



BEIS SELECT COMMITTEE – SMALL BUSINESS AND PRODUCTIVITY INQUIRY

Issued 7 March 2018

ICAEW welcomes the opportunity to comment on the *Small Business and Productivity inquiry* launched by the BEIS committee on 1 February 2018.

Timely and well-targeted support for small businesses is vital to the future prosperity of the UK and we welcome government attention and support for this important sector. However, we question whether the scope of this inquiry is appropriately targeted where SMEs most need additional government help. In our response to the industrial strategy green paper we highlighted minimising red tape, and adequate, timely and practicable access to expansion finance as crucial areas for SMEs. It would be helpful for the inquiry to consider whether sufficient progress is being made in these areas. Management of working capital is important to small businesses, and we explore in this response the initiatives underway to encourage prompt payment. However, at this time it is too early to assess the success of these measures.

This response of 7 March 2018 has been prepared in consultation with the Corporate Finance Faculty and the Business and Management Faculty. Recognised internationally as a source of expertise on corporate finance issues and for its monthly Corporate Financier magazine, the Corporate Finance Faculty is responsible for ICAEW policy on corporate finance issues including submissions to consultations. The Faculty's membership is drawn from professional services groups, advisory firms, companies, banks, private equity, law firms, consultants, academics and brokers.

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MAJOR POINTS

1. We welcome this inquiry. Timely and well-targeted support for small businesses is vital to the future prosperity of the UK. SMEs represent 60% of private sector employment and 51% of UK private sector turnover, and include the high-growth high-productivity businesses that will emerge as future market leaders. ICAEW members support and advise over 2 million UK businesses, providing the advice to help them grow and thrive. In addition many of our members are themselves entrepreneurs or hold senior roles in small businesses. Our *Business Finance Guide* has been distributed to over 750,000 UK businesses. It provides practical guidance on sources of finance and other forms of support, such as government initiatives, to help small businesses establish and grow.
2. We believe targeted government support is important. Government can help sustain an environment that nurtures small businesses as they establish and expand. One particularly helpful action that government could take would be to establish a single information point for the variety of initiatives that government provides or supports. Many small businesses would struggle to identify where to go for help with improving efficiency or productivity, despite there being a range of support that they could in fact access. For example, ICAEW's *Business Advice Service* provides a range of advice to businesses as well as enabling them to access a free initial consultation with an ICAEW Chartered Accountant. Information about services such as this could helpfully be provided through a single access point. At present much advice is disseminated through the 38 growth hubs. It would be helpful to supplement this local support with a comprehensive national web-hub that gathers together all support in one place.
3. With this in mind we question whether the focus of the current inquiry is on those areas where further help is most urgently needed. Before answering the detailed questions, we suggest below, two particularly important areas where government could provide valuable support.

MINIMISING RED TAPE

4. Firstly we believe it is important to recognise the disproportionate burden that 'red tape' places on small businesses. We urge government to continue in its commitment to minimise red tape for businesses, particularly at the smaller, entrepreneurial, end of the scale. In particular, we note the government's commitment to making tax digital and highlight the support businesses will need to address the incremental compliance costs that will result from this initiative. With the UK's departure from the EU there will also be an opportunity to look again at aspects of the accounting model for small companies. The government might, for example, consider carrying out a post-implementation review of the recently introduced micro entity regime to assess whether it is delivering the efficiency savings envisaged.

ACCESS TO CAPITAL

5. Adequate, timely and practicable access to expansion capital is vital to help businesses take advantage of new commercial opportunities, 'scale-up', and so provide innovation, economic growth and long-term, high-quality employment. In our response *REP 48/17* to the industrial strategy green paper we recommended that the Government, in partnership with the private sector and bodies such as ICAEW:

- researches the effectiveness of public sector investment, funding agencies, indirect public support via tax incentives, and private investment, and their combined effectiveness, in channelling investment to growth companies across the UK;
- plans how it will support equity investment in growth companies once EU-derived funds, such as the European Investment Fund, are withdrawn after 2020, particularly in those parts of the UK that do not current benefit from major regional or devolved-government programmes;
- ensures that relatively new forms of consumer investment, such as equity crowd-funding, are well understood in terms of their risks, due diligence, disclosure and impact on business growth, and therefore proportionately supported and regulated; and
- supports the provision of expert financial advice to companies that are raising expansion/scale-up capital, including from incubators, accelerators, Innovate UK's KTN, LEPs/growth hubs, and professional organisations such as ICAEW.

