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Policy Group on the Promotion of Enterprise

Report

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'Everyman a Capitalist'

SUMMARY

The group was asked 'to review the measures already taken' to revive business, 'to advise on measures which might improve its working still further', 'to consider whether there are any steps which might be taken to restore profitability levels', and 'to consider whether pension funds are yet pulling their weight in the enterprise sector'. We have attended to all of these matters, and now make a series of recommendations, which might conveniently be brought together under the heading: 'Through Enterprise and Ownership comes Employment and Prosperity'. We wish to involve people in the success of our industrial society, to increase commitment at all levels, and to create a national sense of common purpose.

Recommendations:

- (1) Pensions. There should be a fundamental review of pension legislation to remove the penalty on changing jobs, to aid mobility and to link individuals more closely with the wealth represented by their pension fund. To these ends, pensions should become personal, portable, identifiable by the individual and attributable to him. In certain circumstances, he should have the opportunity to use part of his capital in constructive ways before retirement.
- (2) Enterprise allowances. Consideration should be given to relaxing the condition that the recipient should invest at least £1000 in the business. And the availability of the allowance should be extended to franchising.
- (3) Self-Employment. Self-employment should be more vigorously promoted within MSC job-centres.

- (4) Statutory right to tender. Businesses in the private sector should be granted a statutory right to tender for the provision of a wide range of local authority, central government and other public sector functions.
- (5) Deregulation. The 'Rayner' scrutiny should be extended to those regulatory activities of government and local authorities that impose costs on business.
- (6) Share Options. The government should alter tax arrangements for capital gains made by an employee on shares obtained from his company under share option schemes.
- (7) Venture Capital.
 - i. The opportunity to set up Small Firms Investments Companies (SFICs) should be created; and investors in such companies should be given tax advantages.
 - ii. The Business Expansion Scheme should be applied to research and development.
- (8) Encouraging Investment. Individuals should be allowed to claim a deduction against taxable income on equity investments of up to £1000 p.a.
- (9) Enterprise through Innovation. University contracts of employment should be changed, to ensure that interaction with business is vigorously encouraged. NRDC marketing of British inventions should be privatised. Universities should be encouraged to associate themselves with the growth of science parks.

PROPOSAL 1 - PERSONAL AND PORTABLE PENSIONS FOR THE EMPLOYEE

Proposal:

There should be a fundamental review of pension legislation to remove the penalty on changing jobs, to aid mobility, to link individuals more closely with the ownership of the wealth represented by their pension fund and to protect funds from political direction of investment.

To these ends, pensions should become personal, portable, identifiable by the individual and attributable to him. In certain circumstances, he should have the opportunity to use part of his capital in constructive ways before retirement.

Notes:

PRESENT POSITION: THE PROBLEM OF THE EARLY LEAVER

There is currently deep concern at the grave injustice inflicted on those who change jobs - the so called "early leavers."

Many pension schemes are able to offer pensions of two thirds of final salary only by making use of excess contributions from 'early leavers'. However, some 75% of those in employment change their jobs several times; and these employees are treated unfairly. Thus the Occupational Pensions Board tells us that: 'two changes of employment in a lifetime can reduce a person's pension rights by more than half, despite his having been a member of equally good pension schemes in each employment.' [Early Leavers Report, Cmnd. 8271, para. 5.16].

A SOLUTION

To rectify the injustice to early leavers, their rights should be improved. And the changes that this requires present the opportunity, if the political will is there, not only for pension benefits to be put on a far more equitable basis but also for people if they wish, to be given the chance to run their own personalised pensions as if they were self-employed, through segregated funds.

In brief, we think it is desirable to encourage a gradual move to money - purchase schemes and progressively to eliminate subsidisation of the non-leaver.

Having talked to individuals in the Inland Revenue, the Treasury, the OPB, senior pension fund managers and company directors, we see no overriding difficulties that make our suggestion impractical. Some of the changes proposed could be achieved by altering the OPB regulations: one useful alteration would be the insertion of the condition that preserved pensions of early leavers be increased in line with pensions in payment. This is likely to happen anyway - but it is not a sufficient solution.

To achieve a full solution, we suggest that the managers of pension schemes should be required to report annually to each member the pension entitlement that his contributions will have earned him if he leaves his employment, (i.e. he should be given a 'discontinuance valuation'). This valuation could be expressed in units.

This would open the way to a number of major policy changes.

- i. An employee leaving a scheme and becoming self-employed should have the right to withdraw his units, not for current consumption, but into an authorised S226-type scheme of his choice. He should be able to add contributions to the new scheme, up to the normal self-employed allowances.
- ii. An employee going to a new employer should have the option to transfer his units either into an S226-type scheme or into the new employer's fund. At the request of the employee, the employer should have the option to pay into an S226-type scheme contributions of an equal value to those that would have been paid on the employee's behalf had he opted to join the company scheme.
- iii. Where the new employer was claiming tax relief on contributions at less than $17\frac{1}{2}\%$ of the employee's gross salary (or 20% for those born before 1933), the employee should be entitled to make tax deductible payments up to that percentage either as annual voluntary contributions to the company scheme or into his S226-type scheme. Where the employer had 'contracted out', the appropriate scales of contribution by the employer on behalf of the employee should be published by the OPB.
- iii. Where the employee joined his new employer's scheme, but did not transfer his previous units to that scheme, those units might be placed in an S226-type scheme, and continue to grow, without further funding.

