



Rt. Hon George Osborne MP
The Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

14th February 2013

Dear Chancellor

FSB 2013 BUDGET SUBMISSION

Following your helpful set of measures announced in the Autumn Statement, the Federation of Small Businesses (FSB) writes to you ahead of the Budget with a set of recommendations that will further help small businesses with the confidence to start investing, employing and creating sustainable growth. We present these under the following themes: *access to finance; taxation; exporting; supporting enterprise; energy and infrastructure; and procurement*.

In line with our previous submissions to you, I want to stress the need to provide consistency and clarity of purpose to enterprise policy that has been absent for too long. Instead, enterprise policy has been piecemeal and often characterised by intervention for the sake of 'doing something'. That is why small business enterprise policy needs a fundamental re-think both in terms of content and delivery, and ultimately why an agency model based on the USA's Small Business Administration devoted to small businesses is so desirable.

Part of that thinking appears to have been taken on board with the approach to the Business Bank. But we would like you to be even more radical and announce in your Budget that you will review how enterprise support is currently delivered through central and local government. In that regard, the FSB has written a summary of enterprise policy starting with Harold Macmillan in the 1930s. Our discussion paper, *Enterprise 2050*, setting out the arguments is being sent to you under separate cover. I would welcome your thoughts on this report and its findings.

Our themes

- 1) **Access to finance.** Finding funding at the right price remains challenging for many of our members. The FSB believes that solidity in the provision of credit to the SME sector will only come with both stability and measures to stimulate greater competition. As such, your support for the Banking Reform Bill and the Business Bank will have a crucial role in creating a more diverse SME finance eco-system. A key player in this area will be the Financial Conduct Authority and whether it can safely lower barriers to entry for new banks, and adequately regulate non-bank channels whilst at the same time encouraging their growth. As well as regulatory aspects, the tax treatment of investments in new non-bank finance channels also has an important part to play if these models are to take hold with investors, and the FSB will bring forward suggestions to improve this aspect.

- 2) **Taxation.** The Government's efforts to simplify the taxation of the smallest businesses are welcomed by the FSB. If carried through as intended, this will be a major deregulatory step. We now encourage you to look at further methods of simplification, and ask the Office of Tax Simplification (OTS) to review the myriad of taxation schemes which encourage private investment in small businesses with the aim of radically simplifying the offer. To continue this theme, we urge you to look at a better tax policy making machine and bring in the independent scrutiny regime which exists outside of HMRC and HMT. In addition we also ask you to look at policies to encourage employment, notably through an enhanced National Insurance Contributions (NICs) holiday for small firms or more ambitiously and if finances allow, through a lower employer's rate for small business in general. We have welcomed your doubling of Small Business Rate Relief and now urge you to make it permanent.
- 3) **Exporting.** The additional funding you announced at the Autumn Statement will support UKTI's activities in boosting our export performance. The key now is to focus resources on new exporters from the small business community, for example by setting up dedicated 'micro firm desks' in the regions, and to encourage those who are starting a business to look seriously at exporting from the start. To link domestic producers with foreign customers, one important task would be to set up a central referral point to source international enquires for UK small businesses.
- 4) **Supporting enterprise.** The nature of the labour market is changing and policy formulation and implementation must reflect that. Our recent research shows small businesses and the self-employed provide 9 out of 10 jobs for those moving from unemployment and inactivity into private sector work, while self-employment is on the rise and has increased by 10 percent since 2009. Government work programmes and employment regulation must reflect the critical social and economic role played by small firms in the labour market. In addition, the role of education and skills in long term economic performance also needs to be highlighted. A first step is to change attitudes towards quality above quantity when it comes to apprenticeships. This can be done by placing small firms in charge of the funding.
- 5) **Energy and infrastructure.** Energy prices present a major cost factor, and are still rising for small firms. As with banking, the energy sector lacks a competitive edge and with necessary investment bills will continue to rise requiring stronger consumer protection. We urge you to look at rollover contracts and calculate the Climate Change Levy on an annual basis for small businesses.

