



PRIME MINISTER

SMALL FIRMS POLICY

We are to meet on 14 October to discuss progress on our small firms policies. This note sets the scene on what I hope we can agree as our immediate and longer term objectives for the sector.

This country urgently needs more businesses to create additional wealth and to provide extra jobs. Most of these additional firms will result from 'start ups', as well as growth of small firms. The Government can hasten this process by helping to create the right environment. Our policy is founded on this objective and currently has four main components:-

- (a) reducing the hurdles and burdens facing new firms;
- (b) improved motivation, encouraging start ups and growth through lower personal taxes;
- (c) increasing resources within firms enabling them to weather inflation and grow;
- (d) improved counselling (advisory) services to help start ups and to reduce business failures.



I attach at annex 'C' a note of progress achieved so far under each of these headings. The list may appear long, but the effect of these measures, whilst representing a promising start, has been relatively modest and more needs to be done if we are to realise the sector's potential.

Clearly, we have to be realistic about what resources are likely to be at our disposal. This calls for cost-effectiveness and a careful ordering of priorities. In the short term, action is in hand on a number of fronts and these are summarised in annex 'A'. Most of the items are self-explanatory and can be aired at our meeting.

Lack of premises and the raising of finance are foremost amongst the problems encountered by those who seek to start up or expand.

Satisfactory changes are in hand on premises, but finance remains the major outstanding problem. I would like to set out the reasons for this:-

- (a) most small businesses start significantly under-capitalised;
- (b) inflation makes businesses cash hungry, pre-empting the resources which would otherwise be available to finance growth;
- (c) most (not all) entrepreneurs will not wish to share their equity;
- (d) the more dynamic are borrowed up to the limit permitted by their bank and frequently tend to over-trade;



-3-

- (e) although the High Street banks have moved to extend the frontiers of their lending, there is a consensus in the non-banking business sector that their lending decisions are too much related to the ability of the borrower to pledge security (this is a common phenomena in most industrialised countries which is met by a loan guarantee scheme in Germany, the Netherlands, Japan, Canada, USA);
- (f) in their early months/years, new businesses are unlikely to be making a profit. This sets them at a severe disadvantage relative to businesses which are profitable in that the latter can set against tax the cost of servicing their overdraft and most other expenses of running the business. True, when profits are made, they can subsequently write off their accumulated losses, but it is a major drag on achieving profitability.

We are already encouraging the financial institutions to do more to help small businessmen and our work involves contact with the clearing banks, merchant banks, pension funds, venture capital companies and other specialist organisations. I attach particular importance to the work we are doing on the pursuit of funds by new technology-based firms (NTBFs) and I understand you have recently received a separate report about this. A further development worth reporting is the arrangement that the NEB is trying to bring off with an American venture capital company (the Melchor Corporation) to stimulate new technology-based activity in the Assisted Areas. It is intended that the NEB and Melchor will jointly manage an NEB fund directed

Minutes from
Dr. Ashworth
Flag
B



-4-

towards small NTBFs in California that want to set up in association with partly privately-funded ventures in the UK.

In general, the financial institutions are responding well and some interesting new schemes are being announced but, notwithstanding these developments, there still seem to be a number of gaps in the market and important opportunities for growth are being lost. We must fill one of these gaps by providing a new incentive for the private backer who offers a potentially valuable source of venture capital. The best incentive we can offer in this precise area is tax relief for equity investment in small firms and I would rank the introduction of such relief as one of the most immediate priorities for action in our policy for small firms.

The private backer can offer a more flexible approach to his investment in a small firm than a bank or other financial institution. He can take a longer term view of a business's chances of success and provided the rewards are sufficient, he may be prepared to take a higher risk. A small businessman is generally more willing to give up equity to such a partner, particularly if he is a relative or a friend, and he stands to benefit from any relevant business experience the private backer may have. The introduction of the proposed buy-back of shares scheme will go a long way to overcome the reluctance of many proprietors to part with any of their equity.

I believe a much greater incentive than those offered so far will be necessary to woo investors away from making safe and attractive



-5-

institutional investments. I understand consideration of tax relief for equity investment in small firms in the FASE Group should be completed by the end of the year and I hope that the scheme will then be introduced in the next Budget.

