Policy on Small Firms
Enterprise Proposals.

Part 2

ECONOMIC POLICY

Part 1: June 1979
Part 2: July 1980

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~9.7.80.~~		— Pt 2 Ends —					
~~21.7.80~~							
~~24.7.80~~							
~~25.7.80~~							
~~5.8.80~~							
~~8.8.80~~							
~~12.8.80~~							
~~13.10.80~~							
~~17.10.80~~							
~~4.11.80~~							
~~7.11.80.~~							
~~4.12.80~~							
~~30.12.80~~							
~~8.1.81~~							
~~13.1.81.~~							
~~26.1.81~~							
~~3.2.81~~							
~~4.2.81~~							
~~12.2.81~~							
~~19.2.81~~							
~~9.3.81~~							
7.4.81							

PREM 19/431

Dd 533270 5M 2/78 8362633 JET

PART 2 ends:-

8/5 DUI to 8/5 NIO 7/4

PART 3 begins:-

Scottish Office to HMT 1/5

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
L(81) 32	29/01/81
L(81) 4th Meeting, Item 4	04/02/81
L(81) 52	19/02/81

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed CWayland Date 17 March 2011

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

House of Commons Hansard Financial Institutions	23/01/81 Columns 575-584
Small Firms Expansion (Inquiry) Bill HMSO	16/01/81

Signed OWayland Date 17 March 2011

PREM Records Team

PV

Econ Pol

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

7 April 1981

The Rt Hon Humphrey Atkins Esq MP
Secretary of State for
Northern Ireland
Northern Ireland Office
Great George Street
London SW1P 3AJ

Dear Humphrey,

with TL?

Thank you for your letter of 26 March about the Loan Guarantee Scheme for small businesses.

I note your wish to see the scheme introduced in Northern Ireland at an early date. I understand officials here are waiting to hear from those in the Northern Ireland Office about how the scheme might be operated there but I should like to assure you of our full cooperation on this matter.

Thank you also for your comments on the Scheme's coverage.

I am copying this letter to the recipients of yours.

Ever,

Keith

Chancellor of the Duchy of Lancaster

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

9th March 1981

Dear Tony

ASSISTANCE TO SMALL FIRMS

The Chancellor of the Duchy of Lancaster has seen a copy of your Minister's minute of 6 March to the Prime Minister about the proposals to use the Development Commission as the basis for a single unified public service organisation bringing together the Small Firms Service and the Council for Small Industries in Rural Areas in a partnership.

The Chancellor has noted that your Department has made no bid in the current QL exercise for a Bill for this purpose next Session. A decision on the inclusion of legislation in a future Session will be a matter for collective decision by QL when your Minister brings forward a proposal to that Committee, but given the likely pressures on the legislative programme for the remainder of this Parliament, the Chancellor of the Duchy is opposed to any implied commitment about timing being given now either in the Budget statement, or in the proposed press release. He would therefore like the third sentence on page 2 of the draft press release to read "Legislation to this effect will be introduced at the appropriate time, though the other pressures on the Parliamentary timetable may mean that this will not be possible in the near future." Any reference in the Budget statement would, of course, be made consistent with this amendment.

I am copying this letter to the Private Secretaries to the recipients of your Minister's minute.

Yours sincerely

N P M HUXTABLE
Private Secretary

A Willis Esq
Private Secretary
Department of Industry
123 Victoria Street

E CON POL

Reference

1 Mr Batten

2 Mr Holmes 12/2 I agree with the draft.

3 Mr Kendall OK 12.2.

4 PS/Mr MacGregor

The enclosed letter is from Mr P J de M Rudolf who has the idea of setting up an advisory service for small firms using the skills and experience of retired executives, much on the lines of the Small Firms Service. I have given Mr de Rudolf details of the Small Firms Service, together with a leaflet, and suggested he contacts the Birmingham Centre if he requires any further information.

Rosemary Buck

ROSEMARY BUCK
Small Firms Division
Room 834 Abell House
211 6018

12 February 1981

CODE 18-77

File No.

DRAFT

Addressed to:

Mr P J de H Rudolk
8 Dowells Gardens
Wordsley
West Midlands
DY8 5QA

Copies to:

PS/Prime Minister
Miss Mueller
Mr Wright
Mr Kendall - on file
Mr Plant - SFC B'Ham

Enclosures:

SFS Leaflet

Originated by:
(Initials and date)

RB 12/2

Seen by:
(Initials and date)

CoK 12.2

Type for signature of

MR MACGREGOR
(Initials and date)

DEPARTMENT OF INDUSTRY

The Prime Minister has asked me to thank you for your letter of 1 February which has been passed to me for answer in view of my responsibility for small firms. I was encouraged to learn of your concern for the small business sector and of your plans to assist small firms.

You may be interested to know, however, that advice and assistance is available to both small businessmen and those thinking of starting in business from the Department of Industry's Small Firms Service, a leaflet on which is enclosed for your information.

The Service is operated through a nationwide network of Small Firms Centres which provide free information on a wide variety of subjects ranging from sources of supply to Government legislation. In addition to this free information service, a counselling facility is provided. Counsellors are ~~retired or semi-retired~~ experienced successful businessmen who are engaged by the Department of Industry on a part-time basis to give impartial and confidential advice on management and financial problems to small businessmen and those thinking of starting in business. The first counselling session is free and a modest charge is made for the second and subsequent sessions.

If you should require any further information on the work of the Small Firms Service please do not hesitate to contact Mr Ken Plant, the Manager of the Birmingham Centre, on 021 643 3344, or by dialling 100 and asking the operator for freefone 2444. I am sure he would be most willing to assist you with any queries you may have.

HS

6 February 1981

I am writing on behalf of the Prime Minister to acknowledge your letter of 1 February. This is receiving attention and a reply will be sent to you as soon as possible.

M.A. PATTISON

P.J. de M. Rudolf, Esq.

BIC

HS

Th. de Rudolf
6/3

6 February 1981

I enclose a letter to the Prime Minister from a Mr. P.J. de M. Rudolf, who believes that he has identified a gap in the range of advisory services available to small businesses. I should be grateful if you could arrange for a suitable reply to be sent on the Prime Minister's behalf with a copy to me for our records in due course.

M.A. PATTISON

A.C.S. Willis, Esq.,
Department of Industry.

BK

DL

Econ Pol.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 0002
SWITCHBOARD 01-212 7676

From the
Parliamentary Under Secretary of State 's Office

Miss C Stephens
10 Downing Street
London

6 February 1981

MT

Dear Caroline,

In your letter of 30 January you asked for briefing for the Prime Minister's meeting on 10 February with the officers of Smaller Businesses Committee.

They have already had separate meetings with the Chancellor of the Exchequer and the Secretaries of State for Employment, Industry and Health and Social Security.* My Minister was present at all except the last meeting, and has met the officers on several occasions himself. We have prepared the attached brief on the basis of the topics identified in your letter, and a number of other points raised in those meetings.

We have also drawn attention to the two Private Members Bills currently being promoted by John Loveridge and John Page because they could well be raised although both sponsors accept that the Bills will be blocked.

The Committee are particularly anxious that the Government should quickly take a number of major steps to help small businesses. They believe that without such measures (and maximum attendant publicity), small businesses will not be able to make a very great contribution to the reduction of unemployment in the next two or three years.

Copies of this letter and enclosure go to the Private Secretaries to the Chancellor, and the Secretaries of State mentioned above.

Yours sincerely

Anthony Willis

A C S WILLIS
Private Secretary

Enc

* I understand that the full back-bench Committee, with some 50 members, were at the meeting with Mr Jenkin. Thank you also for the copy of John Loveridge's letter of 5 February. I do not think this requires further briefing

PRIME MINISTER'S MEETING WITH THE SMALLER BUSINESSES COMMITTEE ON 10 FEBRUARY

1 The Committee have indicated that they wish to discuss the following topics:

A) LOAN GUARANTEE SCHEME

2 With the Chancellor's and the Secretary of State's agreement, the Department has written to the English and Scottish clearing banks and the ICFC at official level outlining a possible pilot loan guarantee scheme and a first meeting with representatives of these bodies was held on 29 January.

3 There has been intense rumour and speculation in the press about this approach. The present line being taken by the Department is that a loan guarantee scheme is one of a number of options currently under consideration to improve the flow of funds to small businesses. The Department is just beginning confidential consultations with a number of financial institutions as part of its evaluation of a scheme but we have stressed that Ministers have yet to reach any firm conclusions about introducing such a measure. John Loveridge is concerned that the package as reported might be too small to have a major impact - the Prime Minister could emphasise that Ministers are considering a pilot scheme which could be introduced quickly and which is still under negotiation.

B) REFORM OF CAPITAL TAXATION

4 The Committee considers that in its present form capital taxation forms a significant deterrent to medium-sized businesses. They particularly favour the use of tax certificates which could be purchased over a period of years and which could be used to pay CTT without themselves counting as taxable assets.

5 The capital tax review led to the raising of exemption limits rather than structural change and the Department of Industry would like to see CTT impinge less heavily on medium-sized businesses that are not big enough to get a

Stock Exchange quotation. CTT can be a real threat to the existence of such businesses and causes their owners to sell out to larger companies.

6 This is of course a matter for the Chancellor but in the meantime the Prime Minister will wish to reassure the Committee that the Government remains committed to reducing the impact of capital taxation and she will wish to remind them that a useful start was made in the 1980 Finance Act. She could also remind the Committee that the Inland Revenue are reviewing the structure of capital transfer tax and as part of this process have issued a consultative document on CTT and settlements. Further progress will of course depend upon the economic climate.

C) CORPORATION TAX SCALE

7 The Committee feel the corporation tax scale discriminates in particular against medium sized businesses.

8 Profits of up to £70,000 are taxed at 40%. The rate on the next £60,000 is quite high (up to 66%) so that by £130,000 the average rate is 52%. Complaints about this tapering may be legitimate but it would only be possible to abolish this high marginal rate by allowing all companies, or groups of companies, however large to be taxed at the lower rate on the first £70,000 of their profits. The cost to the Exchequer could well exceed £100 million and almost all the benefit would accrue to the largest companies.

D) MEASURES TO STIMULATE THE ENTREPRENEURIAL SPIRIT

9 A fundamental way of stimulating entrepreneurial spirit is by providing increased incentives and rewards for those who are potentially willing to take the plunge. The Government recognised this by introducing income tax changes in their first (1979) budget and with the Venture Capital Scheme in the last budget. A further significant incentive could be provided by an "Aunt Agatha"/"Mr Go-Getter" scheme which would allow tax relief for equity investment in small businesses if the Chancellor decides to include this measure in his budget. The Committee strongly favour this measure which they would wish to see combined with legislation to allow small companies to purchase their own shares.

10 Further consideration is also being given to tax relief for small business investment companies (SBICs). A loan guarantee scheme would also play a part in encouraging aspiring entrepreneurs to start up in business. So to a lesser extent will the Government's policy of reducing the legislative and other burdens which tend to inhibit the start up and growth of small businesses.

11 The Smaller Businesses Committee may also want to make a bid to increase the entrepreneurial spirit by seeking a higher profile for the Government's policy for small firms. Both John Loveridge and John Page have introduced Private Members' Bills on the subject.

12 Mr Loveridge's Bill in effect publicises a list of measures which the Committee feels would benefit the smaller firms sector.

13 Mr Page's Bill is now due for Second Reading on 6 March; L Committee has agreed that it should be blocked. The Bill's title calls for the appointment under the Secretary of State for Industry of a Minister of State with responsibility for small businesses and for changes to the Development Commission. The theme of the Bill is one of a number that abound for raising the profile of the small business cause through changes in the machinery of Government. The Prime Minister turned down a variant of Mr Page's proposal in her letter of 13 January.

14 The Secretary of State is also considering other means of stimulating entrepreneurs including the possibility of using a roving ambassador to tour the Universities in an attempt to harness new talent. A further idea being worked on is the possibility of extending the Small Firms Counselling Service to provide more sophisticated advice to new technology firms and entrepreneurs wishing to start them.

15 The Prime Minister has herself held receptions for entrepreneurs and inventors, and a second reception for entrepreneurs will take place shortly. Mr MacGregor, following discussions with the Chancellor, is looking urgently at ways in which measures already taken to boost enterprise can be better publicised.

OTHER TOPICS

16 The Committee have raised a number of topics with Ministers besides those listed in their letter:

a) They ask that the advisory organisations helping small businesses should be better co-ordinated. Ministers are considering how this idea could be pursued, but the Prime Minister will recall that the importance of "multi-sourcing" of advice was emphasised at her meeting with inventors.

b) The Committee have complained to Mr Prior and Sir Keith Joseph that vast sums of money have gone to Manpower Services Commission programmes, including the Community Enterprise Programme. They believe that more real jobs would be created if these funds were diverted to the small business sector.

c) The Committee have continued to express dissatisfaction about the proposal that employers should be responsible for sick pay. They met Mr Jenkin on 4 February to discuss this.

HS

5 February 1981

The Prime Minister has today received the enclosed letter from John Loveridge, M.P. As it is relevant to your Minister's meeting on Tuesday 10 February at 1630 I thought it might give you some assistance with the briefing material you will be supplying.

M.A. PATTISON

– Not me, surely?

Caroline Stephens.

MAP

A.C.S. Willis, Esq.,
Department of Industry.

LB

10 DOWNING STREET

MR. PATTISON

I think you should attend the meeting of the Smaller Businesses Committee next Tuesday 10 February at 1630 in the Prime Minister's room at the House of Commons. It is all Members of Parliament but you will see from the file that the meeting is going to cover some important Government topics.

5 February 1981

SMALLER BUSINESS COMMITTEE

Chairman: John Loveridge, M.P.
Vice-Chairman: Richard Page, M.P.
Vice-Chairman: Graham Bright, M.P.
Secretary: Michael Colvin, M.P.

HOUSE OF COMMONS
LONDON SWIA OAA

5th February, 1981

Dear Prime Minister,

A CONSERVATIVE STRATEGY FOR EMPLOYMENT

Our Government has done much to bring about national good housekeeping which has resulted in a strong balance of payments, a strong pound, reduced inflation and sustained exports. Last year's budget provided a welcome first step towards such a strategy. The next step is to fill the nation's cupboard with prosperous independent businesses.

The Officers of the Smaller Businesses Committee and Mr. Grylls are very glad to be coming to talk with you. What we want is very simple. It is to persuade you that the small and medium business sector can, if supported, provide a Conservative strategy for employment.

We believe the small and medium sized sectors are the main area from which jobs can come. They will only come if the Government gives priority to this.

On 7th December, 1979, I mentioned to you the dangers of "falling company liquidity." A large number of firms have now borrowed extensively to see them through the recession and this burden of debt will make it difficult for them to find money for future expansion.

We urgently need:

1. A Loan Guarantee Scheme designed to grow on a substantial scale. (As you know, the scheme we have advocated is self-financing.)

2. Investment in small trading businesses should be able to be set against individual taxation.

3. Independent medium sized firms should be encouraged to grow and therefore Capital taxes should be cut by at least half in their real effect.

4. Machinery to inspire small business effort is inadequate. The one effective part covers only a minute fraction of the small business sector and that is the Ministry of Agriculture. By far the greater part of small business is relegated to a small unit forming part of the responsibilities of a Junior Minister at the Department of Industry. We need to co-ordinate the activities of management and scientific consultants who can help to encourage the proper take up of the Loan Guarantee Scheme.

Outside Government we recommend an agency to cover both towns and country. This could incorporate Cosira which although very small provides a useful structure to build on.

It is difficult to find comparative statistics but some have recently been made available by the Economists Advisory Group Limited and these are mainly used in this letter.

The Wilson Committee figures show that there were only some 2,865 businesses with 100-199 staff in our manufacturing sector. This small number has a ring of death about it. In Japan success has partly depended on the scale of their small business sector. In manufacturing, for example, firms with under 200 staff employ 66% of those working in this sector. In Britain the figure is only 29%. The Government should aim to increase the number of businesses by some hundreds of thousands and should encourage existing businesses (1.3 million) to expand. In particular independent medium sized firms deserve encouragement. These firms are the most likely to turn scientific invention into practical production. Small firms have not the capital to achieve this in most cases and large firms are often more interested in their long production lines.

In West Germany I understand that bank advances to small businesses, of under 200 staff, are greater than all advances to business and government put together in this country. In Japan the discrepancy is even wider in loans outstanding to small business. They were said, in March 1979, to total £185 billion which is more than half of all business loans there. At the end of 1978, U.K. bank advances to all business were estimated at £38 billion of which independent small firms had only a limited share.

It is not the large firms with paid directors that are likely to prove the pace-setters of the future. This can come from small independent firms; but only if running such firms is made to pay better, and if educated men are encouraged to become entrepreneurs rather than to join large firms with their eyes set on a distant pension.

I know that the root of this argument is dear to your heart. We must find a Conservative way to success.

I enclose a copy of the Small Firms Expansion (Inquiry) Bill which sets out a list of 50 matters which require action from Government, together with a copy of my speech on the debate on the Wilson Reports, in both of which I have underlined some key aspects.

Our country has only half as many small businesses per head of population as Japan, and has a lower proportion than any of the seven countries studied by the Economists Advisory Group. In spite of our oil I do not believe that we can achieve the impetus required for Britain to overtake our competitors abroad without the most urgent action by the Government to stimulate independent businesses.