6) **Procurement.** While progress has been made in central Government, we remain concerned about disparate practices across the whole of the public sector. We therefore encourage you to continue pressing towards your aspiration that 25 percent of central Government procurement contracts are awarded to SMEs and in addition, to encourage local authorities and other public sector procurers such as the NHS to implement best practice. A key objective for the FSB is to see all Tier 1 firms sign the Prompt Payment Code when procurement projects are awarded so small firms in the supply chain benefit from faster payments. You may also want to look at the tax behaviour of large firms when awarding contracts.

I hope this list of suggestions is helpful and will guide you and your officials when deciding on enterprise policy for this Budget.

Yours sincerely



John Walker
National Chairman

EXECUTIVE SUMMARY

Getting enterprise policy right

- The Government should use the Business Bank as the starting point for the creation of a UK Small Business Administration, focusing on access to finance, exporting, procurement and business advice. It also presents a good opportunity to stand back and fundamentally re-evaluate enterprise support in the UK.

Finance and banking reform

- Intervention from the Business Bank to centre on micro-business financing, longer-term riskier loan applications, and advice. To provide small businesses with confidence, a progress report and timetable for action to develop the bank should be produced now and delivered alongside the Budget.
- FCA to highlight quickly how it will create a more competitive market place for bank and non-bank finance by looking at barriers to entry for small banks and how regulation can encourage and promote innovative non-bank channels.
- Government, through the Business Bank and the FCA to be ambitious in promoting non-bank channels that lend to small and start-up firms. The FSB is working with the British Bankers Association (BBA) to produce proposals to address this issue specifically for community development finance institutions (CDFIs), and will be writing under a separate cover outlining these suggestions.

Taxation

- Expand the current NICs holiday scheme to micro-businesses across the whole of the UK. This will increase employment by 45,000 jobs and add £1.3 billion in extra economic activity. A more ambitious aspiration would be to consider a small business rate of employers NICs at a permanently lower level.
- Cancel the 3p fuel duty rise due in September 2013.
- Office of Tax Simplification (OTS) to review the incentive schemes for private investment into businesses with the aim of simplifying radically the current range of schemes and report back at the Autumn Statement with a clear set of proposals.

- Tax Impact Assessments should undergo the same level of independent and transparent scrutiny that regulatory Impact Assessments are subject to.
- Make the current doubling of Small Business Rate Relief permanent, or at very least extend it for a further 12 months.
- Implement the Portas Review recommendation that business rates be brought into line with other index linked measures by switching from RPI to CPI as the bench mark for inflationary adjustments.

Exporting

- Focus UKTI activity by setting targets aimed at finding new potential exporters through mapping supply chains and other methods. A service to provide overseas contacts and enquires would help first time exporters.
- Develop regional micro-business desks with a named contact for businesses to contact to reel in more businesses. Additionally, UKTI should ensure support packages fully meet the demands from new exporters, and micro businesses.

Supporting enterprise

- Review employment policy making so decision makers always '*think small first*'. This would avoid designing-in lower thresholds, exemptions and other special measures.
- Make self-employment an easier route out of unemployment by enhancing the support available to budding entrepreneurs through the StartUp Loans initiative. Remove and relax onerous reporting conditions that will be placed on self-employed individuals in receipt of the Universal Credit.
- Improve the brand and quality of apprenticeships by changing the model to one where funding is drawn down by the business, remove functional skills from the framework and work with business to develop agreed definitions that guarantee all apprenticeships are a quality product.

Energy and infrastructure

- The scale of investment needed in UK energy infrastructure will have significant impact on business energy bills. There is therefore a need to limit cost increases by strengthening consumer protection for small firms by ending rollover contracts and calculating the Climate Change Levy on an annual basis for small businesses.