Another incentive could be offered through the introduction of Small Firms Investment Clubs with tax incentives for both the Club and the individual who invests in it, but consideration of the proposal (again in FASE) is unlikely to be completed before the next Budget. Although the resources at the Chancellor's disposal in 1981-82 may be limited, the equity investment proposal remains the most imaginative and significant option before us and one which I believe would be of major and lasting importance for small firms.

The above, together with annex 'A' refer to matters in hand. There will be need for more action, and I suggest in annex 'B' additional measures which would be of considerable benefit to the sector. I accept that some of these are ambitious and some potentially costly but I hope they can now be examined. Taken with what we have already achieved, they would go a long way to create the right environment in which small firms would start up and grow; a climate somewhat more akin to that provided by our European competitors who have a significantly more flourishing small firms sector than ours.

I am sending copies of this note to Keith Joseph, Geoffrey Howe, John Nott, Michael Heseltine, Jim Prior, Patrick Jenkin and Sir Robert Armstrong.



SMALL FIRMS POLICY

ANNEX A

OBJECTIVES STILL TO BE FULFILLED

OBJECTIVE / LEAD DEPARTMENT ~~PRESENT~~ ~~STATUS~~ PRESENT STATUSTreasury

- | | | | |
|-----|--|---|--|
| i | tax relief for equity investment
in small firms |) | under consideration
in FASE Group; see
covering note |
| ii | introduction of Small
Business Investment Clubs (SBICs) |) | (work on (ii) is
unlikely to be completed
before the next budget) |
| iii | review of capital taxation | | I was disappointed
to note that the
Capital Tax Review
led only to the
raising of exemption
limits rather than
structural change.
CTT is a major
cause of the sale of
medium sized smaller
firms and leads to an
unhealthy concentration
in industry. I have
asked officials to
consider whether some
amelioration of the
CTT burden can be
linked to the proposed
legislation providing
for buy back of shares.
Very small firms
benefit from the 1980
budget relief exempting
businesses up to £100,000.
There is no business
problem with Quoted
companies. The problem
lies between these 2
sizes. |
| iv | VAT estimated quarterly pay-
ments for small firms. This would
involve interim payment of VAT
based on an agreed percentage of
turnover. It would relieve to some
extent the administrative burden
on the small businessman. | | Under consideration
in the Treasury. I
hope an early decision
can be taken to
introduce this option. |



OBJECTIVE / LEAD DEPARTMENT

PRESENT STATUS

Employment

Management Training for Small Firms. This is an important objective which is vital to the well being of the small business sector.

Assuming the review of ITBs leads to their retention in broadly their present form I hope that DOI discussions with the MSC and DES will lead to the provision of management advice through the ITBs and a better co-ordinated approach to management training in general.

Environment

i De-rating of sealed parts of business premises.

This proposal has been examined and seems unlikely to be adopted but I consider it would be of considerable value to those small firms to which it applied.

ii Relaxation of building regulations.

Under consideration in inter-departmental working party.

iii A small but niggling matter, the collection of dustbins

Local authorities have no discretion to waive charges for the collection of one or two dustbins. I urge that a de minimis discretion be given to local authorities.

Energy/Trade

Steps should be taken to privatise the retailing and contracting activities of the electricity boards.

Awaiting official consideration of MMC report on gas boards.

DHSS

i Full sickness benefit and hospital cover for the self employed and their families while travelling in the EEC.

DHSS have pushed this strongly in the EEC but attempts to introduce this measure are, so far, blocked by the Danes.



OBJECTIVE / LEAD DEPARTMENT

ii Sick Pay A consultation document has been issued advocating the transfer of the provision of sickness pay for the first 8 weeks to the employer, partly compensated for by a rebate on the NI contribution.

PRESENT STATUS

Colleagues should be aware that in its present form this proposal will be fiercely resented.



SMALL FIRMS POLICY

ANNEX B

SUMMARY OF POSSIBLE FURTHER MEASURES TO IMPROVE THE ENVIRONMENT FOR SMALL FIRMS

REVIEW OF CORPORATION TAXATION

Stock Relief

The 1980 Budget statement foreshadowed fundamental change in the 1981 Finance Act. If this change does not materialise then we must consider extending the one year 'dip' relief to two years and writing off past stock relief more quickly so as to improve the borrowing capacity of small firms.