The cost of our programme is likely to be small compared to the outlay of money to "lame ducks" but it is no use going about such a programme on a piecemeal basis. This is probably the last year before the next election when it is possible to establish a successful Conservative strategy for employment.

Yours ever,

John

MG

Econ PA.

10 DOWNING STREET

From the Private Secretary

MR. WRIGHT
CABINET OFFICE

The Prime Minister has read your letter of 26 January and Sir Charles Villiers's report on Small Business and Regional and Local Policy. She was grateful for your summary of Sir Charles's discussion with Sir Robert Armstrong.

TPL

KRB

3 February 1981

8, Dowells Gardens
Wordsley
West Midlands DY8 5QA
Kingswinford 77549

0384 277549

1st February 1981

Dear Prime Minister,

First let me say, as one of the 2.5 million un-employed, I fully support your overall economic objectives. However, your policy has certain glaring defects and I doubt that your party and the 'establishment' have the guts and motivation to carry it to a successful conclusion. Past experience indicates that economic sanity is political suicide - the present opposition as a government is un-thinkable.

We both agree the salvation of this Country is in small businesses - let me give you an example of the situation in one small company I came across in a personal job creation venture.

The company employs 14 people including the owner who works about 90 hours a week; the company overdraft is guaranteed by his house. Due to lack of financial expertise and capital they are technically insolvent. A strong order book, based largely on the 'Metro' which has caused a 'turnover' explosion leading to their liquidity crisis is compounded by one or two other problems.

If they survive February they will employ a further 4 full time and 6 part time workers. An equity injection of £40,000 would create a further 19 full time vacancies. (Beats funding Nissan!) Any investment is strictly not for widows and orphans!

What they need is a financial entrepreneur to get them over their immediate crisis and put the firm on a solid footing, this will take about 6 months. At current market rates the cost is around £10,000. They can really afford only £1,500.

I have offered a 'package' to save the company within the owner's resources so the immediate employment creation prospects may rise to 5 full time and 6 part time!

Now it occured to me some time ago that there must be hundreds of small companies with similar problems. There are thousands of un-employed executives, many with the skills and experience to save them, safeguarding existing employees and perhaps creating small numbers of additional vacancies. But how to bring both parties together?

............/cont.

So I had a quick chat with the local CBI and Chamber of Commerce about sponsoring such a scheme. Neither was interested. Then I talked to the Manpower Services Commission about funding. They advised such a scheme would cut across the responsibilities of 3 ministries, consequently it was not worth pursueing!

Next I asked about funding for adult job creation programmes and was told it was only available for 'community projects'. These by their very nature tend to be inflationary.

The type of small company assistance programme I envisage could be an extension of the Small Business Advisory Service who have never been able to provide suitable advice when I have consulted them! The additional administration cost would be marginal provided the 'bureaucracy' does not get too involved. In fact, rough costings show the operation to be self supporting at a comparatively low level of activity.

Do you like the sound of this? Could you use it to get the TUC, CBI, Institute of Directors, Association of Independent Businesses and the various other pressure groups 'off your back'?

Wouldn't you like to cut some 'red tape' and make a positive step towards reducing the socially and economically indefensible waste of human resources?

Yours faithfully,

P. J de M. Rudolf.

The Prime Minister,
10, Downing Street,
London.

Tim

30 January 1981

The Prime Minister is now going to meet Michael Colvin and the officers of the Smaller Businesses Committee at 1630 on Tuesday, 10 February in her room at the House. We will require a full brief relevant to my letter of 7 January to Ian Ellison, to reach us by close of play on Friday, 6 February.

CAROLINE STEPHENS

A.C.S. Willis, Esq.,
Department of Industry.

DBG

Jw

30 January 1981

This is just to confirm that the new time for your meeting with the Prime Minister, together with the other officers of the Smaller Businesses Committee, is at 1630 on Tuesday, 10 February in her room at the House. John MacGregor will be attending.

CAROLINE STEPHENS

Michael Colvin, Esq., M.P.

DSG

Econ Pol 4

Prime Minister

To glance.

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

TL 28/1

Ref: A04085

26th January 1981

Dear Tim,

MB

Sir Charles Villiers: Small Business and Regional Development

Sir Charles Villiers called at his own request on Sir Robert Armstrong on Thursday 22nd January to discuss with him certain aspects of the report on small business and regional development which he had submitted to Lord Thorneycroft. I enclose a copy of this report in case you have not already seen it.

Sir Charles explained that he had been in touch with a wide cross-section of interested parties in preparing this report: businessmen, bankers, members of the Government and senior civil servants. He believed very strongly in the advantages for the development of small businesses in Britain of the introduction of a "subordinated loan scheme" which would be issued through the Scottish and Welsh Development Agencies and through a newly-established agency in England. The principal advantage which he saw for such a subordinated loan scheme was the special treatment it would provide for repayment at a differential rate of interest: the first three to five years would be a "holiday period" with the rate rising to the normal commercial going-rate later in the life of the loan.

In examining this subordinated loan scheme, he had paid particular attention to the current arrangements in France. There was no doubt of the great importance which the French Government attached to encouraging the development of small businesses. They realised that the problems facing the Western industrialised economies were such that unless new, young and vigorous enterprises could be built up rapidly in the immediate future, it would be impossible to avert major industrial and economic crisis. The importance accorded to small business policy in France was demonstrated by the role which the French Prime Minister, Monsieur Barre, himself played in overseeing industrial development activities. In this particular context, Sir Charles Villiers thought that Britain could learn a great deal from the experience of the French Delegation à l'Aménagement du Territoire et à l'Action Regionale (DATAR) and its role in promoting business expansion.

/This

T.P. Lankester, Esq

This was the sort of Development Agency which he had in mind for England to provide the same driving force as that which could exist in Wales and Scotland through their respective Development Agencies. In France, the Head of DATAR, who was a civil servant, had direct access to the Prime Minister and therefore his views and advice carried considerable political weight.

In addition, Sir Charles Villiers thought that the British Government's approach to small businesses could be assisted by two other charges. In the first place, a Minister of State should be made responsible for small businesses and should be readily identified as "Mr. Small Business". Someone with considerable Parliamentary and political stature was needed for this role. He should have close and direct access to the Prime Minister. This led on to his second suggestion, namely that the Minister responsible for small businesses should also have behind him a high-level Committee, chaired by the Prime Minister and linked into the Cabinet Committee structure, which would meet several times a year to ensure that the right level of support and encouragement was being given to small business development.

Sir Robert Armstrong took note of Sir Charles Villiers's points. He commented that the approach of DATAR in France implied a degree of Government intervention in industrial and business affairs which might not necessarily accord with the present British Government's views. He also said that Sir Charles Villiers need have no doubt about the importance which the Prime Minister herself, like Monsieur Barre, attached to small businesses and their role in Britain's industrial regeneration. As a demonstration of the importance which she attached to creating the right climate for small business development, the Prime Minister had paid particular attention to the work of the Parliamentary Under-Secretary of State in the Department of Industry responsible for small businesses, Mr. David Mitchell. Although Mr. Mitchell had left the Department of Industry in the recent Government changes, Sir Robert had no doubt at all that the same importance would be attached to the work of his successor. Although the Minister responsible for small businesses in the Department of Industry was not a Minister of State, and this might therefore limit industry's and the public's awareness of his role, there could be no doubt within Government of the role of the Minister in question and of the support which he had from the Prime Minister. Sir Robert undertook, however, to inform the Prime Minister of the points which Sir Charles Villiers had put to him.

I am sending copies of this letter to Ian Ellison, John Neve and Anne Mueller in the Department of Industry and to Jonathan Taylor (Treasury).

Yours ever,

David.

(D.J. Wright)

To: Lord Thorneycroft, CH
From: Sir Charles Villiers, MC

16 December 1980

Small Business and Regional and Local Policy

We live in the shadow of a persistent cloud of unemployment as our industries and services adapt and, where it has not already happened, start again. This is taking over from inflation as top priority. The losses and bitterness of the thirties, when you and I first went to work, are not yet present, but they are not far off.

You asked me to set down the principal points for small business development based on my experience, especially with BSC (Industry) and on talks with others engaged in the regional and small business (up to 500 employees) aspects of job creation. I have done this widely in the UK and have started to investigate in U.S.A., France, Eire and the European Commission in Brussels. I have had useful talks with those connected with your office, as you suggested.

I shall have to go over some of the ground again, but I believe you would rather have 80% now than more later. I have made it short and in general terms, leaving the experts to translate the intentions into their several professional languages. I find regional and local / small business problems two sides of the same coin and have treated them together. I have not covered big business or inward investment, vital elements, because they are different problems, constantly surveyed by others.

The further development of small businesses will not instantly disperse unemployment, nor quickly recreate the national wealth, nor forthwith solve the structural problems of the Trade Unions, but it will do much in each of these areas.

The French President has recently said that 58% of the turnover of all French business comes from firms employing 500 people or less. A recent MIT report found that 66% of new jobs in the USA arose in firms employing less than 20 people. It is currently clearly observable that bigger companies, geared to higher output are shedding labour and are likely to employ fewer people than before, when demand and production rise again.

I do believe that small businesses, as part of regional activity, make a big contribution to the early rebuilding of our country and that more can now be done to speed that process. A very great deal has already been done by the present Government in a detailed way. My rather wider proposals are attached.

MEMORANDUM

To: Lord Thorneycroft
From: Sir Charles Villiers 16th December 1980

Proposals for extending the activities of small businesses, employing up to 500 people, as part of regional and local development.

Problems 2. The chief obstacle to such extension is lack of entrepreneurs willing and able to shoulder the effort and risk involved. Many more would come forward, to list only six items, if:-

(a) More long term capital was available.

(b) Capital was cheaper.

(c) Interest was lower and repayment could be postponed during the early years of investment programmes.

(d) There was total tax exemption on "ploughed back" profits during an initial period.

(e) New investment could be depreciated as a charge before tax.

(f) The extension of small business activity was seen to be a national objective with a structure, both central, regional and local capable of supporting it.

Capital 3. There are many current schemes for providing loan capital all of which should be pursued, including the Government guaranteed Loan Scheme. I believe that the European "prêt participative" adds a new dimension to meet the problems a, b and c above. A full description of the French version is available; an outline is at Appendix 1.

(a) The purpose is to support companies employing 500 people or less to develop new products, markets and techniques and to create new jobs, particularly in the high unemployment regions.

(b) The method is to subordinate this 15 to 20 year Government loan to rank after all other creditors, bringing it alongside ordinary shareholders in a company. In this way borrowing powers are increased, creditors comforted and financial structures which are overloaded with debt can be rebalanced. In addition there is a repayment "holiday" and interest rate reduction in the first 3 to 5 years of investment programmes. Interest is geared to results with a maximum and minimum rate. The minimum rate is the "holiday" period rate for companies in loss; the maximum rate is the rate required to give the Credit National its normal "going rate" over the life of the loan. Funds are provided by the Credit National,

which has access/...

which has access to state funds and can raise money from the public. There is no provision for conversion of these loans into equity, but the rate of dividend cannot exceed the rate of interest paid on the loan while it remains outstanding. Loans can be applied for at branches of the Credit National, which are in all the main industrial centres in France. Last year, the first full year, £35m of such loans were made.

4. If such a scheme was adopted in the U.K., it could be known as the "subordinated loan scheme" with loans issued regionally by the Welsh and Scottish Development Agencies and another agency (see later) in respect of England, out of their existing financial allocations. It would therefore not require additional financial provision, but it would not replace existing grant schemes. The subordinated loan, which is not intended as a subsidy, but as a financial instrument in its own right, raises some important points:

   (a) It constitutes a Cumulative Redeemable Preference share, which has been widely used in the past in capital structures, but in the now proposed form its remuneration would be a charge before tax.

   (b) It would offer some competition to banks and other City institutions in their growing plans for capital investment in small firms, which should not be discouraged. It would therefore be advisable to confine the use of subordinated loans to development areas and to say not more than 50% of the financing of any investment programme.

   (c) It would be very desirable to include I.C.F.C. in the distribution of subordinated loans as part of the financial package which they might chose to put together for their customers' programmes.

   (d) Private Sector financial institutions should be strongly pressed not only to lend on the security of subordinated loans, but also to issue similar instruments themselves.

/...

(e) County and Local Councils in development areas should be encouraged to form Business Advisory Committees to help them in applying for subordinated loans for use in the development of small businesses in their localities.

(f) Agencies issuing subordinated loans would be expected to follow up the loans with a view to fixing the appropriate rate of interest after the "holiday" period and trying to ensure that the loan would at maturity be repaid.

(g) Subordinated loans could be linked to new employment. This is not a requirement in Europe and has obvious difficulties but negotiators could be instructed to get employment commitment from borrowers.

<u>Agency</u>

5. The Report of the Wilson Committee on the Functioning of Financial Insitutions refers to "the difficulty in meeting the demands of small and especially new, firms ... and in financing investment involving an unusually high degree of risk, particularly where there is a lengthy period before positive returns can be expected to accrue". The Committee was divided on the question of a new investment facility, it was however united on the need for an "<u>English Development Agency</u>" directed particularly towards small firms "to supplement the Scottish and Welsh Development Agencies". The proposals of the "Cork minority" (paras 991 to 998) are also relevant.

6. Bodies such as the Development Commission, N.E.B., N.R.D.C. and the Small Firms Division of the Department of Industry have between them most of the capabilities required for an English Development Agency, which would be capable of issuing and monitoring subordinated loans and of many other functions. I have heard many views expressed on

the composition/...

the composition of an E.D.A. and there is some concensus on the criteria:-

(a) It must have a strong local as well as regional base.

(b) It would need a powerful private sector input in the selection of support-worthy schemes, in the speedy negotiation of them and in regular follow-up advice, by experienced businessmen sitting in with borrowers in their offices on request.

7. The formation of an English Development Agency along the above lines has a lot of support. The composition is so much a matter of the machinery of Government that I stop short at that point ... where angels fear to tread!

Taxation

8. The June 1979 Budget and the "enterprise package" in the 1980 Budget made notable progress in help for small firms and in measures to encourage investment in them. Nevertheless, there remain serious deterrents to entrepreneurs and investors in small businesses. Two points have constantly recurred in my investigation:-

(a) Recent concessions make it possible for new small firms to avoid tax under most circumstances for the first five years of their operation. This does, however, depend on expert counselling, which is not always obtained. My proposal is:- A clear statement that no tax will be payable by new small firms on profits retained in the business for the first five years. It would be for the proprietor to decide whether he took profits out and paid tax on them, or left them in the business tax free. There would be small loss to the Revenue and a big gain in confidence to continue a firm's growth.

(b) The 1980 Budget permits losses on disposal of shares in unquoted trading companies to be set against income rather than capital gains. So far so good, but what is needed is a reward for success, after all there are concessions for house mortgages, and life assurance and donations to charity, art and sport. My proposal is:- Investors in small business would be entitled to depreciate new unquoted investments by setting against income before tax, say, 25% of that investment in the first year and lesser amounts in following years so that the whole amount could be written down over, say, 7 years. This, if it

could be/...

could be clearly defined and stated, would prove a powerful incentive to new investment in small businesses by both individuals and institutions. There clearly would be loss to the Revenue in this case, but in exchange for investment, which remains a national priority.

Leadership

9. Unless small business as a regional and local activity becomes a recognised national objective the present favourable movement in the UK could get lost. There is a useful Government organisation in Paris called DATAR (Delegation a l'Amenagement du Territoire et a l'action regionale) which co-ordinates, but does not centralise all regional funds and development and acts as Secretariat to meetings of all concerned. It is chaired quarterly by the Prime Minister who signs the Annual Report, which shows 64,000 job opportunities created by regional aids in the development areas of France in 1979. Co-ordination and leadership is very often raised in the UK as a desirable objective for the following purposes:-

(a) To provide a reference point for:-

(i) Central and Local Government and Regional bodies.
(ii) The 38 Development Associations and authorities throughout the U.K.
(iii) Over 20 voluntary organisations and trusts working in this field.
(iv) Small Business Clubs and Chambers of Commerce.
(v) Specialised departments of Technical Colleges.
(vi) Banks, Trusts and other funds seeking financial business.

(b) To conduct a nationwide campaign on a regional and local basis for the extension of small business, setting out clearly and simply the motivation, the need, the aids, the facts, the results and where to go for information and counselling.

(c) To press for still further reliefs for small businesses (I have a list as long as your arm) and fight for them with the Departments.

(d) To ensure that the movement in favour of small business is fuelled by professional advice by other businessmen to small firms in need of help by visiting them on site and on request. This is a key point.

10. This movement chimes precisely in tune and time with Government objectives and is widely thought to deserve the overt support of the Prime Minister. This might be achieved by the appointment of a Minister of State at the Department of Industry enjoying the full support of the Secretary of State and that important and experienced department. He could also be linked closely to the Prime Minister's Office as responsible not only for

small businesses/...

small businesses but also for the co-ordination of regional development. Thus he would draw inspiration and authority from two sources in the detailed agenda and planning of meetings, the setting of policies, reporting of progress, removal of bottlenecks and the solution of inter institutional problems. He must, of course, be a good politician and have wide support in Whitehall, but he should also have strong professional and business aid in dealing with business matters. As I have said earlier, regional and small business are different sides of the same coin: it is a valuable coin to be handled and cared for preciously.