- Exempt self build housing projects from the Community Infrastructure Levy (CIL). Though a minor measure, this would encourage house building and be a relatively simple deregulatory measure.

Procurement

- Include payment practices and tax behaviour when awarding contracts for large projects, and for infrastructure projects.
- Push more public agencies, including the NHS, central government departments and all local authorities to sign the Prompt Payment Code.

RECOMMENDATIONS

ACCESS TO FINANCE

The Business Bank

If correctly designed and if it is supported for the long term, the Business Bank has the potential to influence radically the small business finance landscape both through rationalising the confusing plethora of existing Government schemes and developing innovative private sector finance channels.

Fitting with the FSB's view that enterprise policy needs a much clearer focus and consistency, the FSB continues to urge thorough thinking about how the business bank will be shaped and where it intervenes before committing to a course of action. We therefore err on the side of building the bank cautiously and on firm foundations. Nonetheless the Budget should clearly set out the progress of this work and how the bank will interact with other Government aims such as a more competitive bank and non-bank finance environment. The FSB argues that you should set out the following principles to underlie the bank's design:

1. **The bank should act at the wholesale level**, as a second tier agency above retail finance institutions. It would therefore not directly lend to small businesses or take deposits, but distribute loans through the existing banks and other institutions to make decisions at the local level. A similar model has been in place for many years in Germany (The KfW Banking Group), and has been more successful than the UK banking system in keeping credit flowing to small businesses during the recession.
2. The bank should have a large degree of **independence** from the day-to-day running of Government and for it to have legislative powers to embed it as the champion for small businesses. It needs both time and close measurement, but not daily interference from Government. It should be target driven, allowed to devise its own products and recommend additional powers and resources if needed.
3. It should have an initial tight focus on **core activities**, reviewed over time once the bank has bedded in. This should be in the provision of finance to small businesses, and particularly around 'patient capital' and micro finance. As with previous submissions, there are good lessons to be learnt from the activities of the Small Business Administration in the US.

4. Finally, to be consistent with wider Government policy, the bank should have specific remit to **promote competition in the provision of finance** to small businesses, in particular non-bank sources of finance such as peer-to-peer lenders and CDFIs. A good start has been made with your recent announcements in December 2012; the key is to maintain that momentum so these institutions reach a critical mass in the market and provide a real challenge to incumbent banks.

Financial regulation: the Financial Conduct Authority

The document '*Journey to a FCA*' sets out that competition will be one of the FCA's core remits. The FSB strongly supports this approach. The FSB has long argued that true stability in the provision of SME credit can only come when there is a more diverse market place where banks and non-banks all play their parts. To this end, the FCA should review quickly:

1. **Lowering barriers to entry for small banks.** This is especially important in areas such as capital raising and holding, IT investment, branch coverage and the payment systems. The FCA needs to think about the positive impacts on consumers and product innovation, and the health of the sector, rather than just the conduct of the banks.
2. **Effective regulation and consumer protection for non-bank channels.** This has the two-fold benefit of (i) helping non-bank channels grow and lend more to small businesses but also (ii) increases their investment attractiveness. The FSB welcomed recent news that peer-to-peer lending will be regulated and that crowd funding websites will be approved by regulators.

Non-bank channels of finance

The work of the Business Finance Partnership (BFP) and its aims should be welcomed and made a permanent fixture on the policy landscape. The aim now should be to look at how this scheme can be moved into the Business Bank as we see it having a key role in scaling up non-banks. The FSB believes there is potential in existing non-bank channels, such as in CDFIs and building societies, and that they should be able to use the BFP to help finance SME lending and their own growth. Effective regulation is also needed but in a way which helps investors and potential borrowers feel confident while not overly restricting the activities of the lenders. We look forward to the consultation documents from the Treasury and the FSA on how this will progress.