Investment: Fixed Assets

The three year carryback of first year allowances still does not give relief to certain small companies who from time to time have to invest in particularly expensive items of equipment. Unless the Corporation Tax Review significantly alters the first year allowance system I should like to see the time limit extended back from three to perhaps five or six years.

Start-ups

Turning now to individuals and partnerships, I should like to see the existing relief for trading losses, which can be set-off against pre-trading income, extended to investment in working capital.

In the context of such enhanced benefits, I would also like to see consideration being given as to how the transition from sole trader or partner to corporate entity could be made more easy in respect of tax liability.

A further idea would be to counter the disadvantage that new businesses have in not being able to offset borrowing costs against tax. This would be done with a scheme which allowed borrowing costs to be net (not dissimilar in principle from the benefit of the Mortgage Option Scheme for the low tax-paying house buyer). As a protection against abuse it could be assumed that the proprietor draws say £5,000 per annum as salary during the first five years otherwise artificial losses would be created.

A LOAN GUARANTEE SCHEME

I hope further consideration can now be given to a government loan guarantee scheme for small firms for introduction when the need for monetary constraint diminishes. There has been considerable pressure for the introduction of such a



measure amongst representatives of the small business community and our own back-bench small business committee. The clearing banks however are unenthusiastic about guarantee schemes and their lending policies for small firms have become somewhat more imaginative recently. The value and cost-effectiveness of such a scheme cannot be proved without a trial run but for my part I am convinced that it would lead to additional lending in an area where there is a specific inadequacy in our institutional arrangements, namely the start up or fast growing small firm which characteristically is short of collateral. I believe we should now explore with the banks the arrangements for a pilot scheme to be introduced as soon as circumstances are more favourable.

MANAGEMENT ADVISORY SERVICES: THE SMALL FIRMS SERVICE AND COSIRA

There is little doubt that the Small Firms Service run by this Department is a success and that its counselling arm in particular is proving of real benefit to small business owners. But with a responsive role, the service is only getting through to a tiny proportion of the small firms population. A substantial increase in its activities could be achieved with a limited extra call on public funds. The annual cost of the service at present is under £2m. One key change would be to move from a responsive to an actively canvassed form of promotion, such as exists in CoSIRA; in this degree of priority could be accorded to NTBF. **[NEW TECHNOLOGY]**

CoSIRA operates a management advisory service for manufacturing firms in the rural areas and there is a need to consider how the two services could be combined to provide a uniform facility across the country. A single service could be more cost effective than the present side-by-side operation of CoSIRA and the Small Firms Service. Michael Heseltine has put to us his ideas for improving the quality of these advisory services for small firms and Keith Joseph has suggested a more fundamental examination of how management assistance might best be provided in the future to the small firm no matter where it is located. I believe that such an examination might well establish that a single service is the right solution. Other policy objectives, such as rural, regional or inner city, could be accommodated by supplementing the national service in particular selected locations with more intensified promotion and possibly lower fees. In this way I believe that a better service to small firms could be provided.



SMALL FIRMS POLICY

ANNEX C

GOVERNMENT ACHIEVEMENTS IN THE FIRST 15 MONTHS

A HURDLES AND BURDENS

One of the worst is the lack of small premises with planning consent. Steps taken include:

- 1 Swifter planning decisions, announced at public enquiries, not months later.
- 2 A new Circular on Development Control due originally in September should make it easier for inoffensive small firms to use existing non business premises.
- 3 100% tax allowance for 3 years on building or conversion of premises up to 2,500 sq ft. Signs of vigorous take up.
- 4 DOI through English Industrial Estates building over 1,000 small units in the Assisted Areas.
- 5 The lowering of Development Land Tax and the £50,000 exemption for small plots is helping to bring sites onto the market.

The Employment Protection Act actively deterred small firms from taking on extra employees for fear of claims for unfair dismissal.