Conclusion

11. This paper proposes:-

* The adoption of the subordinated loan system for the development areas and also the Government Guaranteed Loan Scheme.
* The establishment of an English Development Agency.
* Tax relief on retained profits during the first, five years of a new small business.
* Depreciation of new investment in small businesses over say 7 years, as a charge on income before tax.
* The appointment of a Minister of State, Department of Industry, responsible for propagating small business, linked to the Prime Minister's office for the co-ordination of regional and local development.

12. These proposals hang together or hang separately. What is essential is that any action is:

* Clear and simple.
* Conveys personal benefit to entrepreneurs.
* Is administered largely by active businessmen.
* Is supported by the Banks and other financial institutions.
* Is professionally followed up on site.

and * Is seen to be part of purpose at the top.

Sir Charles Villiers
BSC (Industry) Limited

16th December 1980

APPENDIX I

Notes on the French Government Participative Loan Scheme

1. **Purpose:** To * increase borrowing powers and comfort creditors
   * rebalance financial structures overloaded with debt
   * provide an amortisation holiday and ease the interest burden for an initial period after investment
   * gear interest to results within maximum and minimum rates
   * finance "implantation" investments overseas.

2. **Availability:** To industrial and commercial companies whose annual turnover does not exceed £35m (sic) and whose employees do not exceed 500, by application to branches of the Credit National.

3. **Maturity:** Loans are issued with a minimum life of 15 years and a maximum of 20 years.

4. **Status:** Loans rank after all other creditors with, ordinary shares, but have no votes. In fact participative loans have the status of non-voting preference shares.

5. **Repayment:**
   1. By equal annual installments after an initial "holiday" of five years for loans in development areas and three years elsewhere.

   or

   2. By anticipated redemption, provided an equal amount is subscribed ranking after all creditors.

6. **Security:** Nil

7. **Rate of Interest:**
   1. During amortisation holiday a rate below the going rate; (4% in development areas, and 8% elsewhere)
   2. After the holiday a higher rate calculated to produce the normal rate for Credit National loans over the whole life of the loan.
   3. Modification of (2) if the borrower is in loss, but not below the holiday period rate.

8. **Dividends:** To be at no higher rate than that paid on the participative loan.

9. **Other loans:** To ensure that participative loans are fully effective it is considered essential that other lenders will give to them the role of "own funds" or capital, which the legislation intends. The nature of the participative loan and the risks it carries justify this special treatment.

Sir Charles Villiers
BSC (Industry) Limited

16th December 1980

cc Domestic Monetary Policy Pt 7 SECRET Econ Pol

PRIME MINISTER

Meeting with the Chancellor: 1730, Wednesday, 14 January

There are two things which you might like to discuss:-

DMP Pt 7 I The attached progress report, which you had asked for on monetary control.

II The Italian scheme of tax relief for non-quoted companies (see Flag A).

The Treasury tell me that they and the Bank are practically "home and dry" on the proposed swap arrangement with the Americans. They have established that there are no bugs in it from our point of view; the only outstanding point as of 7.30 this evening which - amazingly enough - the Americans have not clearly thought about - is whether they have powers to ship the gold to us. But it is thought that they have.

The Chancellor may also want to have a word about the press treatment of your interview yesterday. I have told him that you were misrepresented, and he accepts this. But I think he will want to suggest that, from now on, we should all go into absolute purdah on the Budget. (He has recently reviewed what happened last year, and has concluded that there should be no attempt this year to anticipate the Budget by any calculated leaks.)

D.J.S. Collings
for T. Lankester

13 January, 1981.

SECRET

FROM: THE RT HON MICHAEL JOPLING MP

Prime Minister

MS

Government Chief Whip

12 Downing Street, London SW1

SIR KEITH JOSEPH PRIVATE AND CONFIDENTIAL

I understand the Prime Minister is meeting the Party Small Businesses Committee on 3 February. I understand they are anxious that the move of David Mitchell from the Department of Industry will not be seen as a blow to the small business interests. You will remember I spoke to you last week about the importance of the appointment of one of your Ministerial team to look after this topic, not ruling out one of the Ministers of State of looking after it.

I am copying this to the Prime Minister.

13 January 1981

Econ Pol.

10 DOWNING STREET

8 January 1981

The Rt Hon Sir Keith Joseph Bt MP
Secretary of State for Industry
Ashdown House
123 Victoria Street
LONDON SW1

Dear Keith,

SMALL BUSINESSES

Bill Poeton of UIC rang me to say that he was concerned about David Mitchell's move. He had been under pressure to go on radio etc to moan and groan that the Government were only paying lip service to small businesses and that the Minister was now up-to-date with all the proposals in this area which had been moved. We agreed that he would not say any such thing and that, if he was asked to comment, he would say that he understood from his contacts with the Government that there was no question of the Government assigning a lower importance to this crucial area. As you know, Bill Poeton is a very robust supporter, and he will certainly not try to cause any trouble for its own sake. He is, however, concerned about David's move at this particular point, and will no doubt be coming to you for reassurance that everything will be done to maintain momentum.

I am copying this letter to the Prime Minister.

Yours ever,

John

JOHN HOSKYNS

H8

BF 30/1/81

Mr. Colvin & Cons. Smaller Businesses Cttee

10 DOWNING STREET

From the Private Secretary

7 January 1981

On Tuesday 3 February at 1600 in her room in the House the Prime Minister is meeting Michael Colvin and the officers of the Smaller Businesses Committee. Topics to be discussed are:

(a) A Loan Guarantee Scheme, which they suggest can be implemented without any cost to Government.

(b) The reform of Capital Taxation, which at present forms a sharp deterrent to medium sized businesses.

(c) Alterations to the scale of Corporation Tax, which hits medium sized Companies unfairly.

(d) Measures to stimulate the entrepreneural spirit in well-educated people, thereby achieving an improvement in the rate of the start-up of new firms.

We will require a brief to reach this office by close of play on Friday 30 January. We would also like the new Minister in charge of smaller businesses to be present, so after he has been nominated would you kindly let him know of this engagement.

CS

I.K.C. Ellison, Esq.,
Department of Industry.

Caroline Stephens

2nd January, 1981

Thank you very much for your letter of 22nd December.

I would, of course, be pleased to see you and the Officers of our Smaller Businesses Committee.

I have asked Caroline Stephens to arrange a meeting at the end of this month or early in February, and she will be in touch with you about this.

I am very glad to know that you will be seeing Geoffrey, Keith and Jim.

Michael Colvin, Esq. M.P.
House of Commons,
Westminster, London SW1

R H

Econ Pol

30 December, 1980

BF for next Ch/Ex mtg. 13.1.81

The Prime Minister has read your letter of 22 December about the idea of tax relief for unquoted companies, which had arisen in her discussions with Signor Forlani. She has noted that the Treasury do not seem to think that anything on the lines of the Italian scheme are possible, but she would like to discuss the matter further with the Chancellor.

I suggest that they do this at their next regular weekly meeting.

T. P. LANKESTER

R I Tolkien, Esq
HM Treasury

SP.

Finance For Industry Limited
91 Waterloo Road, London SE1 8XP Telephone: 01-928 7822

1

Chairman

(1) £ million fund new jobs each month.

(2) Trade figures - far better than forecast Exports.

(3)

29th December 1980

Prime Minister
Some good material for your broadcasts on ICFC. Note in particular side-lined passages on pps 2-4 and 7.

TL 30/12

T.P. Lankester, Esq.,
Private Secretary to the Prime Minister,
Prime Minister's Office,
10 Downing Street,
London, SW1.

Dear Mr Lankester

Industrial and Commercial Finance Corporation

Herewith, as promised, some notes on ICFC, a subsidiary company of Finance for Industry Limited (FFI), of which I enclose the latest Annual Report, together with an ICFC booklet - "How we help Private Enterprise".

We are greatly encouraged in the current recession by the continuing flow of proposals for investment put to ICFC which is greater than last year, although it is taking rather longer to complete the agreements, partly owing to expectations of a further fall in interest rates.

In the attached notes I would draw particular attention to the increasing investment in "startups", including brand new companies, to our growing investment in the high technology area, with its high financial risks, and to the increasing number of "management buyouts" which ICFC has pioneered.

As I am sure you are aware, FFI is a private-sector financial institution - a "licensed deposit taker" under the Banking Act. We do not receive any subsidy, although we administer one or two Government schemes. We carry all our own financial risks and in this connection we are very pleased to see the relatively low rate of bankruptcies amongst the companies in which we are invested in spite of the current recession: this is also referred to in the attached notes.

(continued)

I hope this gives you the information you want, but if you need any further information, please telephone my secretary at the above address.

Yours sincerely

Caldecote

Viscount Caldecote

NOTES FOR PRIME MINISTER'S OFFICE ON ICFC

A. BACKGROUND

1. ICFC is a private enterprise source of long term risk finance and advice for small and medium sized businesses in the UK. It is part of the Finance For Industry group which is 85% owned by the English and Scottish clearing banks and 15% by the Bank of England. In 1979/80 ICFC contributed a substantial proportion of the profits of £28M made by its parent company Finance for Industry Ltd.

2. ICFC provides amounts of £5,000 to £2 million. The average size of investment is £100,000. Half of all investments are for amounts of less than £50,000.

3. ICFC has £350 million invested in 3,250 private businesses over the whole range of British industry. These firms employ around 300,000 people.

   Industrial sectors financed by ICFC in the year ended 31st March 1980 were:-

	£M
Agriculture, Mining and Construction	11.6
Engineering and Metal Goods	25.6
Other Manufacturing	28.0
Distribution and Services	39.3
	104.5

4. There are 18 area offices situated in the major towns. Local managers make over 60% of all investment decisions. The staff are highly qualified and especially trained in an understanding of industry. They come from a wide range of disciplines including science and engineering as well as law and accountancy.

5. There is also a strong team of Management Advisers, including those experienced in engineering, accounting, marketing, production and property, who play an important role in assessing potential investments. Many competitors are now established in the venture capital market but none has the support of such an experienced team of advisers.

6. The finance is provided for:

   a) People who want to start up in business.

   b) Businesses which need money for new buildings, plant or working capital or to fund an acquisition.

c) Shareholders who wish to sell a minority equity stake.

d) Managers who have the opportunity to buy control of their division or company but have little cash of their own.

7. 55% of all investment in the current year carried an element of risk. Where there is substantial risk ICFC looks for a minority stake in the customer's equity. Personal guarantees are never sought. Where loan capital is provided it is at fixed interest rates for periods of between 10 and 20 years.

8. The vast majority of the money which ICFC invests is obtained from the private financial sector at market rates. It also obtains funds from ECSC at special rates which is lent, with ICFC taking the financial risk, to companies in areas where steel and coal production has declined.

9. ICFC does not usually interfere in the management of the companies in which it invests but stands ready to help and advise them when needed. To assist in this ICFC has a management consultancy service, which operates on a commercial profit making basis.

B. THE RECENT GROWTH

1. Numbers and amounts of investments

The last three years have seen remarkable growth in terms of numbers of customers and amounts of investment. Numbers of staff have grown more slowly; productivity has trebled.

	Nos of Business Financed	Amounts Advanced
Year to 31st March 1978	518	£ 50.0M
1978/79	733	£ 67.5M
1979/80	920	£104.5M
1980/81 - 8 months	634	£ 61.0M

In the current year approximately the same amount of money will be provided as last year but the number of businesses helped will be higher. There will be a slight fall in capital investment by more substantial companies and a sharp rise in the numbers of new businesses starting up, young businesses expanding and management teams splitting off from larger groups to trade independently under own management.

There are three main areas of growth - startups, technology and management buy outs:

2. Startups

ICFC defines startups as either brand new ventures or businesses trading for less than three years.

The number of startups and amounts involved in recent years are:

	No.	Amount
1977/78	88	N/K
1978/79	112	£ 4.8M
1979/80	309	£21.0M (of which 146 (£8.2M) were brand new ventures)
1980/81 (6 months)	200	£14.0M (of which 115 were brand new)
1980/81 (estimated full year)	400	£28.0M

Startups are often one man businesses spinning off from larger companies with ideas or products which are not being fully exploited. The startup manager often is design, market or product/production orientated. He has to learn financial management the hard way and leans heavily on people like ICFC for advice.

3. Technology

The exploitation of new ideas and products is often undertaken by very small businesses.

This is an area of very high financial risk particularly where there is innovation. ICFC invests in high technology companies; where there is clear innovation the investment is made through a wholly owned subsidiary Technical Development Capital Ltd (TDC).

TDC's business is growing substantially:

	No.	Amount
1978/79	37	£2.7M
1979/80	48	£5.5M
1980 - 7 months	44	£5.8M

Earlier this year it was decided to strengthen TDC's ability to finance larger innovations where TDC staff involvement would be essential. A technologist/venture capitalist was recruited from California and now heads a specialist team which in a few months has made four investments with a total value of £3 million. He is a British citizen who went to work in California during the period of very high personal taxation in the UK.

Areas of innovation include:

- Micro-Winchester disc drives.
- Bio-technology.
- Photo typesetting.
- Computer based security systems.

TDC made a major contribution to the Spinks paper on "Exploiting Innovation" produced for the Cabinet Office.

4. Management Buy Outs

(a) Background

This is one of the fastest growing areas of ICFC's current operations. Financial institutions have for many years been able to help managers to buy control of the companies for which they work but such schemes have been relatively rare in practice. Until 1978 ICFC completed four or five such investments each year. Since then ICFC has pioneered the development of new ways of financing these propositions and has marketed these aggressively and popularised the idea to such an extent that other institutions have now been set up which specialise in the area .

ICFC's growth in this area has been remarkable.

	No.	Amount
1977/78	10	N/K
1978/79	20	£ 3.2M
1979/80	49	£11.6M
1980/81 (6 months)	29	£ 6.3M
1980/81 (estimated)	70	£16.0M

(b) How do buy outs arise?

There are two basic ways in which they happen:

(i) An overseas or UK parent decides to sell or close down a UK division because:

a) the particular activity no longer fits in with strategic plans,
b) the division is losing money or is not profitable enough,
c) an acquisition is found to contain unwanted elements,
d) the parent needs to raise cash.

(ii) Private company shareholders, having built a business over many years wish to sell out completely.

In these cases the management may not wish to become part of a new group and may get the opportunity to buy.

However managers rarely have much money. Typically they will provide 10% or 20% of the funds required. ICFC provides 80% or 90% by subscribing for a minority stake in the equity and the provision of loan or preference share capital.

(c) What are the advantages?

A buy out is attractive:

(i) to the vendor because:

(i) One man's cash is as good as another's.

(ii) There will be less odium and bad PR.

(iii) Having a friendly ex-member of the group who may be a supplier or customer can be beneficial.

(iv) The management know what they are buying and there need not be a prolonged period of "hawking" the company around.

(ii) to management because:

(i) The team (rarely an individual) can run their own business with real incentives to succeed.

(ii) They will not be working for new masters.

(iii) to employees, customers and suppliers because:

(i) It takes a long time to build up reliable supplies, outlets, and an experienced work force. Closure or sale causes these complicated relationships to be destroyed which is inefficient and wasteful. Continuity is important.

(ii) Management are more committed to the running of the business.

(iii) Jobs may be saved.

(iv) to a potential investor such as ICFC, because:

(i) The management has a track record.

(ii) Skeletons in the cupboard are known about and will be declared by the management who are also investing.

(iii) New manager owners are committed and motivated. The business will be low on overheads and high on productivity.

(v) to the economy because:

(i) businesses are saved, management is motivated and evidence suggests that productivity improves.

(d) Examples of Buy Outs

Customer confidentiality is an essential part of ICFC's operations. However there has been press coverage on some of the 100 deals completed in the last two years and brief details of four examples are set out below.

(i) Truflo

The business was bought in December 1980 for £6.8 million out of Wilmot Breeden which had been taken over last year by Rockwell International of the US. ICFC led a syndicate which provided £3.5 million.

This is an example of a very large buy out and of a parent selling off unwanted parts of an acquisition. The company is based in the West Midlands, makes turbine components and ball valves and employs 650 people.

Another buy out of a Wilmot Breeden subsidiary involving £1 million of ICFC finance was completed last week.

(ii) Panache Upholstery

Sixty employees faced the loss of their jobs when A. & H. Upholstery went into liquidation earlier this year. The workers put up £60,000 of redundancy payments in October 1980 and ICFC provided £190,000. Redundancy amounts invested ranged from £500 to £2,500. Two former managers (now directors) each put in £10,000. The company makes three piece suites and expects to turnover £1.3 million in its first year.

(iii) Flexiform

In July 1980 senior management put up £90,000 as part of a package to buy their company from the receiver of the Fairbairn Lawson Group. ICFC provided £180,000, and a supplier and the company's bankers provided working capital. This example of a small buy-out had sixty employees and sales of £2 million.

(iv) Decorettes

This company was a tiny diversification by Newman Tonks, a £34 million turnover Birmingham group. The company which makes a range of transfers no longer fitted into their plans. The managers put up £100,000 and ICFC £500,000. The directors control 75% of the equity and ICFC has 25%.

C. THE RECESSION

1. It is too early to know to what extent small businesses will survive the recession. Often it is cash problems associated with the upturn that causes overtrading small firms to fail.

However our experience is that because small firms are flexible and innovative and decision making is fast they tend to react quickly to economic changes and are adept at surviving.