OBJECTIONS

Many employers would undoubtedly complain that the removal of the early leaver's disadvantage would make it more expensive to finance pension schemes, and that schemes would gradually wither as more and more early leavers exercised their option to transfer to an S226-type scheme. But in future, people will either have their own S226-type scheme covering their early years, or have a better preserved pension, or have brought with them an inflow of units when they join, thus removing some of the burdens currently placed on funds by 'late joiners'.

We believe that it would be wrong to maintain the current irrational system of funding, which penalises up to 75% of employees, merely on the grounds that change would put the burden of funding where it more properly belongs.

ADDITIONAL BENEFITS

We believe that the possibility of direct investment in a segregated fund would provide:

- i. more funds for the smaller business sector;
- ii. the reduction of arguments about 'political' investment;
- iii. greater availability of funds for management buy-outs, especially for those approaching retirement with substantial accumulated resources;
- iv. subject to all the known hazards, greater direct investment in the employee's own company, and hence greater 'grass-roots' financial participation in business.

PROPOSAL 2 - ENTERPRISE ALLOWANCESProposal:

We are delighted that Enterprise Allowances, are to be spread progressively to the whole of the UK. Consideration should now be given to relaxing the condition that the recipient invest at least £1,000 in the business. And the availability of the allowance should be extended to franchising, an industry employing over 5 million people in the United States.

Notes:

It should be noted that the incentives for local enterprise provided by the Enterprise allowance might be a better way to reward investors than large subsidies, especially in areas such as Northern Ireland.

The allowance requires declaration that one is in business; and this declaration brings the firm into the 'legitimate' economy. Besides being desirable in itself, such legitimacy removes the inhibitions that the 'black' economy creates. Firms can more easily advertise their products and services, employ people, invest and seek help from agencies and banks.

The number of new businesses in the five experimental areas to the end of January 1983 is 1,863. Based on these figures, a national scheme could well result in 100,000 extra new businesses in a year.

PROPOSAL 3 - SELF-EMPLOYMENT: THE ROLE OF JOB CENTRES

Proposal:

To promote self-employment more vigorously within MSC job centres so that self-employment is encouraged as an alternative to employment.

To devote more staff resources to professional guidance in job centres on self-employment. The minimum level of advice should consist of pointing people to the right sources of specialist help.

Notes:

A recent survey conducted by the EIU and co-sponsored by the Institute of Directors found that 34% of those unemployed people interviewed had thought about setting up in business on their own since they became unemployed. This would be equivalent to 1 million potential small businessmen among the unemployed. Most of those who are interested in starting their own business had no idea how to set about raising the necessary finance and considered that they would not be able to find the money. There is obviously an urgent need for more advice.

We recognize that the Small Firms Service of the Department of Industry already provides advice centres. But these centres are principally devoted to those who have already started new businesses and it is clear that the unemployed are not seeking their help. Only 19 job centres are linked with the Small Firms Service.

The additional costs might well be offset by removing job centres from the high-street. Their present locations seem to be unnecessarily expensive in relation to the task in hand.

PROPOSAL 4 - STATUTORY RIGHT TO TENDER FOR THE PROVISION OF LOCAL
AUTHORITY, CENTRAL GOVERNMENT AND OTHER PUBLIC SERVICES.

Proposal:

Businesses in the private sector should be granted a statutory right to tender for the provision of a wide range of local authority and central government functions, as well as certain other public sector services.

Notes:

Statute now regulates the accountability systems of local authority direct labour organisations, and imposes obligations on local authorities to put out to tender certain construction work. But competitive pressures are widely absent in the provision of local authority, central government and other public services. Councillors and others seeking to secure better value for money are prevented from doing so by the absence of competitive bids.

These problems could be solved by introducing a statutory right to tender. The introduction could be achieved in either of two ways.

METHOD I

One method would be to give private sector businesses a right to submit tenders for the provision of a widely-drawn list of public functions.

This approach would require:

- i. an obligation on local authorities, certain parts of central government and other parts of the public sector, to provide the full information necessary to allow a realistic tender to be drawn up;
- ii a means of policing the system to secure that the right is not used frivolously and that local authorities and others act reasonably in determining whether or not to accept tenders.

The Federation of Civil Engineering Contractors, which first made this proposal, considers that, in the case of local authorities, the District Auditor is the appropriate officer to deal with (i) and (ii).

METHOD II

A second method, which might be administratively less complicated, would be to extend existing legislation to widen the categories of local authority and other functions that must be put out to tender.

PROPOSAL 5 - DEREGULATIONProposal:

The 'Rayner' scrutiny should be extended to those regulatory and other activities of government and local authorities that impose costs on business.

