innovate by scrapping the sunset clause for EIS, SEIS, & VCTs and simplifying the process for Advanced Assurance.

4. Reinstate and expand the New Enterprise Allowance to £100 per week for up to a year, allow recipients to access more of it upfront, and expand the eligibility of the scheme to all 23-year-olds earning less than the National Living Wage.

5. Use data to make it easier for small businesses to learn about the wide array of support schemes available.

As the economy recovers from the pandemic, it is vital that the businesses who will be the engines of growth and prosperity for the years to come are supported.

Acknowledgements

This report was produced by Enterprise Nation and The Entrepreneurs Network.

Enterprise Nation is the UK's leading small business network and business support provider delivering support to more than 50,000 small businesses every month. Its aim is to help people turn their good ideas into great businesses – through expert advice (including a comprehensive resources library), events, acceleration support and networking.

Enterprise Nation was founded in 2005 by British entrepreneur Emma Jones CBE, also co-founder of national enterprise campaign StartUp Britain. She is author of best-selling business books including Spare Room Startup, Working 5 to 9, Go Global, Start a Business for £99 and the StartUp Kit. She is a frequently called-on and regular media commentator on a range of issues which affect the UK's growing number of SMEs. In 2018 FTSE 100 entrepreneur and HomeServe founder Richard Harpin invested in Enterprise Nation with the aim of creating a 'more entrepreneurial Britain'.

www.enterprisenation.com

The Entrepreneurs Network is a think tank for Britain's most ambitious entrepreneurs. We support entrepreneurs by:

– Producing cutting-edge research into the best policies to support entrepreneurship;
– Campaigning for policy changes that will help entrepreneurship flourish;
– Hosting regular events to bridge the gap between entrepreneurs and policymakers;
– Updating entrepreneurs on how policy changes will impact their business;
– Making the case in the media for entrepreneurs' contributions to society.

www.tenentrepreneurs.org

Small businesses need access to succeed.

That includes:

– access to finance – to spur their growth;
– access to people – including mentors, networks, investors, trusted experts & employees;
– access to markets – both domestic and international;
– access to government – whether for procurement or lobbying.

'Access all areas: Finance' is the first of four briefing papers from Enterprise Nation and The Entrepreneurs Network on key areas of policy for small business owners.

Informing the report are meetings with the Small Business Forum, a group of 20 business owners who provide valuable insights about the challenges SMEs are facing.