As you are aware, CDFIs assist people starting or running small and micro businesses who need extra help; help which is different to the current customer experience at banks. CDFIs have a role to play in financing micros and start-ups where other Government and industry schemes can

help too, such as mentoring and StartUp Loans. They also help firms whose growth and profit rates are slower. They should be looked at as part of the Business Bank but also through other Government lending schemes to see how they can play a bigger role. To help with that goal, the FSB and the BBA will be making representation to you separately on shared views on how CDFIs can be scaled up and given targeted support for consideration in your the Budget statement.

EXPORTING

As part of its drive to rebalance the economy, the Government has rightly set itself some challenging targets to increase the number of exporters by 100,000 by 2020. UKTI will play an important role in supporting that effort, and we welcome the additional £70 million support for UKTI you announced at the Autumn Statement.

With new and small businesses expected to deliver the bulk of that growth, UKTI needs to deploy a significant proportion of those resources to encouraging new small businesses to export for the first time. To do this, UKTI needs to further reform itself if the ambitious target is to be met. The planned greater presence on the ground through more trade advisors is a good start. However we still believe a cultural shift is required in the way UKTI approaches 'SMEs'. It is to our members' great frustration the important differences and needs of 'micro', 'small' and 'medium' sized firms still goes unrecognised. UKTI should specifically tailor products, services and support to potential and first time exporters recognising these differences. Too many FSB members are still of the impression that UKTI is for 'big business', and not for smaller firms. Specific actions we would like to see include:

- Focus UKTI activity by setting targets aimed at finding new potential exporters through mapping supply chains and other methods.
- Develop support packages to reel in potential exporters including a 'micro desk' where an accessible and named contact is available to take businesses through first steps and direct them towards appropriate advice and support, ideally with access on favorable terms to UKTI support services through using the additional resources already announced.
- Ensure export support strategy focuses on matching a company's export potential to the right overseas market. Despite the obvious economic challenges we would still want an emphasis on the EU as well as other untapped, developing markets.

- Develop a referral mechanism so that all types of financial support, both public and private sector, can be tapped for funding, and a referral system that feeds international enquires to small UK firms.

Further ahead, there is a case for a clear distinction between UKTI export activity and UKTI inward investment activity. That could be through establishing a separate UK Small Business Exports Department that brings together export advice and finance. The Business Bank would be the natural place to locate that activity, as they do in the USA through its Small Business Administration, and we would suggest the Business Bank looks at this option when deliberating the bank's design.

The FSB and the BBA will be exploring new ways to help small and micro businesses export and will report in due course.

TAXATION

Fuel duty

It is simply not feasible to constantly keep postponing fuel duty increases since it stops businesses and households from planning their finances. However the FSB urges you to cancel the 3 pence increase due in September 2013. The Government now needs to take the politics out of fuel prices and look at ways of raising revenue that gives road users greater certainty as to what their overheads will be from one Budget to the next.

NICs

In this submission the FSB asks you to consider one of two options to reduce employers NICs burdens.

1. First is to instigate a lower employer NICs for all small companies, mirroring the principles behind the lower Corporation Tax for smaller businesses.
2. Alternatively, while the aim of the current regional NICs holiday scheme for small businesses is laudable, it is widely recognised to have had minimum effect with take up rates of around six per cent. The scheme should therefore be revised, better publicised, and thresholds increased. We believe that a long-term scheme which gives employers that have less than four staff a tax reduction for the next three hires will have far more positive benefits. Using conservative assumptions, FSB research shared with you before

the 2012 Autumn Statement shows that if this initiative were expanded across the UK, it would generate an extra 45,000 jobs and an extra £1.3billion in economic activity over the next three years.

Tax simplification

The FSB strongly supports the work of the Office of Tax Simplification (OTS) and hopes good progress can be made on the new work streams of business expenses and the general complexity and better administration (with the Advisory Board for Administrative Burdens properly consulting with the business community).