2. ICFC's portfolio is composed of small/medium private businesses covering every field of industry from mechanical engineering in the West Midlands to computer software firms in the South East. For the first six months of the financial year starting 1st April 1980 62 customers went into receivership or liquidation compared with 47 for the whole of the previous financial year. However in the past two months the number of receiverships and liquidations has abated to 11. Seen against a background of a fast growing portfolio and a huge increase in the financing of new ventures where "infant mortality" is high the results are encouraging.

3. Failures have generally stemmed from weaknesses indentified some time ago. There are few instances where good management has failed in the current climate.

C 29/12

RHS/WVE
29.12.80

Finance for Industry Ltd

FFI

1979/80 Seventh annual report and accounts

These accounts are delivered under the Protection of Depositors Act 1963

Finance for Industry Ltd

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Banking Act 1979

Finance for Industry Ltd is licensed to accept deposits under the Banking Act 1979

Finance for Industry Ltd

Directors and General Management

Directors

Chairman

Viscount Caldecote DSC FEng CBIM

Deputy Chairmen

L. V. D. Tindale CBE CA

Sir Eric Faulkner MBE

Directors

Dr. D. V. Atterton PhD

Sir Donald Barron CA

The Hon. John Eccles

H. J. Foulds

Sir Campbell Fraser

P. F. G. Hildesley

Sir Michael Milne-Watson CBE

Sir Francis Sandilands CBE

The Rt. Hon. Lord Seebohm TD

G. S. Stone FCA

General Management

H. J. Foulds	Group General Manager
D. R. Clarke FCA	General Manager – Finance
D. E. Marlow FCA	General Manager – ICFC
I. N. Momtchiloff OBE MIMechE	General Manager – Property
	– Shipping
	– Consultancy
L. N. G. Olsen FCA	General Manager – FCI
	– Leasing
B. L. Mann	Group Secretary

Finance for Industry Ltd

Senior Management

Industrial and Commercial Finance Corporation Ltd (ICFC)	
R. K. Hamilton CA	Director and Assistant General Manager
A. G. Martin FCA	Director and Assistant General Manager
Dr. G. R. Mathewson PhD	Director and Assistant General Manager
P. B. Mackenzie Ross CA	Director and Assistant General Manager
TDC Development Capital Ltd/TDC Developments	
G. N. Taylor	Director and Manager
ICFC Properties Ltd	
P. G. Willcock	Director and Manager
ICFC Leasing Ltd	
R. G. McIntosh CA	Manager
Hamilton Leasing Ltd	
D. S. Fielden FCA	Managing Director
N. Shapland	Managing Director (Ireland)
Highland Leasing Ltd	
E. A. Robson	Managing Director
Estate Duties Investment Trust Ltd	
R. Plant	Manager
Investment Trust and Pension Fund Management	
J. L. Evans	Manager
ICFC Corporate Finance Ltd	
N. M. Williamson	Director and Manager
Finance Corporation for Industry Ltd (FCI)	
D. H. Millard FCA	Director and Manager
Finance for Shipping Ltd (FFS)	
W. B. Kirkpatrick	Director and Manager
ICFC Consultants Ltd	
G. M. J. Richardson FCA	Managing Director
Group Services	
J. D. Driver	Group Solicitor
J. H. Stewart	Group Personnel Manager

Chairman's Statement

In this, my first Report as Chairman of FFI, I want to say how greatly I appreciated the invitation to join the Board and become its Chairman. From many years' experience in the engineering industry, I have learnt the value of innovation, and also the importance of capital investment to reduce manufacturing costs. Regrettably, but inevitably, the latter also tends to reduce employment in the short term, particularly in times of low growth. The creation and expansion of small companies is one effective way, both of encouraging innovation and of creating new employment opportunities. In this, we are playing a most constructive and valuable role and I greatly welcome the opportunity to be associated with it.

I well recognise that my predecessor, Lord Seebohm, set a high standard of chairmanship which it will be hard to maintain. He is a banker of long and wide experience and his contribution to FFI during his five years as Chairman has been immense. We are greatly in his debt and his legacy of a strong balance sheet and an enthusiastic, competent management team gives me great confidence for the future, in which I shall do my best to serve the Company as well as he has done.

We will greatly miss Lord Seebohm's wise counsel when he leaves the Board at the Annual General Meeting, but we can only sympathise with his wish for greater leisure after such a long banking career. I know that all who have worked with him throughout the Group will wish him and his wife a long and happy retirement.

Last year, Lord Seebohm referred to the difficult financial climate in which we were operating with MLR at the end of the year standing at 13%. Since then MLR has risen further to its current level of 17%, an indication of the general fragility of the economic climate which is making life even more difficult both for FFI itself and for our customers. High interest rates of themselves bring us no advantage but reflect the Government's determination to bring down inflation which has not so far been achieved. But the battle against inflation must be won, and control of the money supply is one important factor. It now seems unlikely that interest rates will fall appreciably in the near future, even though the damaging effect on industry of the present high rates continues.

Profits and Dividends

I am glad to be able to report another successful year for FFI with profits before tax increased by some 13% to a record £28.8 million. All activities of the Group contributed to these improved results which reflect not only a great deal of hard work by our staff, but also the underlying strength and enterprise of British industry, particularly amongst small, growing companies.

It is also gratifying that as a result of the successful progress of the Group under Lord Seebohm's chairmanship, the Board have decided that the time has come to pay more than a token dividend. Accordingly, the Board declared an interim dividend of 2% in November 1979 and now recommends a further 3% by way of final dividend.

ICFC

Throughout last year, ICFC maintained its leading position in the market as an investor in small and medium sized companies, thus enabling them to grow and provide new opportunities for employment. This sector is now recognised as vitally important to the economy, and there is no doubt that this Government and its predecessor have been right to place so much emphasis on the need to encourage smaller businesses.

So we warmly welcome the changes in the recent budget relating to them and to individuals willing to support them. Not only are the measures helpful in themselves, but they also serve to foster an improvement in the climate in which small businesses operate.

In the year ended March 31 1980, competition in ICFC's area of operation grew steadily, but nevertheless ICFC increased its gross investment by over 50% from £68 million in 1978/79 to £105 million. A total of 905 applications for finance were completed, which included 618 new customers. Overall ICFC's investment portfolio rose from 2,456 to 2,907 during the year, contributing to an increase of over 46% in the last three years. The average investment was £112,000 compared to £98,000 in 1978/79 and 481 investments were between our lower limit of £5,000 and £50,000. Since March 31 1980 the activity in ICFC has continued at a high level.

We give a large measure of delegated authority to our Area Managers in their offices located throughout the country where they can establish a close understanding of the opportunities and problems of local industry. This is reflected in the high proportion (nearly 60%) of the offers to customers which were approved at local level.

In addition to long term financing of capital projects such as the building of factories and warehouses, the equipping of these premises and the provision of permanent working capital, ICFC has been involved

Chairman's Statement *continued*

in what is seen as a welcome resurgence of entrepreneurial activity in the UK. This has taken two forms; first, ICFC has backed 309 new businesses or start-up propositions (defined for our purposes as companies which have traded for three years or less) compared with 112 in 1978/79. Secondly, ICFC has helped 49 (1978/79 : 20) management teams to buy control of the division or company for which they work.

Another arm of ICFC's services is ICFC Corporate Finance Limited, which has had an active year dealing with mergers and takeovers, rights issues and the general run of advisory work.

I would like to give special emphasis to ICFC's role as a provider of risk capital in amounts from £5,000 upwards. At March 31 1980, ICFC had equity investments in 1,100 companies, amounting in total to £63 million. The evaluation of these companies and the relation of risk to potential reward is a difficult task. From my short experience I am confident that ICFC's expertise in this area is second to none and that this, coupled with a flexible and rapid response to our customers' needs, will enable us to meet the growing competition effectively and profitably.

ICFC also operates a scheme, with funds provided by the European Coal and Steel Community, which benefits both from low cost European Community funds and a UK Government exchange risk guarantee. We thus have Sterling available to lend at specially low interest rates for capital investment projects in areas of steel works and pit closures. Applications approved by ICFC now total over £20 million and a further £5 million is under consideration. Over 2,000 jobs will be created by the projects approved so far.

Technical Development Capital

It is most satisfactory that, for the second year in succession, we have been able roughly to double our investment in technology-based companies. We are, however, by no means complacent about the level of support we give this vitally important sector, and we have recently taken steps to widen our range of services and to augment our industrially-experienced staff.

Property Division

For most of the year, the industrial property market has been characterised by low investment yields and high site costs. Despite the latter, we have been able to increase the rate of development of property suitable for the smaller company. At the year end, 55% of our developments were units of under 5,000 sq. ft. Demand for well-located units of this type continues to be very encouraging, as does the yield on our property investments.

Leasing Division

Our four leasing companies in the industrial, commercial and agricultural sectors have all had another record year. The value of assets purchased for leasing to customers increased from £46 million in 1978/79 to £75 million this year. Our industrial hire purchase business also showed significant growth with advances increasing by 57% to £55 million, which is again a record.

Estate Duties Investment Trust

During the year, this listed investment trust company, managed by ICFC which holds about 40% of its equity, invested a record £3.4 million in unlisted shares in 25 companies.

Investment Trust and Pension Fund Management

In addition to Estate Duties Investment Trust, ICFC manages two other listed investment trusts, provides investment management services to a number of pension funds and is assisting the Post Office Pension Fund in establishing a specialised portfolio of smaller companies. This special expertise in smaller company investment has been well demonstrated over a long period in the successful record of the two listed trusts, London Atlantic Investment Trust and North British Canadian Investment Company which have both been consistently at or near the top of their "league table". This creditable performance continued during the year under review.

FCI

We believe that amongst the large companies in FCI's sector of the market there exists a substantial

Chairman's Statement *continued*

appetite for fixed rate money but interest rates at their present levels, coupled with the ready availability of floating rate bank finance at fine margins, tend to encourage company treasurers to defer fixed rate funding plans. During the year, we extended the range of facilities which we offer to include droplock loans. These offer the borrower a variable rate which switches to a fixed rate once interest rates fall to a level pre-selected by the borrower. Through this and other methods FCI was able to advance £44.8 million during the year and it had undrawn commitments at the year end of a further £44 million.

Finance for Shipping

Finance for Shipping has had another good year, in an industry climate that improved only slowly and from a very low base. Gross investment for the year was £29.5 million, which compares with £32 million last year. Much work has also been done in connection with applications for new loans and deferments of existing loans under Section 10, Industry Act 1972, in respect of which Ship Mortgage Finance Company acts as adviser to and agent for the Department of Industry.

Training and Consultancy

This year has seen the integration of our consultancy and training companies, forming what is now known as ICFC Consultants Limited. Like all mergers, this one has not been without its problems, but we are now able to offer a closely co-ordinated range of services to the small company sector. The Understanding Industry scheme, now funded by the Industrial Training Foundation, has demonstrated its effectiveness in introducing school-leavers to industry, and achieving a better understanding of its vital role in the nation's economy.

Resources

We again started the year with substantial funds in hand and most of our funding requirement had been met by June 1979 when we made a £30 million issue of Sterling Eurobonds. The balance of our requirements was substantially met in February 1980 by a further £20 million issue, taking advantage of a temporary improvement in market conditions, and using a new vehicle for such issues, Finance for Industry International BV. Following this issue, at the start of the new financial year, we were comfortably liquid.

Group Reorganisation

The Group structure was re-organised on December 31 1979 in order to simplify operations by the separation of fund-raising from investment activities.

Under the new structure, Finance for Industry Limited, the holding company, will continue to be the main fund-raising unit for the Group, using our Dutch company, Finance for Industry International BV, where necessary for overseas issues. FFI (UK Finance) Limited—formerly Industrial and Commercial Finance Corporation Limited—which owns the majority of the assets of the Group will guarantee the borrowing of FFI. It also borrows to a certain extent in its own name. The investment operations will continue to be carried out by operating companies acting on behalf of FFI (UK Finance) Limited. A new company has been incorporated to take over the name and operational role of ICFC itself; the activities of ICFC will be continued unchanged by the Area Offices established throughout the country. Both FFI and FFI (UK Finance) Limited have been granted deposit-taking status by the Bank of England.

Board Membership

Mr. G. S. Stone joined the Board in April 1980; he has been a Director of ICFC since 1967 and has a long-standing connection with the Group. We are delighted to have the benefit of his experience on the FFI Board.

In addition to Lord Seebohm, this year, sadly, we say goodbye to two old and trusted friends—Sir Michael Milne-Watson and Sir Eric Faulkner. Sir Michael has been a Director of ICFC since 1963 and of FFI since its formation in 1974. Sir Eric joined the Boards of both FFI and ICFC in January 1977 and has been Joint Deputy Chairman since July 1977. We have greatly benefited from their wise counsel and support, for which we are immensely grateful. We wish them both a long and happy retirement.

Staff

Since becoming Chairman on January 1, I have visited a number of ICFC's Area Offices and other

Chairman's Statement *continued*

operations; I have been greatly impressed by the enthusiasm and competence of our staff and by the ingenuity used to meet the widely varying needs of our customers, some of whom I have also met during these visits.

I would like to take this opportunity to congratulate all our staff who have contributed so much to the year's record results. I look forward with great enthusiasm to working with them in carrying forward the varied and valuable work which FFI is doing in support of industry.

Prospects

There can seldom have been a more difficult moment to make any assessment of the prospects for the current year. The volume of applications on hand in the various divisions of FFI is encouraging, particularly from smaller companies. However, it is difficult to believe that this sector of industry will be immune from the difficulties being reported by many public companies where a downward trend is already apparent.

Clearly no organisation will escape from the effects of the recession during 1980/81 and no doubt some of the companies, in which we have investments, will experience difficulties. In such circumstances, it would be unwise to attempt to forecast the results of the current year. But FFI has a strong balance sheet and an experienced staff which I am confident will carry us through the storms ahead and enable us to continue to provide a valuable service to industry.

Caldecote

Directors' Report

The Directors submit their report with the Group Accounts for the year ended March 31 1980.

Shareholders		%
Bank of England		15.02
Bank of Scotland		3.12
Barclays Bank Limited		18.86
Lloyds Bank Limited		13.70
Midland Bank Limited	16.18	
Clydesdale Bank Limited	1.85	18.03
The Royal Bank of Scotland Group		
The Royal Bank of Scotland Limited	4.58	
Williams & Glyn's Bank Limited	3.00	7.58
National Westminster Bank Limited	22.99	
Coutts & Co.	0.70	23.69
		100.00

Activities

The main activity of the Company is to act as a holding company for FFI (UK Finance) Limited (below referred to as UK Finance), which now owns beneficially substantially all the investments and other assets of the Group, as well as the other subsidiaries through which the Company carries on its investment activities, Industrial and Commercial Finance Corporation Limited (ICFC), Finance Corporation for Industry Limited (FCI) and Finance for Shipping Limited (FFS), and other companies involved in leasing, property and consultancy activities.

ICFC provides capital, financial advice and other services to small and medium sized companies.
FCI undertakes the provision of medium term finance for projects or companies which are larger than those financed by ICFC.
FFS finances British shipowners. With Ship Mortgage Finance Company Limited (SMFC) and Nile Steamship Company Limited (Nile), it forms the Marine Division of the Group which provides loans secured on ships and acquires and owns ships which are chartered to responsible shipowners.

ICFC Leasing Limited and Hamilton Leasing Limited together provide plant and equipment leasing facilities, principally to small and medium sized companies. Highland Leasing Limited provides equipment leasing and stocking loan facilities to the agricultural industry.

The Group's property activities are primarily concerned with the provision of industrial premises for small and medium sized companies. ICFC Properties Limited undertakes property investment and industrial developments are carried out through ICFC Developments Limited.

ICFC Consultants Limited provides management consultancy and training services.

In addition the Group has interests in a number of industrial subsidiaries whose names and activities are listed on page 30.

Group Reorganisation

With a view to simplification of the operations of the Group by separation of fund-raising from investment activities, with effect from January 1 1980, UK Finance (in its then name of Industrial and Commercial Finance Corporation Limited) acquired substantially all the assets previously owned by other subsidiaries of the Company, part of the consideration being satisfied by the issue, credited as fully paid, of 95,000,000 shares of £1 each of UK Finance which were subsequently transferred to the Company. From that date, the majority of the investment operations of the Group have been and will continue to be carried out by operating companies acting on behalf of UK Finance. With effect from May 16 1980, on which date the change of name of UK Finance became effective, the name of a dormant subsidiary of the Company was changed to Industrial and Commercial Finance Corporation Limited and this company has now taken over the operational role of ICFC described above.

There has been no other significant change in the activities of the Company or any of its subsidiaries during the year.

Loan Stock and Bond Issues

In addition to its function as a holding company, the Company also acts as the principal vehicle for raising funds for investment by the Company and its subsidiaries. During the year ended March 31 1980, the following issues of loan stock and bonds were made:

on various dates during the year UK Finance issued for a consideration other than cash at different prices a total of £44,725 11% Unsecured Loan Stock 1988 and £46,361 11¾% Unsecured Loan Stock 1990.

On June 27 1979 the Company issued £30,000,000 12½% Sterling/U.S. dollar payable Bonds 1989 for cash at £99¼ per centum and on February 22 1980 Finance for Industry International B.V., a wholly owned subsidiary of the Company registered in the Netherlands, issued £20,000,000 14½% Guaranteed Sterling/U.S. dollar payable Bonds 1988 for cash at £99½ per centum.