ANSWERS TO QUESTIONS

Management capability:

How adequate is the availability of, and funding for, training courses aimed at SME managers; what more can be done to provide co-ordinated and high quality support to improve management capability throughout the UK?

6. ICAEW offers management and professional development courses through our Academy programme, and we have seen that there is a demand for well-targeted management training. Providing funding for management training might help more SMEs to access this support. However, we believe that any initiatives in this area need to be clearly focused. The Government's definition of 'good management training' is elusive. It is not clear what this encompasses, or exactly which types of skills they are referring to. There are a wide range of different industrial sectors that need different approaches and types of management training. SME managers are typically time poor. The problems they need support with are often business specific. Generic management training might be much less useful than, for example, access to finance or help with product development or entering new markets.
7. We also note that over the past few years businesses have been over-loaded by implementing the new apprenticeship policy, which has often required them to redesign their training models to access funding, and can even impact employment models. More could now be done to inform businesses of the broad range of skills training that qualifies for support from the apprenticeship fund and the government could perhaps encourage the development of well-targeted, qualifying management training or training in high demand technical skills. Apprenticeship training might, in particular, help SMEs to better develop a pipeline of future managers who, by growing with the business, have a deeper understanding of it. The apprenticeship levy policy provides more benefits to small businesses than large companies as SMEs with annual pay bills below £3 million do not pay the levy, can have 90% of their apprenticeship training paid for, and can benefit from transfer of funds from larger companies. But with the implementation disruption in mind, the government may wish to wait and ensure that this becomes well embedded before introducing yet another 'productivity' policy.

8. Management capability might be enhanced through access to professional qualifications. ICAEW has seen that it can be quite onerous for small businesses to take on our professional qualifications, with the time and cost implications involved. However, the productivity benefits from professional training can be considerable, and we believe there is definitely a demand as the majority of our 'Authorised Training Employers' are in fact SMEs.

Fair treatment:

How effective are measures in place to protect small businesses against systematic late payment practices of large companies; are the powers of the Small Business Commissioner to police poor payment practices strong enough?

9. It is too early to judge the effectiveness of the Small Business Commissioner or indeed other recent measures such as the establishment of the Groceries Code Adjudicator or increased adoption of the prompt payment code. The key questions are; whether smaller business will respond to the new information available from the Commissioner to help them to better assess credit risk and improve their credit management procedures; whether larger businesses will respond to the publically available information through the Prompt Payment Code and the Small Business Commissioner by paying suppliers more promptly; and what the enforcement record will be. The Small Business Commissioner's first report to the Secretary of State will be eagerly awaited.
10. It should also be recognised that there is no panacea here, nor would one be helpful. The extension of credit between UK businesses is not a cost to the UK economy. Rather it is in itself a major enabler of economic activity; trade credit is the largest source of finance to UK businesses. Managing working capital is a key skill of a professional finance department and a reasonable balance has to be kept by all businesses between prompt payment and maximising the credit terms that are offered.
11. In this context, the measures already put in place by government to support small businesses with prompt payment from larger customers are welcome. The focus now should be on ensuring that these initiatives are well established, before, in due course, assessing their effectiveness. Government should also consider that the issues faced by smaller suppliers in dealing with larger companies are not only prompt payment – these initiatives could also consider other ways in which contractual risk might be being passed on to smaller suppliers.
12. To support the inquiry we thought it would be helpful to explore below recent progress in encouraging prompt payment:

Prompt Payment Code

13. In summary the changes to the code required signatories to commit to 60 days maximum period for payment of invoices, signatories would be required to provide five references (rather than the previous two) and a new Code Compliance Board was created to ensure signatories operated with the terms of the Code.
14. There has been an increase in signatories and the Code is very close to achieving 2,000 signatories and all strategic suppliers to government are now signed up. The additional referees are now obtained, and followed up, as standard. The number of signatories providing additional information (such as the How to Get Paid guide) is steadily increasing. The PPC Compliance Board has dealt with very few cases because almost all challenges are resolved quickly by the Chartered Institute of Credit Management (CICM), who manage the Code without the need to involve the Board. Over the past couple of years well over £2m has been paid, often immediately, as a

result of the Code's intervention and dialogue between supplier and buyer has been initiated and improved.