- 6 The qualifying period for alleged unfair dismissal claims has been extended from 6 months to 12. For firms with 20 employees or less it will from autumn 1980 be extended to 2 years in respect of new employees. An important simplification since Redundancy has a similar 2 year qualifying period.
 - 7 Industrial Tribunals to take account of size and resources of employer.
 - 8 Frivolous claims deterred by a liability to costs.
 - 9 Post Maternity re-instatement waived for firms of 5 employees or less, if re-instatement not practicable.
- Two specific unfairnesses in Rating systems have been corrected.
- 10 The right to pay rates by installments conferred on small firms.
 - 11 Given to owners of "Mixed Heriditaments" the right to more domestic rate relief.



Numerous regulations and controls eased or swept away.

- 12 Price controls abolished.
- 13 Abolished office development permits.
- 14 IDC exemption lifted from 12,500 to 50,000 sq ft.

The Industrial Training Boards have aroused a number of small firm criticisms.

- 15 A major review of the ITB system has been undertaken - the results are being considered.

Direct Labour Departments of local authorities threaten unfair competition to private sector builders.

- 16 DLO's are being established as separate trading organisations.

- 17 A proportion of contracts must be put out to tender.

- 18 DLO's must trade at a profit, 3 years of failure risks being closed down.

Sub-contractors in the building industry have had unreasonable conditions to comply with when they wanted a 714 tax certificate, accordingly we have:

- 19 Removed the conditions requiring £250,000 insurance cover.
- 20 Relaxed the 3 year rule.
- 21 Introduced a right of appeal against refusal of certificate by tax inspectors.
- 22 Ensured reasons for refusal are disclosed to applicants.
- 23 Deleted a number of peripheral activities from scope of 714's.

Self employed have to make their own retirement annuity arrangements to top up the basic state pension.

- 24 Increased from 15 to 17½% the tax allowed contribution.
- 25 Removed the ceiling of £3,000 on contributions.



26 New concessions enable unutilized contributions to be carried forward for 6 years.

27 Contributors have 12 months after year of assessment in which to pay and claim for that year.

There has been criticism of the use of powers of entry by Inspectors.

28 Committee of Enquiry has been set up to look into the tax enforcement powers of Inland Revenue and Customs and Excise.

29 A detailed review has been carried out of all other powers of entry by a Minister in each Department concerned.

The administration of VAT cannot avoid being a burden to the smallest firms.

30 We have fulfilled our promise to move to a single rate.

31 Lifted the exemption to £13,500 the maximum permitted under EEC regulations agreed by the previous government.

Statistical questionnaires can be a time consuming burden as can disclosing detailed accounting information.

32 We have cut out over a million questionnaires.

32 Limited companies with turnover of £1 million or less have disclosure requirements reduced.

B IMPROVED MOTIVATION

Less burdens and more rewards are the key to encouraging more start ups.

34 The largest ever cut in Income Tax for those who succeed and hit the top rate: 60% is in line with Europe.

35 Capital Taxes under review. As an interim measure CTT exemption lifted to £100,000 on business assets.

C INCREASED FINANCIAL RESOURCES AVAILABLE WITHIN SMALL FIRMS

By lower taxes and encouraging lenders and private backers.

36 Reduced small firms rate of corporation tax from 42% to 40%.



- 37 Extended the lower rate to firms with up to £70,000 pre tax profits.
- 38 Ended the 'close' company distribution requirements in respect of trading profits.
- 39 Written off the first 2 years of stock relief deferred liability.
- 40 Provided £4 million for loans by COSIRA this year.
- 41 Arranged EIB loans for 7 years at 10% fixed plus 2% insurance cover (on risk of exchange rate changes) now available at a lower limit of £15,000 in assisted areas only.
- 42 Encouraged private backers by cutting investment income surcharge from 98 to 75%.
- 43 Interest on loans for investment in close companies, where there is a 5% shareholding, allowed against income tax.
- 44 Tax allowance on losses on investments in unquoted companies.
- 45 Commenced using the DOI Small Firms Counselling service for assessment of investment propositions on behalf of pension funds.
- 46 Published a consultation paper on 'share buy backs' which would help to overcome the reluctance of small firm proprietors to accept outside investors.

D IMPROVED COUNSELLING SERVICE

- 47 The Small Firms Service of the DOI has been allocated more resources and provides a comprehensive service covering information and business advice both to those considering start ups and firms who have run into problems. (Nation wide Freephone number 2444 automatically ties up to nearest local centre.)
- 48 The counselling service now covers all main towns with a system of clinics and personal appointments.