Directors' Report *continued*

In addition, the Company accepted deposits totalling £8,850,103 for terms varying from 1 to 10 years at different rates of interest.
On May 19 1980, both the Company and UK Finance were granted full licences by the Bank of England under the Banking Act 1979 to accept deposits.

Directors

The names of the present Directors are set out on page 2.
Lord Caldecote was appointed a Director on October 1 1979 and became Chairman of the Company on January 1 1980.
Mr. G. S. Stone was appointed a Director on April 29 1980.
Sir Donald Barron was appointed a Director on June 1 1979 and, in accordance with Article 101 of the Company's Articles of Association, retired at the last Annual General Meeting and was duly re-elected. Sir Henry Benson and Mr. R. C. Smith served as Directors until the last Annual General Meeting on August 7 1979, when Sir Henry Benson, having reached the age of 70 years, retired and Mr. R. C. Smith, who retired by rotation, in view of other commitments did not seek re-election.
Lord Seebohm, who was re-appointed a director at the last Annual General Meeting, notwithstanding having reached the age of 70 years, has indicated that he wishes to retire at the next Annual General Meeting.
Sir Michael Milne-Watson, who has attained the age of 70 years, will retire at the next Annual General Meeting in accordance with Article 98 of the Company's Articles of Association.
Lord Caldecote and Mr. G. S. Stone, having been appointed since the last Annual General Meeting, retire in accordance with Article 101 of the Company's Articles of Association and, being eligible, will offer themselves for re-election.
In accordance with Article 97 of the Company's Articles of Association, Mr. John Eccles, Mr. H. J. Foulds and Mr. L. V. D. Tindale retire by rotation and, being eligible, offer themselves for re-election. Sir Eric Faulkner, who also retires by rotation in accordance with Article 97, has intimated that he does not wish to offer himself for re-election.
Mr. L. V. D. Tindale is interested in 27,240 Ordinary Shares of 25p of London Atlantic Investment Trust Limited (LAIT) a consolidated subsidiary. None of the Directors had any disclosable interest in the shares or loan stock of the Company and no other Director had any disclosable interest in the shares, debentures or loan stock of its subsidiaries during the year. No Director, at the end of or during the financial year, was materially interested in any contract that was significant in relation to the business of the Company.

Accounts and Dividend

The Accounts of the Company appear on pages 10 to 30. In the opinion of the Directors, the market value as at March 31 1980 of such of the Group's assets as consist in interests in land was substantially different from the amount at which such interests are included in the balance sheet. The market value is considered to exceed the book amount by approximately £40,000,000.
On December 5 1979 an interim dividend of 2.0p per share was declared and paid on the share capital of the Company in issue at March 31 1979 in respect of the financial year ending March 31 1980. The Directors now recommend a final dividend of 3.0p per share, which is fully covered by available franked investment income. Subject to approval at the Annual General Meeting, this dividend will be paid on July 30 1980. After taking account of £1,573,000 arising from extraordinary items the amount added to the retained surplus of the Group is £9,041,000, making a total of £43,618,000 carried forward.

General

During the year ended March 31 1980 the average number of persons employed in each week by the Company and its financial subsidiaries was 867 and by the industrial subsidiaries was 1,433. The aggregate remuneration during the same period was £7,502,000 and £5,755,000 respectively.
No political donations were made during the year. Charitable donations made by UK Finance amounted to £57,000 in total.
Exports by the industrial subsidiaries totalled £5,678,000.
The close company provisions of the Income and Corporation Taxes Act 1970 do not apply to the Company.
In accordance with Section 14 of the Companies Act 1976 a resolution proposing the re-appointment of Ernst & Whinney as auditors of the Company will be put to the Members at the Annual General Meeting.

By Order of the Board

B. L. MANN

Secretary

Registered Office: 91 Waterloo Road, London, SE1 8XP

June 24 1980

Protection of Depositors Act 1963

Directors' Statement

(i) The principal activities of the Group and any material changes therein during the year ended March 31 1980 are set out in the Directors' Report.
(ii) In the opinion of the Directors and from their knowledge of the Company's affairs, the current assets shown in the Company's balance sheet and the Group balance sheet were realisable in the ordinary course of business at amounts not less than the total shown after making allowance for all appropriate costs, including costs of realisation and financing.

CALDECOTE
FRANCIS SANDILANDS } Directors

Finance for Industry Ltd

Revenue Statement
year ended March 31 1980

	notes	Group 1980 £000	1979 £000
Income of company and consolidated subsidiaries less provisions	1	106,031	*83,546*
Attributable profits less losses of associated companies		3,091	*3,402*
Profit before interest on borrowings	2	109,122	*86,948*
Interest on borrowings	3	80,313	*61,597*
Profit before tax		28,809	*25,351*
Tax	4	12,755	*10,517*
Profit after tax		16,054	*14,834*
Amount attributable to outside shareholders		440	*533*
Profit before extraordinary items	5	15,614	*14,301*
Extraordinary items	6	1,573	*3,158*
Surplus for year		14,041	*11,143*
Dividends:			
Interim paid 2.0 pence per share		2,000	*—*
Final proposed 3.0 pence per share: *1979 0.2 pence*		3,000	*200*
		5,000	*200*
Increase in retained surplus		9,041	*10,943*
Earnings per share	7	15.6p	*14.3p*

Finance for Industry Ltd

Balance Sheet
March 31 1980

	notes	Group 1980 £000	Group *1979* *£000*	FFI 1980 £000	FFI *1979* *£000*
Investments and financial facilities extended to customers less provisions	9	597,744	*494,761*	—	—
Hire purchase receivables	9	50,283	*35,750*	—	—
Property, plant and ships under charter	10, 11	149,428	*125,046*	—	—
Development sites	11	24,173	*18,289*	—	—
Associated companies	12	19,393	*18,234*	—	—
Consolidated subsidiaries	13			564,640	*474,756*
		841,021	*692,080*	564,640	*474,756*
Current assets					
Money market assets and balances with bankers	14	90,019	*121,170*	83,648	*117,226*
Unsecured loan stock instalments		—	*12,000*	—	—
		90,019	*133,170*	83,648	*117,226*
Other current assets	15	46,679	*31,631*	14,944	*7,817*
		136,698	*164,801*	98,592	*125,043*
		977,719	*856,881*	663,232	*599,799*
Authorised share capital of FFI 150,000,000 shares of £1 each					
Issued shares of £1 each, fully paid		100,000	*100,000*	100,000	*100,000*
Share premium		2,030	*2,030*	2,030	*2,030*
Retained surplus	16	43,618	*34,577*	10,625	*9,231*
		145,648	*136,607*	112,655	*111,261*
Deferred tax	17	56,180	*40,297*	(3,288)	*(2,047)*
Outside shareholders' interests in subsidiaries		3,185	*2,976*		
Borrowings repayable after more than 1 year	18	386,067	*388,678*	205,702	*234,350*
Borrowings repayable within 1 year	18	349,292	*257,655*	332,840	*245,929*
Current liabilities other than borrowings	19	37,347	*30,668*	15,323	*10,306*
		977,719	*856,881*	663,232	*599,799*

CALDECOTE
FRANCIS SANDILANDS } Directors

Funds Statement
year ended March 31 1980

	Group 1980 £000	*1979 £000*
Outflow		
Gross investment adjusted for non-cash items £624,000: *1979 £1,109,000*	277,056	*241,756*
Other outflows	8,546	*5,503*
	285,602	*247,259*
Inflow		
Net increase in borrowings adjusted for non-cash items £93,000: *1979 £290,000*	101,119	*72,516*
Repayments and realisations	95,000	*137,258*
Retained surplus for year adjusted for non-cash items £49,291,000: *1979 £43,248,000*	58,332	*54,191*
	254,451	*263,965*
Net outflow represented by decrease in liquid funds: *1979 inflow*	31,151	*16,706*

Finance for Industry Ltd

Inflation Accounting Statement
year ended March 31 1980

The following supplementary statement is provided in accordance with the interim recommendations regarding inflation accounting issued by the Accounting Standards Committee on November 4 1977.

	Group	
	1980	*1979*
	£000	*£000*
Profit before tax as shown in the historical cost revenue statement	28,809	*25,351*
Additional depreciation	522	*349*
Monetary adjustment	6,332	*3,217*
	6,854	*3,566*
Adjusted profit before tax	21,955	*21,785*

Notes:

1. The additional depreciation is the difference between depreciation based on current replacement cost arrived at by valuation, and the depreciation charge in respect of non-monetary assets as included in the accounts.

2. The monetary adjustment is arrived at by applying the change in the UK Retail Price Index to the average excess of monetary assets over monetary liabilities during the year.

Accounting Policies

a Accounting convention

The accounts have been prepared under the historical cost convention.

b Consolidation of the Company and its subsidiaries

The consolidated accounts deal with the state of affairs of the Company and its subsidiaries, excluding certain companies regarded as industrial subsidiaries, at March 31 1980 and the results for the year ended on that date. Having regard to the intention not to retain the holdings in the industrial subsidiaries as long-term investments and to the purposes for which they were acquired and to the widely diverse nature of the businesses carried on by them, the Secretary of State has exempted the Company, so far as these subsidiaries are concerned, from compliance with the provisions of Section 150 of the Companies Act 1948 with respect to the submission of group accounts embracing such companies and from the obligations laid down in paragraph 15(4) of Part II of the Eighth Schedule to that Act and has also granted permission under Regulation 5(1) (b) of the Protection of Depositors (Accounts) Regulations 1976 for the group accounts not to deal with these subsidiaries.

c Associated companies

Companies whose business is not industrial in nature and in which the holdings are intended to be retained as long-term investments and in which the Group has both management involvement and more than 20% of the equity are treated as associated companies.

d Charter hire of ships, rent of plant and equipment and freehold and leasehold property, depreciation and grants receivable

Income from leasing transactions is taken to revenue on a straight line basis. Depreciation is generally calculated on a straight line basis over the period of the charter, lease or estimated life of the building, regional and other grants receivable being deducted from cost.

e Hire purchase

Income from hire purchase transactions is taken to revenue on a straight line basis.

f Provisions

Specific provisions are made in respect of development sites and properties, and in respect of investments other than loans and unlisted share investments under £1,000,000 (previously £500,000) to write them down to estimated realisable value if this is less than book amount (i.e. cost or the lowest estimated realisable value at any previous year-end). A general provision is maintained in respect of loans and unlisted share investments under £1,000,000 (previously £500,000) and all other latent risks.

g Deferred tax

Deferred tax is provided by the liability method on the proportion, considered to be applicable to future hiring periods, of capital allowances in respect of plant and equipment leased to customers and ships under charter and other timing differences. Since, in the opinion of the Directors, it is not possible to foresee with any certainty the level of future leasing and charter hire operations by the Group, full provision is made for deferred tax liabilities.

h Foreign currency translation

Foreign currency balances are translated at the rates ruling at the balance sheet date. Assets and liabilities of overseas subsidiaries are translated at the rates ruling at the balance sheet date. Revenue items are translated at the average rates during the period. The resultant adjustments are dealt with in income.

Notes on the Accounts

1 Income of company and consolidated subsidiaries less provisions

	Listed		Unlisted		Total	
	1980 £000	*1979 £000*	1980 £000	*1979 £000*	1980 £000	*1979 £000*
Interest receivable from customers (including £97,000: *1979 £97,000* from associated companies)	43	*84*	67,894	*56,085*	67,937	*56,169*
Short term interest	—	—	12,063	*8,756*	12,063	*8,756*
Dividends received (excluding £1,498,000: *1979 £1,316,000* from associated companies)	4,248	*2,971*	8,129	*6,921*	12,377	*9,892*
	4,291	*3,055*	88,086	*71,762*	92,377	*74,817*
Profits less losses on realisation					18,234	*9,981*
Rents from leased assets and charter hire					46,973	*36,620*
Less depreciation					30,507	*24,057*
					16,466	*12,563*
Income from hire purchase					6,663	*3,702*
Fees and other income					5,200	*3,707*
					138,940	*104,770*
Less Provisions against investments and financial facilities					13,873	*6,547*
Other provisions					954	*457*
Operating costs and administrative expenses					17,082	*13,220*
Additional contribution to staff pension plan					1,000	*1,000*
					32,909	*21,224*
					106,031	*83,546*

Gross franked income, including dividends from associated companies, totalled £12,683,000: *1979 £10,336,000*

2 Profit before interest on borrowings

This is arrived at after charging:		
Directors' emoluments (Fees totalled: £28,895: *1979 £26,009*)—note 8	172	*152*
Audit fees (FFI £24,000: *1979 £19,000*)	161	*120*
Hire of equipment	134	*110*
Purchases of office equipment and motor cars less sales	1,446	*1,090*

Notes on the Accounts *continued*

3 Interest on borrowings

	1980 £000	*1979 £000*
Debenture stocks		
Repayable within 5 years	1,175	*1,175*
Repayable after more than 5 years	4,081	*4,081*
Unsecured loan stocks		
Repayable within 5 years	13,208	*16,118*
Repayable after more than 5 years	6,204	*3,527*
Sterling/U.S. dollar payable Bonds		
Repayable by instalments ending after 5 years	7,848	*3,251*
Bank loans		
Overdrafts	20	*4*
Repayable by instalments within 5 years	1,180	*3,095*
Repayable by instalments ending after 5 years	1,191	*534*
Other loans		
Repayable by instalments ending after 5 years	466	*461*
Deposits		
Bank	5,797	*4,455*
Other		
Repayable within 5 years	36,171	*22,294*
Repayable after more than 5 years	2,972	*2,602*
	80,313	*61,597*

4 Tax

Corporation tax at 52%	703	*641*
Foreign tax	486	*322*
Tax attributable to franked income	3,693	*149*
	4,882	*1,112*
Deferred tax	6,993	*8,477*
	11,875	*9,589*
Adjustment in respect of prior years	880	*928*
Charge in the year	12,755	*10,517*
The Company and consolidated subsidiaries	11,365	*9,142*
Associated companies	1,390	*1,375*
	12,755	*10,517*

Losses and capital allowances estimated to be in excess of £9,000,000: *1979 £18,000,000* are available to reduce the group's future liability to pay corporation tax.

5 Profit before extraordinary items

The amount dealt with in the accounts of FFI is £7,341,000: *1979 £5,497,000.*

Notes on the Accounts *continued*

6 Extraordinary items

	Group 1980 £000	*1979 £000*
Net deficit on acquisition and disposal of subsidiaries	—	*(1,481)*
Discount and issue expenses of unsecured loan stocks and bonds less discount on purchase of loan stocks and bonds for redemption	(1,573)	*(2,759)*
Profit on sale of associated company	—	*1,082*
	(1,573)	*(3,158)*

Extraordinary expenses dealt with in the accounts of FFI amount to £947,000: *1979 £804,000.*

7 Earnings per share

	1980	*1979*
Profit before extraordinary items	15,614	*14,301*
Average number of ordinary shares in issue	100,000	*100,000*
Amount per share	15.6p	*14.3p*

8 Emoluments

Two chairmen held office during the year and their emoluments, excluding pension contributions, were £13,068 and £3,563 respectively: *1979 £17,298.*

The emoluments of the highest paid director, excluding pension contributions, were £45,535: *1979 £35,380.*

Directors (including the chairmen and the highest paid director) and employees were in receipt of emoluments, excluding pension contributions, within the following ranges:

	1980 number	*1979 number*	£	£
Directors	10	*9*	—	5,000
	1	*1*	5,001	10,000
	1	*–*	10,001	15,000
	–	*1*	15,001	20,000
	–	*1*	30,001	35,000
	1	*1*	35,001	40,000
	1	*–*	45,001	50,000
Employees	1	*2*	25,001	30,000
	1	*–*	30,001	35,000

Fourteen Directors: *1979 thirteen* have waived fees totalling £31,084: *1979 £28,748.*

Notes on the Accounts *continued*

9 Investments and financial facilities extended to customers less provisions

	Listed 1980 £000	*Listed 1979 £000*	Unlisted 1980 £000	*Unlisted 1979 £000*	Group Total 1980 £000	*Group Total 1979 £000*
Debentures and secured loans	6	*6*	355,080	*291,104*	355,086	*291,110*
Unsecured loans	171	*193*	167,970	*140,386*	168,141	*140,579*
Redeemable preference shares	1,023	*1,023*	11,405	*9,022*	12,428	*10,045*
Irredeemable preference shares	950	*419*	5,822	*5,060*	6,772	*5,479*
Equity shares	21,828	*20,526*	47,128	*37,054*	68,956	*57,580*
	23,978	*22,167*	587,405	*482,626*	611,383	*504,793*
Less general provision net of tax					13,639	*10,032*
					597,744	*494,761*
Market value	59,207	*64,896*				

a Subsidiaries not consolidated

Unlisted investments and financial facilities extended to customers less provisions include investments in certain industrial subsidiaries which have not been consolidated, see accounting policy b. These investments comprise shares £2,882,000: *1979 £2,281,000* and advances £1,012,000: *1979 £6,558,000.*

Details of the groups interests in these companies are set out on page 30.

b In respect of provisions against advances and investments which are not allowable for tax purposes until the relevant losses are realised the tax charges have been debited against the provisions.

c Provisions

	Specific provision 1980 £000	*Specific provision 1979 £000*	General provision 1980 £000	*General provision 1979 £000*
Gross provision at April 1 1979	35,767	*35,247*	20,332	*15,618*
Utilised or released	7,639	*811*	1,441	*502*
	28,128	*34,436*	18,891	*15,116*
Charged in Revenue Statement	5,476	*1,331*	8,397	*5,216*
Gross provision at March 31 1980	33,604	*35,767*	27,288	*20,332*
Less deferred tax applicable thereto	4,082	*66*	13,649	*10,300*
Net provision at March 31 1980	29,522	*35,701*	13,639	*10,032*

d Debentures and secured loans

In the normal course of its business, the Group has lent money on the security of mortgages or charges on freehold and leasehold land, in the majority of cases linked with floating charges on land and other assets. In these circumstances the directors consider that it would not be feasible to calculate the amounts separately receivable in respect of money lent on the security of first mortgages and other charges relating to the classes of land specified in paragraph 13 of Schedule 2 to the Protection of Depositors (Accounts) Regulations 1976, and the Secretary of State has modified the requirements of the Regulations for the purpose of these accounts.