Large companies duty to report payment practices and performance

15. The Payment Practices Reporting Regulations came into force on 6 April 2017. This required large businesses to report their payment practices and performance by providing prescribed information. Some large businesses will start to publish reports from October 2017. By the end of November 2018, the majority of large businesses will have begun to publish reports. The government has set up a website which assists large companies to find out if they need to report and if so to identify their reporting deadline. The site will also host the reports provided by businesses. The site will enable small businesses to search for businesses' published payment practice and performance. The web service is available at <https://beis-ppr-live.herokuapp.com>

Small Business Commissioner

16. The Enterprise Act created a new role for a Small Business Commissioner. The Commissioner would:
 - enable small businesses to resolve disputes and avoid future issues through general advice and information
 - signpost to appropriate services e.g. sector ombudsmen or regulators, existing independent advice services, approved alternative dispute resolution (ADR) providers or the Commissioner's own complaints handling function
 - consider complaints by small business suppliers about payment issues with larger businesses that they supply
17. The Commissioner must produce a report on each complaint and has the discretion to make it public, naming the respondent to the complaint, in order to bring good and poor practice to light and to help bring change to UK payment practice. The Commissioner's reports are not legally binding but the reports will draw attention to poor payment practices, particularly of serial offenders.
18. Perhaps the most powerful tool that the Commissioner will possess is that they will make an annual report to the Secretary of State on the effectiveness of the current Late Payment measures and make recommendations for change.
19. In October 2017 the Secretary of State for Business, Greg Clark, announced the appointment of Paul Uppal to the post of Small Business Commissioner. The Commissioner has established his office in Birmingham and is in the process of recruiting staff. We hope that the commissioner's efforts to publicise their work will result in a broad awareness among SMEs of the support now available.

The Groceries Code Adjudicator

20. The Groceries Code Adjudicator (GCA) is the UK's first independent adjudicator to oversee the relationship between supermarkets and their suppliers. It aims to ensure that large supermarkets treat their direct suppliers lawfully and fairly, investigates complaints and arbitrates in disputes. The GCA works with the Department for Business, Energy & Industrial Strategy.

Improving productivity:

What access do small businesses have to advice on improving efficiency and productivity through adoption of best business practices? What more should the Government do in this respect?

21. It is important that SMEs are able to access advice on improving efficiency and productivity. ICAEW provides free practical support to SMEs through our Business Advice Service and Business Finance Guide and we try to promote these resources as broadly as possible to SMEs. The 38 growth hubs play an important role in ensuring businesses can find the help they need and it would be helpful to supplement this local support with a single, national point of reference that all businesses could access. BEIS' small business task force is one forum that might help with taking this forward.
22. We agree that in addressing the UK's productivity problem the government needs to consider carefully the role that SMEs in particular can play. With more than 5 million small businesses in the UK, there will always be a range of productivity in the sector. 4.3 million of these businesses do not employ anyone except the owner and therefore for these businesses, efficiency and productivity improvements are limited to what the owner has the time and capacity to implement. Nevertheless, as SMEs represent the majority of UK private sector employment and turnover, the productivity problem will not be solved without SMEs on board. In 2016 we published a paper *Productivity Now*, which suggested four actions the government could take to boost productivity:
 1. Adopt a national productivity target of 2–3% growth to transform the government's productivity plan into a clear plan of action
 2. Improve the UK's international and infrastructure connectivity to boost global competitiveness
 3. Close the skills gap through a national skills strategy that is underpinned by employer engagement
 4. Create a proportionate and balanced regulatory environment to encourage productivity-led growth
23. Each of these actions would benefit businesses of all sizes, and in seeking to boost the productivity of SMEs we urge the committee to consider what more could be done to take action on these points.

Scale-Up:

For those businesses wanting to scale-up, how effective is the promotion of available Government support? Do existing concessions for small businesses serve to discourage growth? What impact has the Scale-Up Task Force had so far?

24. ICAEW agrees that the evidence – both academic and anecdotal – suggests that the UK may be lagging behind its competitors in terms of long-term investment in high-growth enterprises/scale-up companies. However, we question the focus of the current inquiry and in paragraph 25 onwards, we suggest areas that merit attention. While promotion of government support would certainly be helpful, UK SMEs have ready availability to professional advice through existing channels such as ICAEW's *Business Advice Service*. As suggested in paragraph 21, many SMEs might be unaware of the range of support available and we therefore suggest that the government consider building a central online hub to bring together all of the various initiatives providing advice to SMEs.