The FSB is particularly pleased that you and David Gauke MP have listened to the FSB and developed an ambitious cash-based accounting scheme, one which should be built on. We continue to encourage you to be radical and not allow the existing proposals to be watered down: the prize here is deregulation for millions of small businesses and increased compliance by that community.

As well as these measures, the tax simplification net needs to be cast wider. All are agreed that investment in small businesses, especially those with high growth potential, is desirable. However the evidence the FSB has is that rather than helping get capital to these firms, the plethora of schemes can hamper that effort. So while FSB members fully support the intention behind schemes such as the Enterprise Investment Scheme, the SEED scheme, and Community Investment Tax Relief, they can cause complexity and confusion, especially if the scheme is short lived. Therefore, the FSB proposes that you task the OTS to look at how all these schemes can be pooled together in a simple 'one-stop-shop' through which reliefs for investment in businesses can be obtained, and to report back with firm proposals by the 2013 Autumn Statement.

Tax Impact Assessments

While tax compliance cannot be classified as regulation and is therefore outside the regulatory development process, there are lessons to be learnt from the work of the Regulatory Policy Committee (RPC).

All Tax Impact Assessments should be subjected to independent scrutiny at both consultation and final stage by a body external to HMRC, as is the case for all other Government departments. Potentially this could be through the OTS, some components of it, or the RPC itself. It would have the expertise to fully scrutinise the impact assessment and understand how businesses will implement and be impacted by the changes.

Business Rates

FSB members have warmly welcomed the doubling of Small Business Rate Relief over the past few years. In some areas, members pay more in rates than in rents. To provide certainty, this should now become a permanent fixture.

We also see much merit in the recommendation from the Portas Review to switch indexation of rates from RPI to CPI. This would bring business rates into line with a number of other areas of Government policy, and we are therefore calling on you to consult on this option at the Budget. This would further provide the opportunity to correct anomalies such as the absence of a mechanism for adjusting thresholds by inflation, the treatment of multiple properties for small business rate relief, and the absence of small business rate relief on empty properties.

SUPPORTING ENTERPRISE

The Government's approach to employment policy and the labour market needs to be repositioned. The FSB encourages you and your colleagues in BIS and DWP to place small businesses at the front and centre of their work. Research commissioned by the FSB has found that small businesses offer the most important pathway back to work for the unemployed and the economically inactive, however at a time when business confidence remains fragile they need a helping hand.

Government should focus all its efforts on encouraging small and micro businesses to hire, by introducing targeted incentives and by further easing the burden of employment regulation that prevent small firms from adding to their workforce or taking on the first employee. Policies that are currently in motion – such as Shared Parental Leave and pension auto-enrolment – must be as light touch as possible and Government must ensure that administrative burdens on small firms are kept to a minimum. The FSB encourages you to review employment policy making and to encourage decision makers to '*think small first*'. This would avoid having to design-in lower thresholds, exemptions and other special measures at the end of the policy making process.

A skilled, flexible workforce is essential for an entrepreneurial economy. The FSB welcomes the Richard Review recommendation that in order to develop a market-driven apprenticeship system, businesses should be able to draw down the funding and spend it on the necessary external support. Getting the detail right on the implementation of this proposal will be crucial and the FSB urges Government to take its time to ensure the new system works for employers. The position of SMEs must be a key consideration; simplicity is crucial as is consideration of cash-

flow implications. Furthermore, this is an area that requires sustained investment. The FSB urges Government to ensure that the money spent subsidising employers taking on apprentices is as generous as it currently is.

StartUp Loans

Providing potential entrepreneurs with the necessary tools to start up and grow their businesses is important if the UK is to develop the enterprise society. As part of achieving that, the FSB would encourage you to investigate greater incentives to support self-employment. For many self-employed people accessing finance remains a key problem, and while StartUp Loans are an idea we have welcomed, there is a case for extending the sums available and the payback period. As part of our argument that government schemes should be rationalised, there is a strong case for housing this scheme within the Business Bank and using CDFIs as a distribution model.