The amount under this heading is £355,086,000: *1979 £291,110,000* most of which is charged on land. The interest on the secured loans, which is taken to revenue as it accrues, amounted to £45,244,000: *1979 £38,388,000.*

Notes on the Accounts *continued*

9 Investments and financial facilities extended to customers less provisions—*continued*

	Repayable in not more than one year	one to five years	more than five years	Group 1980 Total	*1979 Total*
e Instalment credit agreements	£000	£000	£000	£000	*£000*
(i) Hire purchase agreements	25,913	24,267	103	50,283	*35,750*
(ii) Secured and unsecured loan agreements repayable at intervals not exceeding 3 months	2,470	13,348	22,965	38,783	*25,653*
	28,383	37,615	23,068	89,066	*61,403*

New business entered into in the six months to March 31 1980:	1980 £000	*1979 £000*
(i) Hire purchase agreements		
Private and commercial vehicles and caravans	2,739	*838*
Farm and industrial equipment	25,478	*19,462*
Other goods	241	*178*
	28,458	*20,478*
(ii) Secured and unsecured loan agreements repayable at intervals not exceeding 3 months	7,685	*6,182*
	36,143	*26,660*

f Loans to directors and associates of directors for house purchase or improvement.

These loans are secured and were all made in accordance with the ICFC Staff House Loan Scheme. They are repayable either by instalments over, or in one sum at the end of, a period usually ending on the normal retirement date of the employee concerned. All interest due on these loans to March 31 1980 has been paid.

The Secretary of State has modified the definition of "associate of a director" in paragraph 16 of Schedule 2 of the Protection of Depositors (Accounts) Regulations 1976 by restricting sub-paragraph (v) thereof to employees of UK Finance and ICFC Consultants Ltd. and by modifying the reference in sub-paragraph (iv) to employees of directors. In accordance with paragraphs 9 and 16 of Schedule 2 of those Regulations as so modified, the aggregate of loans outstanding at March 31 1980 and owing by directors and associates of directors was £5,436,000: *1979 £3,956,000.*

g Secured and unsecured loans	Group 1980	*1979*
These loans (excluding those detailed under e and f above) are repayable:	£000	*£000*
On demand	1,960	*6,072*
In not more than one year	41,870	*32,703*
In one to five years	186,812	*160,457*
In more than five years	248,366	*202,848*
	479,008	*402,080*

The majority of these loans are repayable by annual or half-yearly instalments. Interest is taken to revenue as it accrues.

An amount of £35,000,000 from one borrower exceeds 5% of the aggregate of all sums owing to the group and also exceeds 5% of the total deposits shown in note 18 (b).

Notes on the Accounts *continued*

9 Investments and financial facilities extended to customers less provisions—*continued*

h Unlisted equity investments	Group 1980 £000	*1979 £000*
Net book amount	47,128	*37,054*
Dividends received	5,751	*4,642*
No accounts for the appropriate period since acquisition have been received during the year in respect of investments having a book value of	8,657	*5,494*
Share of the profits less losses as shown by accounts received during the year was		
Profits less losses before tax	27,339	*22,434*
Profits less losses after tax	17,772	*14,116*
Share of the undistributed profits less losses since acquisition was	57,940	*41,384*
This includes the share of profits subsequently capitalised amounting to	6,096	*2,286*

The group provisions are regarded as adequate to cover any losses incurred by the companies in which these investments are held.

10 Property, plant and ships under charter

	Group			
	Total £000	Property £000	Plant £000	Ships £000
Cost April 1 1979	223,215	26,024	115,711	81,480
Additions	59,904	3,775	28,237	27,892
	283,119	29,799	143,948	109,372
Disposals	22,577	—	11,884	10,693
Cost March 31 1980	260,542	29,799	132,064	98,679
Accumulated grants receivable	8,308	—	1,951	6,357
	252,234	29,799	130,113	92,322
Accumulated depreciation	102,806	4,305	78,529	19,972
Book amount March 31 1980	149,428	25,494	51,584	72,350
Book amount March 31 1979	*125,046*	*22,230*	*49,862*	*52,954*
Leased to customers	142,209	18,275	51,584	72,350
In use by the group	7,219	7,219	—	—

Depreciation rates relating to property in use by the group range from 2% to 7% per annum.

Notes on the Accounts *continued*

11 Property and development sites

The following supplementary particulars relating to property are provided in conformity with the Protection of Depositors (Accounts) Regulations 1976.

	Group					
	1980			*1979*		
	Freehold Land	Leasehold Land 50 years or more to run	Leasehold Land Less than 50 years, more than 5 years	*Freehold Land*	*Leasehold Land 50 years or more to run*	*Leasehold Land Less than 50 years, more than 5 years*
	£000	£000	£000	*£000*	*£000*	*£000*
Cost of acquisition	27,432	6,807	257	*25,972*	*6,831*	*207*
Additions	19,641	9,996	—	*13,441*	*7,996*	—
	47,073	16,803	257	*39,413*	*14,827*	*207*
Depreciation and provisions for diminution in value	12,697	1,664	105	*12,478*	*1,360*	*90*
	34,376	15,139	152	*26,935*	*13,467*	*117*

The figures shown above for land are the aggregate of the amounts for property shown in note 10 and the development sites shown in the balance sheet.

	Group	
	1980	*1979*
	£000	*£000*
Rents receivable	4,911	*3,115*
Outgoings	1,161	*1,054*
Profits less losses on sale	657	*2,377*

No revenue expenses have been capitalised as costs of development.

12 Associated companies

	Group			
	1980		*1979*	
	Listed £000	Unlisted £000	*Listed £000*	*Unlisted £000*
Debentures and secured loans	—	100	—	*100*
Unsecured loans	—	375	—	*375*
Redeemable preference shares	—	55	—	*55*
Ordinary shares	8,641	5,531	*8,106*	*5,531*
	8,641	6,061	*8,106*	*6,061*
Share of post acquisition retained surpluses less losses	3,059	1,632	*2,642*	*1,425*
	11,700	7,693	*10,748*	*7,486*
Market value	21,053		*25,587*	

Details of the Group's interests are given on page 29.

Notes on the Accounts *continued*

13 Consolidated subsidiaries

	FFI 1980 £000	FFI *1979 £000*
At cost less provisions		
Shares	204,313	*79,017*
Advances by FFI (i)	434,692	*412,194*
	639,005	*491,211*
Advances to FFI	74,365	*16,455*
	564,640	*474,756*

(i) At March 31 1980 advances of £10,182,000: *1979 £52,645,000* by FFI to its subsidiaries were subordinated in favour of the other creditors of those subsidiaries.

(ii) Shares held in subsidiaries carry an uncalled liability of £16,962,000: *1979 £16,962,000.*

(iii) Details of the principal consolidated subsidiaries are given on page 28.

	Group 1980 £000	Group *1979 £000*	FFI 1980 £000	FFI *1979 £000*
14 Money market assets and balances with bankers				
Sterling certificates of deposit and other marketable securities maturing within one year	13,356	*52,423*	12,906	*52,423*
Deposits maturing within one year	72,038	*65,622*	70,691	*62,786*
Balances with bankers	4,625	*3,125*	51	*2,017*
	90,019	*121,170*	83,648	*117,226*
15 Other current assets				
Tax recoverable	8,893	*9,690*	—	*828*
Interest receivable, debtors and prepayments	37,786	*21,941*	3,634	*2,439*
Dividends receivable from subsidiaries			11,310	*4,550*
	46,679	*31,631*	14,944	*7,817*
16 Retained surplus				
FFI	10,625	*9,231*		
Consolidated subsidiaries	28,302	*21,279*		
Associated companies	4,691	*4,067*		
	43,618	*34,577*		

Of the retained surplus of subsidiaries £748,000: *1979 £5,267,000* is not regarded as distributable by them.

Of the retained surplus relating to associated companies £2,456,000: *1979 £2,099,000* is not regarded as distributable by them.

	Group 1980 £000	Group *1979 £000*	FFI 1980 £000	FFI *1979 £000*
17 Deferred tax				
Short term timing differences	(4,905)	*(1,902)*	(3,288)	*(2,047)*
Leased plant and ships under charter	54,645	*37,086*	—	—
Other timing differences	6,440	*5,113*	—	—
	56,180	*40,297*	(3,288)	*(2,047)*

See also note 9(b)

If the listed investments and listed associated companies were disposed of at the market values shown in note 9 and note 12 respectively there would be an estimated potential taxation charge of £19,200,000.

Notes on the Accounts *continued*

18 Borrowings

a by maturities	Group				FFI			
	No. of Depositors	1980 £000	*No. of Depositors*	*1979 £000*	No. of Depositors	1980 £000	*No. of Depositors*	*1979 £000*
Deposits—notes (i) and (ii)—repayable								
on demand	28	24,407	*24*	*9,537*	28	24,407	*24*	*9,537*
in not more than 1 month	191	194,145	*209*	*141,019*	187	186,495	*209*	*141,019*
in more than 1 month and not more than 3 months	123	50,635	*71*	*58,943*	123	50,635	*71*	*58,943*
in more than 3 months and not more than 1 year	334	26,001	*417*	*31,553*	333	25,001	*417*	*31,553*
within 1 year	676	295,188	*721*	*241,052*	671	286,538	*721*	*241,052*
in more than 1 year and not more than 5 years	2,060	52,161	*1,811*	*49,858*	2,060	52,161	*1,811*	*49,858*
in more than 5 years and not more than 10 years	1,190	28,136	*1,141*	*28,949*	1,189	27,136	*1,140*	*27,949*
in more than 10 years and not more than 15 years	1	750	*2*	*1,590*	1	750	*2*	*1,590*
after more than 1 year	3,251	81,047	*2,954*	*80,397*	3,250	80,047	*2,953*	*79,397*
Total deposits	3,927	376,235	*3,675*	*321,449*	3,921	366,585	*3,674*	*320,449*
Sterling/U.S. dollar payable Bonds repayable								
in more than 3 months and not more than 1 year		1,500		*1,000*		—		*1,000*
within 1 year		1,500		*1,000*		—		*1,000*
in more than 1 year and not more than 5 years		20,935		*10,280*		14,935		*10,280*
in more than 5 years and not more than 10 years		64,720		*28,720*		52,220		*28,720*
in more than 10 years and not more than 15 years		6,000		*7,000*		6,000		*7,000*
after more than 1 year		91,655		*46,000*		73,155		*46,000*
Total bearer bonds		93,155		*47,000*		73,155		*47,000*
Other borrowings including bank loans and overdrafts repayable	No. of Lenders		*No. of Lenders*		No. of Lenders		*No. of Lenders*	
on demand	4	3,691	*4*	*3,988*	1	2,311	—	—
in not more than 1 month	11	1,968	*4*	*2,544*	9	1,500	—	—
in more than 1 month and not more than 3 months	3	808	*3*	*1,742*	—	—	—	—
in more than 3 months and not more than 1 year	3,623	46,137	*140*	*7,329*	3,613	42,491	*133*	*3,877*
within 1 year	3,641	52,604	*151*	*15,603*	3,623	46,302	*133*	*3,877*
in more than 1 year and not more than 5 years	3,199	91,318	*6,112*	*131,117*	1,201	52,000	*5,006*	*107,953*
in more than 5 years and not more than 10 years	1,712	35,886	*1,784*	*42,432*	9	500	—	—
in more than 10 years and not more than 15 years	4,502	69,057	*2,996*	*47,587*	—	—	*9*	*1,000*
in more than 15 years	1,404	17,104	*3,435*	*41,145*	—	—	—	—
after more than 1 year	10,817	213,365	*14,327*	*262,281*	1,210	52,500	*5,015*	*108,953*
Total other borrowings	14,458	265,969	*14,478*	*277,884*	4,833	98,802	*5,148*	*112,830*
Total borrowings		735,359		*646,333*		538,542		*480,279*

Notes on the Accounts *continued*

18 Borrowings—*continued*

	Group 1980 £000	Group *1979 £000*	FFI 1980 £000	FFI *1979 £000*
Repayable within 1 year				
Deposits	295,188	*241,052*	286,538	*241,052*
Bonds	1,500	*1,000*	—	*1,000*
Other borrowings	52,604	*15,603*	46,302	*3,877*
	349,292	*257,655*	332,840	*245,929*
Repayable after more than 1 year				
Deposits	81,047	*80,397*	80,047	*79,397*
Bonds	91,655	*46,000*	73,155	*46,000*
Other borrowings	213,365	*262,281*	52,500	*108,953*
	386,067	*388,678*	205,702	*234,350*
Total borrowings	735,359	*646,333*	538,542	*480,279*

Notes

	No. of Depositors	Group 1980 £000	*No. of Depositors*	Group *1979 £000*	No. of Depositors	FFI 1980 £000	*No. of Depositors*	FFI *1979 £000*
(i) Included in the above figures for deposits are deposits made by bodies corporate, firms and other persons whose ordinary business includes the business of banking,								
repayable on demand	—	—	—	—	—	—	—	—
in not more than 1 month	4	11,300	*2*	*3,575*	4	11,300	*2*	*3,575*
in more than 1 month and not more than 3 months	—	—	*1*	*200*	—	—	*1*	*200*
in more than 3 months and not more than 1 year	1	5,000	*5*	*8,630*	1	5,000	*5*	*8,630*
in more than 1 year and not more than 5 years	6	20,495	*8*	*20,733*	6	20,495	*8*	*20,733*
in more than 5 years and not more than 10 years	—	—	*3*	*2,600*	—	—	*3*	*2,600*
	11	36,795	*19*	*35,738*	11	36,795	*19*	*35,738*
(ii) Deposits made by persons other than bankers, the deposits of each of whom exceed 5% of the total amount of non-banking deposits in each class,								
repayable on demand	7	18,302	*6*	*6,625*	6	11,752	*6*	*6,625*
in not more than 1 month	3	41,050	—	—	3	41,050	—	—
in more than 1 month and not more than 3 months	4	15,985	*4*	*25,500*	4	15,985	*4*	*25,500*
in more than 3 months and not more than 1 year	3	5,500	*4*	*6,525*	3	5,500	*4*	*6,525*
in more than 1 year and not more than 5 years	6	12,169	*4*	*10,062*	6	12,169	*4*	*10,062*
in more than 5 years and not more than 10 years	2	16,816	*4*	*14,369*	2	16,816	*4*	*14,369*
in more than 10 years and not more than 15 years	1	750	*2*	*1,590*	1	750	*2*	*1,590*
	26	110,572	*24*	*64,671*	25	104,022	*24*	*64,671*

Notes on the Accounts *continued*

18 Borrowings—*continued*	Group 1980 £000	*1979 £000*	FFI 1980 £000	*1979 £000*
b by types				
Debenture stocks				
UK Finance 5½% 1980–82	10,000	*10,000*		
UK Finance 6¼% 1981–84	10,000	*10,000*		
UK Finance 6½% 1988–90	10,000	*10,000*		
SMFC 6% 1983–85	2,000	*2,000*		
LAIT 5¼% 1983–88	400	*400*		
SMFC 8% 1991–93	3,000	*3,000*		
'A' Debenture stocks				
UK Finance 7¼% 1989–92	15,000	*15,000*		
UK Finance 7½% 1991–94	15,000	*15,000*		
UK Finance 9% 1991–94	10,000	*10,000*		
	75,400	*75,400*		
Unsecured loan stocks				
FFI 14% 1979	—	*2,027*	—	*2,027*
FFI 13% 1981	41,991	*55,953*	41,991	*55,953*
FFI 14% 1983	50,000	*50,000*	50,000	*50,000*
UK Finance 10½% 1986	13,731	*13,731*		
UK Finance 11% 1988	9,545	*9,500*		
UK Finance 11¾% 1990	3,592	*3,546*		
UK Finance 12¼% 1992	15,000	*15,000*		
UK Finance 8⅞% 1992–97	15,000	*15,000*		
	148,859	*164,757*	91,991	*107,980*
Sterling/U.S. dollar payable Bonds				
FFI 9¾% 1987	18,000	*20,000*	18,000	*20,000*
FFI 10% 1989	11,280	*12,000*	11,280	*12,000*
FFI 12½% 1989	28,875	—	28,875	—
FFI 13% 1991	15,000	*15,000*	15,000	*15,000*
Finance for Industry International B.V. 14½% 1988	20,000	—		
	93,155	*47,000*	73,155	*47,000*
Bank loans and overdrafts (group: secured £7,663,000: *1979 £11,690,000*)	37,473	*30,564*	6,811	*4,850*
Other loans (group: secured £4,136,000: *1979 £4,163,000*)	4,237	*7,163*	—	—
	41,710	*37,727*	6,811	*4,850*
	359,124	*324,884*	171,957	*159,830*
Deposits	376,235	*321,449*	366,585	*320,449*
Total borrowings	735,359	*646,333*	538,542	*480,279*

Notes on the Accounts *continued*

18 Borrowings—*continued*

Notes

(i) Standby facilities

The shareholders have made available two standby facilities as follows:
Facility A amounted to £300,000,000 at March 31 1980. Its purpose is to support FFI's medium term variable rate lending. At March 31 1980 no amount had been drawn down but medium term variable rate loans to customers of £174,427,000 were outstanding, financed by short term borrowings with an initial maturity of less than one year which are covered by this facility.
Facility B amounts to £100,000,000 and its purpose is to support short term borrowings by FFI necessary to finance the provision of fixed rate facilities to customers pending appropriate arrangements being made by raising medium or long term loans or share capital. At March 31 1980 no amounts had been drawn down but after taking account of borrowings covered by Facility A and redeposits there remained short term borrowings of £22,000,000 covered by this facility.