25. Initiatives such as the Scale-Up Task Force could be useful in considering how to optimise the eco-system of support for growing businesses. We look forward to the publication of the Task Force's initial conclusions. But for many businesses, the barriers to growth where external help is needed, require appropriate, timely professional advice to resolve. There is a danger that SMEs are overwhelmed by information, which might perhaps distract them from properly addressing the most critical issues.
26. A particularly acute issue for many growing SMEs is that there is a gap in financing where a commercial technology, product or service cannot be delivered within five to seven years. We explored these issues in our representation *REP 102/17* to the HM Treasury consultation Financing Growth in Innovative Firms. This financing gap is a major hurdle to scale-up and public funding has a key role to play in bridging it. We therefore believe that government should focus its efforts here.
27. As we set out in *REP 102/17*: public funding will continue to play a large and vital role in many aspects of investment in early-stage companies, particularly in terms of grants and equity investment. Early-stage ventures have to achieve very significant milestones with relatively small amounts of investment. The universe of investors at seed and start-up stages is very fragmented in the UK, which also makes it more difficult to raise sizeable rounds in good time to take advantage of new business opportunities – or, in some cases, merely to stay in business. Many UK institutional venture capital funds are reluctant to back companies that are not already generating revenues of at least £1m per annum. In the case of early-stage companies that are based on capital-intensive technologies, small start-up loans and other existing support may not be sufficient for them to scale up. Increased grant support from government agencies such as Innovate UK is crucial, as evidenced in the policy paper *Boosting Finance for Engineering & Technology*, published by ICAEW with the Institution of Engineering & Technology (IET) in September 2016.
28. This ICAEW/IET research highlighted that many advanced-technology businesses needed to diversify their sources of investment, particularly for technology adoption and commercialisation. In the case of many young advanced-engineering companies, this can require significant sums of many millions of pounds committed for as long as 10 to 15 years before the company and/or its technology could be profitable – and therefore begin generating a return for their investors. ICAEW and the IET found that demand for such capital on such a timescale was not attractive for the traditional business models of most quoted investment funds, private equity houses and venture capital firms, so would require the UK government intervention to develop new funds and financial instruments.
29. From discussions we have held with founders/CFOs/FDs of high growth companies, the gap is most acute for:
 - follow-on capital (Series A) of £1m-£3m in some cases, while in others, up to the low tens of millions (£20m-£40m) to go into production, export or deliver; and
 - in emerging industries and advanced technologies with any or a combination of characteristics including lengthy pre-revenue and production periods, R&D-intensive and capital intensive products.
30. ICAEW has provided practical guidance on sources of finance to over 750,000 UK businesses through our *Business Finance Guide* and this reference source, freely available online, continues to be updated to provide the latest guidance to SMEs. It is important to continue to inform SMEs about the financing opportunities, and advice,

available. We have encountered reticence from some UK businesses to access external finance. For some business owners there may even be a stigma to accepting external finance. More could be done to create a growth culture across the UK to inform and encourage potential growth businesses to take advantage of the opportunities available.

31. In addition, the tax-advantaged venture capital schemes, EIS and SEIS, remain at the heart of a large part of start-up, growth company and 'scale-up' activity in the UK. EIS has underpinned £24.2bn of capital raised by new ventures and small companies since 1993. In its recent submission to the HMRC consultation about tax-advantaged venture capital schemes *REP 19/17*, ICAEW restated the crucial role of advance assurance services in EIS and how that service could be enhanced.
32. The UK's departure from the EU may give the Government the opportunity to reassess some restrictions to EIS, SEIS and Venture Capital Trusts (VCTs) that currently apply under State Aid Rules, but could be regarded as inflexible. These could include the £5m maximum total that a company can receive, so that fast-growing can find it easier to raise scale-up funds. It could also include the seven-year limit for EIS and restrictions as to the application of funds from VCTs.
33. Finally, to support innovation Government could also ensure that an appropriate share of government contracts are with SMEs, in particular early stage ventures and start-ups where innovation can often be found. One way to encourage more SMEs to bid for government work and to gain innovation would be to issue smaller contracts and to have a simplified tender process under a monetary threshold. We appreciate the progress that has been made here by some departments, but more could be done to encourage SME procurement across government – perhaps using targets. In addition, to set an example on prompt payment it is important that all departments are also committed to honouring payment terms to SME suppliers.