Notes:

The extension of the scrutiny will no doubt involve extra costs, and may reveal embarrassing deficiencies in present administrative arrangements. It might, for example, recommend a switch from basing VAT on invoices to basing it on accounts. Nevertheless, we believe that the benefits accruing from the extension would far outweigh these disadvantages: the present exclusion of compliance costs from scrutiny makes it possible simply to shift a burden from government to the citizen, thereby adding to the costs incurred by businesses, and providing a disincentive for entrepreneurs.

For maximum effect, scrutiny should be applied prospectively before changes are made to regulations.

PROPOSAL 6 - SHARE OPTIONSProposal:

Companies may now distribute up to £5,000 or 10% of salary to each employee under a share incentive scheme. These schemes are limited in number and affect only quoted companies. If managers in those companies are provided with greater share incentives, in particular share options, they have to pay income tax rather than capital gains tax on the increase in value of shares sold or held for over seven years. We propose that:

- i. if the option price reflects the market price of the shares on the day that the option is granted, the manager should be liable to tax only at capital gains tax rates when the shares are sold to a third party, so long as they have been held for at least five years;
- ii. in the case of unquoted companies, the same rules should apply, except that it will be necessary for the auditors to value the company's shares; rules will have to be established to allow auditors to make fair valuations of the shares at the time of option and at the time of sale.
- iii. In order to make it possible to assess the cost of the scheme, we suggest that there should be a progressively altered limit both on shares acquired by a person in any given year, and on the total proportion of the company's shares distributed in this fashion.

Notes:

These schemes will enable managers to accumulate capital, and thereby foster both investment in other companies and the formation of new enterprises. In the case of small companies, it is often impossible to attract top quality management because of the relatively low salary levels that can be offered in the early stages of a company's life. The ability to provide substantial share options for managers in these companies should ensure that enough able managers are available to them.

We believe that the success of these schemes, once introduced, will make it extremely difficult for an alternative administration to abolish them.

PROPOSAL 7 - VENTURE CAPITALProposal I:

The opportunity to set up Small Firms Investments Companies (SFICs) should be created by legislation, and investors in them should be given tax advantages similar to those enjoyed under the Business Expansion Scheme (BES). SFICs should be allowed to invest in newly issued ordinary shares of unquoted trading companies in qualifying trades employing less than 300 people.

Notes:

The point of creating SFICs is to provide professional investment management for both the private and the institutional investor, and to improve the risk:reward ratio provided to each when investing in emerging companies.

SFICs would provide tax relief for the individual investor at the time of making an investment. The institutional investor should gain no such advantage. There is, however, a need to ensure that capital gains tax which would not be paid by the institutional investor or the private individual if they were to invest directly in the underlying company is not trapped in the venture capital investment company. SFICs should therefore be treated for capital gains tax purposes in the same way as investment trusts: i.e. the SFIC should not pay capital gains tax on capital gains made when realising its investments.

Initial loss of tax revenue will be offset by the growth of small companies providing taxable profits and employment, and thereby increasing the tax take.

Rules to prevent tax-avoidance can be framed, particularly if the SFIC is allowed to have no private investor holding more than 5% of its equity and no investment representing more than 20% of its funds at the time of investment.

At present, the tax relief is not repaid on average for 18 months after investment. The proposed change will therefore remove an inequity. But SFICs should be forced to invest tax-relieved monies within, say, 2 to 3 years, to prevent abuse. If uninvested in that time, the monies should be returned to the investors, and the relief should be clawed back.

Proposal II:

The Business Expansion Scheme should be applied not only, as at present, to qualifying trades, but also to research and development.

Notes:

In the US, R.& D. Partnerships have been used to fund new product development during the early stages of R.& D. without affecting the balance sheet of the company that will subsequently apply the development. If the R.& D. is successful, the investing partners receive a royalty from the company; if it is unsuccessful, the company does not suffer.

It would be simple to extend the terms of the BES from investment in a trading company to include investment in R.& D., thereby increasing support of new product development. The BES rules are sufficiently draconian to prevent abuse.

PROPOSAL 8 - ENCOURAGING INVESTMENTProposal:

Individuals should be allowed to claim a deduction against taxable income on investments in quoted shares of up to £1,000 p.a.

Notes:

The object of this proposal is to encourage interest in the ownership of shares at first hand. This will increase many people's understanding of the process of wealth creation.

The relief is likely to stimulate investment, and provide some stimulus to the economy. The interest in the success of the business so engendered would offset the cost to the Exchequer.

French experience suggests that the introduction of similar relief under the Loi Monory, multiplied the number of active private investors on the Bourse several fold.

PROPOSAL 9 - ENTERPRISE THROUGH INNOVATIONProposal:

University contracts of employment should be changed, to ensure that interaction with the business community is vigorously encouraged.

NRDC marketing of British inventions should be privatised.

Universities should be encouraged to associate themselves with the growth of Science Parks.

Notes:

Britain has always been near the top of the league in scientific discovery; but it has a bad reputation for turning inventions into commercial propositions. This stems largely from the separation of academics from industry, caused by:

- i. academic contracts of employment;
- ii. the failure of NRDC to act as a catalyst;

Our proposals address these two problems.