(ii) Other Information

The debenture stocks are secured by floating charges on the assets of the issuing companies.

The other secured borrowings are secured as follows:

Ships under charter £7,663,000: *1979 £11,690,000*, property £4,136,000: *1979 £4,163,000*, and other assets £Nil: *1979 £Nil*.
All borrowings are repayable at par.
UK Finance and FCI have jointly and severally guaranteed the payment of principal of and interest on the unsecured loan stocks issued by FFI and the payment of principal of, premium, if any, and interest on the Sterling/U.S. dollar payable Bonds issued by FFI.
UK Finance has entered into Finance Contracts dated July 18 1973 and November 28 1974 with European Investment Bank under which the Bank has granted a credit of £4,100,000: *1979 £4,100,000* to be used in financing projects in Development Areas. The sterling equivalent of the liability outstanding at March 31 1980 included in Bank Loans and overdrafts was £1,981,000: *1979 £2,383,000*. Amounts due from customers in respect of loans relating to the EIB credits total £1,734,000: *1979 £2,012,000* and are included with debentures and secured loans (note 9). The securities given by customers for these loans are held in trust for the Bank.
A global loan facility of £10,000,000: *1979 £10,000,000* has been granted to FFI by the European Coal and Steel Community to be used for onward lending to businesses. At March 31 1980 £10,000,000: *1979 £9,535,000* had been drawn down and £10,000,000: *1979 £2,359,000* had been advanced to customers.
A second global loan facility of £20,000,000: *1979 £Nil* for onward lending to customers has been granted to FFI by the European Coal and Steel Community with an exchange risk guarantee by the Department of Industry. At March 31 1980, £5,231,000: *1979 £Nil* had been drawn down and £2,749,000: *1979 £Nil* had been advanced to customers.

19 Current liabilities other than borrowings

	Group		FFI	
	1980	*1979*	1980	*1979*
	£000	*£000*	£000	*£000*
Creditors and accrued charges	34,347	*30,468*	12,323	*10,106*
Proposed dividend	3,000	*200*	3,000	*200*
	37,347	*30,668*	15,323	*10,306*

20 Further commitments

a Under contract				
Financial facilities	64,065	*56,773*	—	—
Hire purchase receivables	6,383	*9,589*	—	—
Properties and development sites	7,909	*5,683*	—	—
Ships	16,900	*8,200*	—	—
Onward leasing	47,375	*11,474*	—	—
	142,632	*91,719*	—	—
b On offer subject to acceptance and contract				
Financial facilities	70,393	*17,265*	—	—
Hire purchase receivables	1,424	*2,455*	—	—
Development sites	6,993	*330*	—	—
	78,810	*20,050*	—	—

Notes on the Accounts *continued*

	Group 1980 £000	*1979 £000*	FFI 1980 £000	*1979 £000*
21 Contingent liabilities				
a Contingent liabilities relating to the guarantee of recourse agreements and loans	27,658	*34,899*	28,179	*26,800*
b Contingent liabilities relating to underwriting agreements	173	*129*	—	—

No material claims are expected

FFI and FCI have jointly and severally given guarantees as to the payment of principal of and interest on the undermentioned loan capital of UK Finance:

(i) £20,000,000 10½% Unsecured Loan Stock 1986, of which £13,731,172 was outstanding at March 31 1980

(ii) £15,000,000 11% Unsecured Loan Stock 1988, of which £9,545,251 was outstanding at March 31 1980

(iii) £10,000,000 11¾% Unsecured Loan Stock 1990, of which £3,592,146 was outstanding at March 31 1980

(iv) £15,000,000 12½% Unsecured Loan Stock 1992 all of which was outstanding at March 31 1980

In addition, FFI and FCI have jointly guaranteed borrowings of UK Finance made after March 2 1976 up to £23,734,000: *1979 £20,000,000* at March 31 1980 these borrowings amounted to £8,650,000: *1979 £1,000,000.*

FFI and UK Finance have jointly and severally given guarantees as to the payment of principal of, premium, if any, and interest on £20,000,000 14½% Sterling/U.S. dollar payable Bonds 1988 issued by Finance for Industry International B.V. all of which was outstanding at March 31 1980.

Finance for Industry Ltd

Consolidated Subsidiaries

The following list includes the principal Consolidated Subsidiaries, which are incorporated in the UK unless otherwise stated.	Issued share capital preference	Issued share capital equity	percentage held by FFI %
Subsidiaries Involved in Fund Raising Activities			
FFI (UK Finance) Ltd. (formerly Industrial and Commercial Finance Corporation Ltd.)		£150,000,000	100
Finance for Industry International B.V. (*The Netherlands*)		D.Fl 35,000	100
Subsidiaries Involved in Investment Activities			
Finance Corporation for Industry Ltd.		£3,750,000	100
Industrial and Commercial Finance Corporation Ltd. (formerly Donbry Investments Ltd.)		£200,000	100
ICFC (Guernsey) Ltd. (*Guernsey*)		£3,250,000	100
ICFC (Jersey) Ltd. (*Jersey*)		£2,500,000	100
ICFC (Isle of Man) Ltd. (*Isle of Man*)		£1,000,000	100
Technical Development Capital Ltd.		£2,000,000	100
London Atlantic Investment Trust Ltd.		£2,851,876	55
Finance for Shipping Ltd.		£285,000	100
wholly owned subsidiaries			
Ship Mortgage Finance Co. Ltd.			
Nile Steamship Co. Ltd. (*registered in Scotland*)			
Hamilton Leasing Ltd.		£5,921,250	100
wholly owned subsidiaries			
Medenta Services Ltd.			
Hamilton Leasing (Scotland) Ltd. (*registered in Scotland*)			
Hamilton Leasing (Ireland) Ltd. (*Republic of Ireland*)		IEP 3,000,000	100
Highland Leasing Ltd.		£1,390,162	100
ICFC Leasing Ltd.	£137,500	£2	100 100
ICFC Developments Ltd.		£100	100
ICFC Properties Ltd.		£100	100
wholly owned subsidiary			
Anglia Commercial Properties Ltd.			
wholly owned subsidiary			
Anglia Commercial Properties (Investments) Ltd.			
Subsidiaries Providing Services			
ICFC Corporate Finance Ltd.		£250,000	100
ICFC Consultants Ltd. (formerly ICFC Training and Management Consultants Ltd.)		£110,000	100
ICFC Trustee Co. Ltd.		£100,000	100
Gardens Pension Trustees Ltd.		£100	100
Gardens Nominees Ltd.		£3	100

Associated Companies

		Loans from FFI Group £	Accounts made up to	% of voting equity held by FFI Group
Listed				
Estate Duties Investment Trust Ltd.	investment trust	—	Mar. 1980	40
North British Canadian Investment Company Ltd. (became an associate on March 31 1980)	investment trust	—	Feb. 1980	22
Unlisted				
London American International Corporation Ltd.	export finance and marketing	—	Sept. 1979	25
W. M. Mann & Co. (Investments) Ltd.	finance company	475,000	Dec. 1979	33
Keep Brothers Ltd.	confirming house	—	Sept. 1979	45
The Frizzell Group Ltd.	insurance broking and finance	—	Dec. 1979	45

The Secretary of State has modified the requirements of the Protection of Depositors (Accounts) Regulations 1976 so that the definition of associated companies accords with that set out on page 14 under Accounting Policies. The loans were made in the ordinary course of business at rates of interest between 12% and 18% and are repayable by instalments over periods up to 1988. All interest due on these loans to March 31 1980 has been paid.

Finance for Industry Ltd

Industrial Subsidiaries—not consolidated

		Issued share capital preference	Issued share capital equity	percentage held by subsidiaries %
Trind Ltd.	engineering group		£2,948,704	100
wholly owned subsidiary				
Triangle International Ltd.				
wholly owned subsidiaries				
Triangle Valve Co. Ltd.				
Henry Livesey Ltd.				
Triangle Controls Ltd.				
Triangle Valve Corporation (*USA*)				
Triangle Alloys Ltd.				
H. Broadbent & Son Ltd.				
Dewracan Ltd. (*Canada*)				
partly owned subsidiaries				
Triangle Valve & Foundry Pty. Ltd. (*Australia*)				50
Triangle Valve of Canada Ltd. (*Canada*)				51
Dewramet Ltd.	engineering company		£100	100
Hudswell Holdings Ltd.	engineering group	£20,000	£2,000	100
partly owned subsidiary				
Hudswell Badger Ltd.				79
partly owned subsidiary				
Total Mechanical Handling Ltd.				71

Auditors' Report
to the members of Finance for Industry Ltd

We have examined the accounts of Finance for Industry Ltd. set out on pages 10 to 12 and 14 to 30. These have been prepared under the historical cost convention. Incorporated in the consolidated accounts are accounts of subsidiary and associated companies audited by other auditors whose reports we have reviewed.

In our opinion the accounts give a true and fair view of the state of affairs of the company and of the group, so far as concerns members of the company, at March 31 1980 and of the profit and source and application of funds of the group for the year then ended and comply with the Companies Acts 1948 and 1967 and the Protection of Depositors (Accounts) Regulations 1976.

We have also examined the inflation accounting statement together with the notes thereon on page 13 for the year ended March 31 1980. In our opinion the statement has been properly prepared in accordance with the methods set out in the notes.

Ernst & Whinney
Chartered Accountants
London June 24 1980

Greenaways London AR 81660

10 DOWNING STREET

Tim, yes. Thank you.

TL..

contents BF 13.1.81

for the next routine meeting? (on 14 Jan)

HMT to TPL 22.12.80.

Gillian

24/12

JU

cc Mr Ingham

2

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

23 December 1980

Tim Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Prime Minister
On x below, ICFC will be sending us some good material on Monday.
TL 23/12

Dear Tim

1 I understand that the Prime Minister asked at this morning's meeting with my Secretary of State for details of births and deaths of companies as derived from VAT registrations and de-registrations. The Prime Minister may recall that this work, which was initiated by Mr Mitchell, was discussed briefly at her meeting on small firms policy on 14 October.

... 2 I attach a note by our statistician which seems to indicate that there were broadly 65,000 "births" and 64,500 "deaths" in the first half of 1980. We are by no means clear at the moment about the validity of these figures. Our statistician is surprised that they appear to show such a degree of buoyancy and is currently carrying out further investigation to see whether the births are artificially inflated, e.g by registration for tax/technical reasons, or whether deaths are under stated. There are also the other caveats recorded in Mr Ganguly's note.

3 Mr Mitchell and my Secretary of State are both taking a close interest in this work and we hope that further figures and some confirmation of their validity can be established quickly, since they are the only likely source of up-to-date statistics on births and deaths of firms, and particularly small firms, in the economy. Meanwhile, I would emphasise that the figures should be used with considerable caution, and in the light of the other economic indicators and the doubts we have about methodology, the grounds for optimism they represent should not be pressed too far.

x 4 In the time available, I have not been able to obtain any detailed information on the ICFC. You may, however, care to note that the ICFC's <u>outstanding</u> investment at 30 September 1980 was £363 million.

Yours ever
Richard Riley
RICHARD RILEY
Private Secretary

Reference CD/86/04

1 Mr ~~Kendall~~

2 PS/Mr Mitchell

RECEIVED IN THE OFFICE OF THE PARLIAMENTARY UNDER SECRETARY OF STATE FOR INDUSTRY
-6 OCT 1980
MR. DAVID MITCHELL

cc Miss Mueller
Mr Wright
Mr Berman
Mr Rees
Mrs Marquand
Mr Norton (BSO)
Mr Middleton (C&E)

BIRTHS AND DEATHS OF FIRMS JANUARY-JUNE 1980

1 I attach a report on the above which Mr Mitchell called for by the end of September but which unfortunately has been delayed.

2 The report spells out the various qualifications and points out that while the VAT information offers what is probably our best chance of monitoring births and deaths across the whole economy, the enclosed estimates which show that there was a net deficit of 501 firms in the first half of the year, can only be regarded as very rough and ready and best restricted for internal purposes only.

3 I am sending a copy of the report to Mr Middleton of Customs and Excise whose help has been invaluable in undertaking this project.

A Ganguly

A GANGULY
Room 330 Abell House
211 6753/6808

7 October 1980

AW ~~DA~~

1. Thank Mr G – he is doing v. valuable work –
2. ask for figs of ~~that~~ new VAT payers to be reduced to account for effect of inflation on riding up in, + a comment on any indication of nos eligible to Deregister when min. level of compulsory registn raised

3. By plotting a straight line graph before & after the (June?) Quarter can we estimate the extent of de-registration arising from the raising of lower limit to £13,500

CODE 18 77

MM

BIRTHS AND DEATHS OF FIRMS BY SECTOR - SUMMARY FOR QUARTERS 1 AND 2 1980

Number of Records

Period	Item	Agricul-ture	Production	Construc-tion	Transport	Whole-sale	Retail	Finance Property and Professional Service	Catering	Motor Trades	Other Services	Total
st Qtr 1980	Net Births	1,370	3,414	6,490	1,728	3,158	6,344	2,794	2,748	2,122	5,679	35,8
	Deaths											
	Total	1,051	2,559	3,974	1,259	2,241	7,392	1,344	2,856	1,461	3,159	27,7
	Code 1	353	1,800	2,882	879	1,642	2,952	834	775	965	1,895	15,4
	Code 2	316	423	244	160	354	3,568	184	1,742	291	506	7,7
	Code 9	382	336	848	220	245	872	326	339	207	758	4,
	Excess	319	855	2,516	469	917	-1 048	1,450	- 108	661	2,520	8,0
d Qtr	Net Births	1,122	2,858	4,879	1,401	2,685	5,324	2,006	2,573	1,673	4,276	28,7
	Deaths											
	Total	1,554	3,003	4,670	1,679	2,548	10,061	2,180	4,287	1,914	5,448	37,
	Code 1	836	1,808	2,806	976	1,614	3,257	970	794	1,043	1,984	16,
	Code 2	366	530	274	147	392	3,983	261	2,077	343	575	8,9
	Code 9	352	665	1,590	556	542	2,841	949	1,416	528	2,889	12,
	Excess	- 432	- 145	209	- 278	137	-4,737	- 174	-1,714	- 241	- 1,172	-8,34
otals	Net Births	2,492	6,272	11,369	3,109	5,843	11,668	4,800	5,321	3,795	9,955	64,6
	Deaths											
	Total	3,105	5,562	8,644	2,938	4,789	17,453	3,524	7,143	3,380	8,607	65,
	Code 1	1,689	3,608	5,688	1,855	3,256	6,189	1,804	1,569	2,011	3,879	31,5
	Code 2	682	953	518	307	746	7,551	445	3,819	634	1,081	16,7
	Code 9	734	1,001	2,438	776	787	3,713	1,275	1,755	735	3,647	16,
	Excess	- 613	710	2,725	171	1,054	-5,785	1,276	-1,822	415	1,348	- 5

Notes: Net Births = All new registrations less registrations following changes of legal identity less Voluntary Registrations.

Deaths:

[illegible]e 1 = Trader going out of business
Code 2 = Trader going out of business buyer already registered or in process of being registered.
Code 9 = Trader falls below exemption limit
Trader registered voluntarily seeks to be deregestered.
Trader makes zero rated supplies only and requests exemption.

BIRTHS AND DEATHS OF FIRMS BY SECTOR: JANUARY-JUNE 1980

1 For some years now the BSO have been receiving notifications of VAT Registrations and deregistrations and from the beginning of this year Customs and Excise have also been providing the "reason codes" relating to deregistrations of traders. The attached figures, based on BSO Computer tabulations, are the first rather provisional estimates of how many firms might have come into being and how many died during the first two quarters of this year. It would appear that there was a net loss of 501 firms in the six months (the respective figures being 64644 and 65145) with retailing, catering and agricultural businesses declining in numbers while those in construction, wholesaling, finance/property/professional services increased. A scrutiny of the detailed information shows the main features to be a relatively large number of new registrations in the first quarter and a sudden increase in June in the number of deregistrations of traders falling below the VAT threshold etc to over six times the monthly average of the previous five months.

2 It is as well to state clearly that we are not sure whether the estimates are meaningful in any real sense since the information is as yet so limited and there are so many issues to consider. However it is possible to point to two sets of factors which, it is reasonable to assume, play an important role in any consideration of estimates based on VAT information:

(i) changes in the environment in which VAT operates, eg tax rates, registration limits etc; and

(ii) problems associated with the use of information for a different purpose than that for which it was collected, eg problems of definition.