Self-employment

Getting people off welfare and into work is an important factor in unlocking a latent part of the labour market and reducing the nation's debts. The key Government policy for this is Universal Credit. While the Government's aim to make work pay is laudable, the arrangements under Universal Credit for self-employed low-earners need to be more flexible. As our letter explained in detail to Lord Freud in July 2012, the reporting and conditionality requirements are onerous and will inhibit the ability of the self-employed to grow their own business and thus reduce their dependency on the working tax credit element of Universal Credit.

ENERGY AND INFRASTRUCTURE

Energy markets

Reform of the electricity market and the need to invest in the UK's energy infrastructure means small business energy bills are going to significantly increase in the coming years. The FSB expressed our view last year that the short time given for a raft of environmental proposals and their cost will pose a significant problem for small businesses in the coming years. This was highlighted in the FSB's '*Making sense of going green*' report published in August 2012.

More than ever, this means it is essential that downstream consumer protections are strengthened to ensure the smallest firms are protected from rising prices. Two practical methods are suggested to help small firms:

- **Rollover contracts.** The FSB believes the practice of micro business energy contract rollovers needs to be addressed as a matter of urgency. This is the practice used by energy companies to rollover contracts and locking small firms into un-negotiated and more expensive terms for a full 12 months. Micro firms are often unaware of the terms relating to contract rollovers, and we believe Government needs to direct Ofgem to tackle this by limiting the amount of time an energy supplier can rollover a contract to 30 days. The FSB has been working with Caroline Lucas MP on a presentation Bill that would limit energy contract rollovers for micro businesses to 30 days as well as tackling the linked issue of out of contract rates. Greg Barker MP, Minister of State at the Department for Energy & Climate Change, has written to Ofgem, the energy regulator, to lend his support for the review of rollover contracts.
- **Climate Change Levy.** Small businesses that use less than 1,000 KWH of electricity a month are exempt from the Climate Change Levy (CCL) this equates to 12,000 KHW per year. However, the FSB is concerned that micro-businesses who use less than 12,000 KHW are being subject to the CCL. Due to the CCL being calculated on a monthly basis, those businesses that use larger amounts of energy during particular periods of the year are being subject to CCL despite only being modest energy users. This problem is further compounded by the fact that once the 1,000 KHW mark has been breached, the CCL is calculated on the basis of a businesses' entire energy bill and not just on the amount of energy used over the 1,000 KHW limit. The FSB believes CCL should be calculated on an annual basis to avoid subjecting micro businesses, whose energy use is periodic but overall still modest, to the CCL.

Community Infrastructure Levy

While the intention of trying to provide greater transparency and predictability to section 106 contributions is obviously welcomed, the CIL effectively extends liability for such contributions beyond their reasonable application. In the FSB's view, CIL contributions have the potential to be harmful to self build development, while yielding little by way of financial support for infrastructure. Given the severity of the current housing crisis we would discourage the application of additional burdens to any form of residential development, especially self-build housing.

PROCUREMENT

Infrastructure spending on big and small projects is important and the FSB reminds you of the important role of small firms in supply chains. Public procurement continues to be a concern for FSB members and while good progress is being made with central Government contracts, the priority now is to look at public sector agencies outside Whitehall where most small firms interact with the procurement process. There remain concerns about disparate practices within local authorities for example, which hamper small businesses from winning contracts and helping local economies rebalance. Two factors should be looked at when awarding large public sector contracts:

1. **Prompt Payment.** All large contracts awarded by the Government or any public agency should follow the guidelines of the Prompt Payment Code and thus, the supply chain should benefit from the fast payment the Tier 1 company enjoys.
2. **Tax Compliance.** Many small firms are disappointed with the behaviour of large companies who avoid tax by choosing favourable tax jurisdictions and setting up complex holdings to aggressively minimise liabilities. The FSB suggests that this is factored in when awarding contracts.