3 Environmental changes:

(a) When the VAT rate was increased from 8% (and 12.5%) to 15% in June 1979 there was no accompanying increase in the registration limit at a time of high inflation (the limit was raised as from 27 March 1980). This suddenly brought a lot of traders above the registration limit (there were also the small unregistered traders who had to increase prices (and therefore turnover) to cover the higher costs of inputs on which they were not reclaiming tax).

(b) This year the March budget increased the deregistration limit as from 1 June 1980 and this was largely responsible for the large increase noted above. Later figures are not yet available so we do not know whether the figures for July onwards have stabilised and if so at what level.

(c) In the longer term the position seems to be that since increases in the registration and deregistration limits are necessarily a step behind inflation (due to the sixth Directive), more traders are forced into the VAT net. And it has been the experienceof Customs and Excise that once registered, traders tended not to deregister when the limit was raised to a level exceeding their turnover. This has produced a "ratchet effect" contributing to the rising trends of net new registrations regardless of the underlying situation.

4 Data problems:

(a) Deaths have been defined as businesses ceasing to trade (whether or not there is a buyer for the business) and those falling below the VAT threshold (including those voluntarily registered and those making zero-rated supplies only seeking exemption). Births have been defined as all new registrations less those arising from changes of legal identity and, since the VAT threshold is at such a level as to bring in virtually all full-time traders, we have also excluded voluntary registrations. It is possible to estimate deaths directly from the available information but there is nothing comparable for births so this has to be estimated indirectly. We have tried to produce definitions which are most nearly compatible with each other and which are more likely in the longer run to yield consistent estimates. But it is perfectly possible to arrive at a different set of definitions using a different permutation of the data and leading to a different balance between births and deaths. Only time can tell what would be the most generally acceptable within the restrictions imposed by the information available.

(b) Due to belated notifications by traders there are substantial and varying time-lags involved in recording new registrations and deregistrations. This means that unless one is prepared to wait for a very long time estimates can only be prepared on the basis of a statistical judgement as to the amount of information outstanding. This in turn is most soundly based on the monitoring of, say, monthly figures of births and deaths at fixed intervals of time. The BSO are producing the computer tabulations but given the short time available to prepare this report it was necessary to use the results of a trial-study of time-lags associated with a sample of tapes from 1977. This is obviously not entirely satisfactory since by its very nature the trial could not take into account dynamic changes in the pattern of time-lags.

5 To conclude, it would appear that during the first half of 1980 there were 501 more deaths than births (as defined) but there are several short-term factors not connected with the underlying situation which might have been instrumented in tipping the overall balance. In addition there are conceptual and practical problems of defining births and deaths and there are complications due to substantial time-lage in the data which would take time to resolve. In short, as we need a lot more information before we can take a reasoned judgement as to the true position regarding births and deaths, at this point in time these rough and ready estimates could be restricted for internal purposes only.

6 Having set out some of the difficulties involved, I think it is only fair to point out that the VAT information probably offers thebest prospect of being able to construct in a cost-effective manner an acceptable body of data relating to births and deaths of firms across the economy.

A Ganguly

A GANGULY
Room 327
Abell House
211 6753

7 October 1980

Prime Minister 2 A

A rather negative response, I am afraid.

TL 23/12

I will speak of course to the Chancellor MS.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000 22 December 1980

T P Lankester Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Tim,

Flag A

You wrote to John Wiggins on 4 December with an idea for a tax relief arising out of the Prime Minister's recent discussions with Signor Forlani. The purpose of the relief was to induce unquoted companies to borrow through the market rather than through the banks.

This has a bearing on two areas which the Chancellor has already asked officials to review. The first is ways of encouraging companies to switch from bank borrowing to debentures. The second is fiscal inducement for outsiders to invest in unquoted companies.

In the first, we are not discriminating between quoted and unquoted companies. But in practice anything which emerges is likely to affect mainly quoted companies. This is because there is little by way of market mechanism whereby unquoted companies can borrow from individuals. For the same reason, it is doubtful whether exempting the individual lender from tax on the first part of any interest would have much practical effect. (Entrepreneurs do of course lend to their own companies, often to avoid their companies having to pay high interest rates to the banks.)

The second - the possibility of encouraging investment by individuals in the equity of unquoted companies - is also relevant. There is of course always the possibility that individuals will in turn borrow from the banks in order to invest, with tax relief, whether in equities or through lending. But investment of either kind could help to reduce the dependence of the companies on bank borrowing.

/While we do not

While we do not think the particular suggestion you mentioned is a runner therefore, you will see that we do have this area under close review.

Yours sincerely,

Richard Tolkien

R I TOLKIEN
Private Secretary

From: Michael Colvin, M.P.

HOUSE OF COMMONS
LONDON SWIA OAA

The Rt. Hon. Mrs. Margaret Thatcher, M.P.,
Prime Minister,
10 Downing Street,
London, SW1.

22nd December 1980

Dear Prime Minister -

The Officers of our Smaller Businesses Committee have asked me to request a meeting with you early in the New Year to discuss the problems which face this vital sector of our economy, and measures which we feel the Government should consider in order to make it easier for Small Businesses to overcome them.

We are concerned about our Manifesto commitments to Small Businesses, which acknowledged that the creation of new jobs depends to a great extent on their success, and promised certain reforms.

The matters of particular concern to us are:-

1. A Loan Guarantee Scheme, which we suggest can be implemented without any cost to Government.

2. The reform of Capital Taxation, which at present forms a sharp deterrent to medium sized businesses.

3. Alterations in the scale of Corporation Tax, which hits medium sized Companies unfairly.

4. Measures to stimulate the entrepreneural spirit in well-educated people, thereby achieving an improvement in the rate of the start-up of new firms.

We should be most grateful if this meeting could be arranged towards the end of January, by which time we shall have had the benefit of discussions with the Chancellor of the Exchequer and Secretaries of State for Industry and Employment.

Yours sincerely

Michael Colvin

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

4 December 1980

Fil
R[illegible]

See Italy: Visits by PM: Part 2.

BF 22.12.80

You will have seen from Michael Alexander's letter of 24 November in which he summarised the Prime Minister's tête-à-tête discussion with Signor Forlani the previous evening that Signor Forlani said that the Italian Government were offering tax incentives to enable non-quoted companies to borrow through the market rather than through the banks.

The Prime Minister has asked me to say that she was much impressed by this idea, and she would like the Chancellor to consider the possibility of introducing something on similar lines here. Presumably this could be looked at as part of the further work on small firms. Signor Forlani indicated that non-quoted companies in Italy would be given an incentive to borrow through the market by being exempted from paying tax on the borrowings. It is not clear that such a scheme would be applicable in the UK since, as I understand it, interest is deducted from trading profits before corporation tax is charged. The Prime Minister has accordingly suggested that we might emulate the Italians, not by exempting them from tax on their borrowings, but by making the interest received by individuals on lending to non-quoted companies up to a certain figure (say £1,000) tax free.

Could you please let me have a note within the next three weeks on whether this idea might be a runner for the Budget.

T. P. LANKESTER

A.J. Wiggins, Esq.,
HM Treasury.

VLB

cc D/I

Econ Pol

10 DOWNING STREET

THE PRIME MINISTER

7 November 1980

Dear Sir Ray,

Thank you for sending me and my colleagues copies of the Confederation's publication "Small Firms in the Economy".

We value the fact that you have commissioned this comprehensive statement both of the role of small firms in the economy and of the policies which the CBI have evolved for its smaller firm membership. I am sure that the coverage in the document of both these aspects will help to provide a greater understanding of the problems faced by the owners of small businesses and will, I believe, contribute to the debate on the requirements which are necessary for the sector to prosper and grow.

For our part, we shall want to give some further thought to the document and to assess the implications of some of your proposals.

Yours sincerely

Margaret Thatcher

Sir Raymond Pennock

JS

6 November 1980

I would be grateful for a draft reply for the Prime Minister to send to the enclosed letter from Sir Ray Pennock about sickness pay. It would be most helpful if this could reach me by Friday, 13 November.

T. P. LANKESTER

Don Brereton, Esq.,
Department of Health and Social Security.

File

6 November 1980

I am writing on behalf of the Prime Minister to acknowledge your letter of 6 November about sickness pay. I will place this before the Prime Minister and a reply will be sent to you as soon as possible.

T. P. LANKESTER

Sir Raymond Pennock

PRIME MINISTER

I attach a draft acknowledgement for you to send to the CBI, in response to their paper "Small Firms in the Economy". Flag A is a commentary from Keith Joseph's office. The Department conclude that none of the points raised in the document have been sufficiently developed to call for a more substantive Government response.

MAP

4 November 1980

JH

A

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

PS/ Secretary of State for Industry

31 October 1980

Mike Pattison Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Mike,

In your letter of 17 October to Tony Willis you asked for advice on the CBI paper entitled "Small Firms in the Economy" which has been sent to the Prime Minister and other appropriate Cabinet Ministers.

2 The principal purpose behind the paper is to provide a stimulus and framework for continuing the debate within the CBI on the role of small firms in the economy. In terms of its status, the paper is an internal staff document but, in the course of its preparation, it was decided to distribute it more widely and hence its publication. However, I understand that the CBI do not see the paper as a vehicle for a comprehensive lobbying of Government and for this reason a co-ordinated, detailed and defensive response is not called for at this stage. What the CBI would welcome is a positive acknowledgement of their paper and the expression of an intention to analyse and take account of its more developed proposals. A draft letter for the Prime Minister to send to
... Sir Raymond Pennock is attached.

3 Taken as a whole the paper represents a long if not inspiring attempt by the CBI to set small firms in the context of the economy generally. They attempt to define the needs of their smaller firm membership and try to identify future policy issues that have yet to be resolved. The paper is well balanced and restrained and in a number aspects represents a clear reflection of Government thinking. For this reason it is largely helpful to the Government's cause and we are glad they have chosen to publish it.

4 As to the contents of the paper, much space is devoted in Chapter I to statistical and background data on the small firms sector and its contribution to the economy. In some instances, comparison is drawn with other western countries. This represents a useful summary of known data but it contains no revelations.

5 The paper continues with a section describing current CBI policies in relation to the needs of small firms (Chapter II). Against the background of a need for a healthy economic climate and

/a ...

a sympathetic environment, the main objectives of their policies are the control of inflation, a steady and maintained economic growth and improved competitiveness. In their view, no amount of subsidies or special incentives can hope to compensate for these essential requirements.

6 Here and elsewhere, the paper gives due recognition to the fact that, since this Government took office, many of the policies that they have been advocating have been accepted. But notwithstanding the measures introduced by the Government they still see scope for further action. On the question of finance for small firms, the CBI see the greatest scope for Government action lying in fiscal and company law measures. They do not see any justification for the provision of a Government backed loan guarantee scheme.

7 As regards direct Government financial assistance, the CBI does not advocate special subsidies for small firms but is concerned that small firms should be eligible for current schemes of assistance. Otherwise, their attitude to financial assistance is the same as that adopted on behalf of their larger members; namely, that it should be reduced as and when company profitability increases.

8 The paper is complimentary about the advice, information and other forms of practical assistance offered through Government agencies such as the Small Firms Service and CoSIRA. It also asks for further action to reduce the legislative and other burdens imposed by Government on industry which have in the past done much to inhibit the start up and growth of small businesses.

9 On industrial relations and employment law the paper states that significant progress has been made since May 1979 but that further measures are required, for example, to restrict trade union immunities and to remove some of the worst abuses of the closed shop. But it recognises over this whole area that the direction of Government policy is clear and that the scope for further reform is being examined. The section continues with a rehearsal of the CBI's views on company and commercial law, international trade policy, on industrial change and innovation.

10 The next section covers weighty chapters (III and IV) on smaller firms and employment and smaller firms and finance. The narrative runs along predictable lines and there are no new departures from established CBI views or policies. On employment, the paper warns that it is important not to overestimate the potential of the small firms sector as a source of employment and future job opportunities as this could lead to unreasonable expectations that would be impossible to fulfil. The paper states that larger businesses, the financial institutions and Government all have a role to play improving the flow of funds to small firms. However, in the case of the latter it reiterates the belief that action should be taken through fiscal and company law measures rather than through direct interventionist measures such as a loan guarantee scheme.

/11 ...

11 The final section of the paper highlights issues for further action and debate (Chapter V). The first part of the Chapter reiterates the specific proposals for action contained in Chapter II. These proposals represent agreed CBI policy but the Chapter continues with some rather vague interrogative comments about unsolved issues which should be the subject of further discussion. These include government intervention in general, public purchasing, regional policy, taxation finance and advice and education. None add up to substantive new points or issues which have been sufficiently developed to call for a Government response.

12 I am sending copies of this letter to the recipients of yours.

Yours ever,

Richard Riley

RICHARD RILEY
Private Secretary

DRAFT LETTER FOR THE PRIME MINISTER TO SEND TO:

Sir Raymond Pennock
President of the Confederation
of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU

Thank you for your letter of 16 October enclosing the Confederation's publication "Small Firms in the Economy". (I am replying on behalf of my colleagues to whom you also sent the report.)

We value the fact that you have commissioned this document which represents a comprehensive statement of the role of small firms in the economy and also the policies which the CBI have evolved for its smaller firm membership. I am sure that the coverage in the document of both these aspects will help to provide a greater understanding of the problems faced by the owners of small businesses and will, I believe, contribute to the debate on the requirements which are necessary for the sector to prosper and grow.

For our part, we shall want to give some further thought to the document and to assess the implications of some of your proposals.

MAP 31/10

2

MR. ~~SANDERS~~ PRIME ~~MINISTER~~

To see MJS 29/10

You asked whether indeed we, in Press Office, revealed the meeting on small firms which the Prime Minister chaired.

The answer is that we did not reveal that this meeting was taking or had taken place. It is not our practice to disclose meetings of this kind and so far as I can establish we have not been asked questions about this meeting.

Bernard Ingham

28.10.80

BF 30.10.80

10 DOWNING STREET

From the Private Secretary

17 October 1980

I enclose a copy of a letter to the Prime Minister from Sir Ray Pennock, which covered the new CBI paper "Smaller Firms in the Economy".

I should be grateful for a note covering the main issues raised in the document, together with the draft of a letter in which the Prime Minister can make initial comments on the main themes of the paper in acknowledging receipt. It would be helpful if we could have something by 30 October.

I am sending copies of this letter to the Private Secretaries to the Chancellor of the Exchequer, and the Secretaries of State for Industry, Trade, Employment and Environment.

M. A. PATTISON

Anthony Willis, Esq.,
Department of Industry.

Econ Pol
Small Firms
Policy

2

BF?

10 DOWNING STREET

PRIME MINISTER

Ray Pennock has sent you a new CBI staff document on the role of smaller firms in the economy.

I shall ask David Mitchell to provide a brief commentary on the document, and to suggest what you might say in a letter to Sir Ray acknowledging the document.

S.J. Pike
Duty Clerk
for MAP

17 October 1980

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From the President
Sir Raymond Pennock

CBI CONFEDERATION OF BRITISH INDUSTRY

16 October 1980

Dear Prime Minister,

I have much pleasure in sending a copy to you of a new CBI staff document entitled "Smaller Firms in the Economy", which is to be published on 20 October.

The document brings together the available information on the position of smaller firms in the economy, and sets out the relevant aspects of CBI policy. It throws light on two important areas - the impact of smaller firms on employment, and their financial needs. In this way the document serves to broaden understanding of the role of smaller firms in the economy.

With over half its members drawn from the smaller firms sector, the CBI is well placed to represent the policy needs of smaller firms; in the final section of the document, attention is drawn to issues affecting smaller firms which we believe need action or further discussion. We think in the CBI that this final chapter is specifically relevant but hope that you will find the full document a valuable contribution to the smaller firms debate.

I am also sending copies to the Chancellor of the Exchequer, the Secretaries of State for Industry, Trade, Employment and the Environment, and the Parliamentary Under Secretary of State responsible for small firms.

Yours sincerely,

Ray Pennock

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

Ref. A03265

MR. LANKESTER R.

Small Firms Policy

I attach a record of the meeting on small firms policy which the Prime Minister held on Tuesday, 14th October. This has been prepared in the Cabinet Office but not distributed to any of the Departments involved. You will no doubt wish to arrange distribution yourself.

D J Wright

D.J. WRIGHT

16th October, 1980

C.F.

1. Copy to all participants

2. Copies also to Mr Wolfson
Mr Duguid
Mr Ingham

3. Mr Lankester to see O/R
then r.a.

MAP 16/x

MINUTES of a Meeting held at 10 Downing Street on
TUESDAY 14 OCTOBER 1980 at 10.30 am to discuss Small Firms Policy

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PRESENT

Prime Minister

Chancellor of the Exchequer	Secretary of State for Industry
Secretary of State for Employment	Secretary of State for the Environment
Secretary of State for Social Services	Minister of State, Department of Trade (Mrs Oppenheim)

Parliamentary Under-Secretary
of State, Department of Industry
(Mr Mitchell)

Sir Robert Armstrong
Mr D J L Moore

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1. The meeting considered a note of 6 October from the Parliamentary Secretary, Department of Industry to the Prime Minister on small firms policy. They also had before them a note of 13 October from the Secretary of State for Trade.

2. The Parliamentary Secretary, Department of Industry said that in the first six months of 1980 start-ups and closures of small firms were broadly in balance. More recently however there were signs of an increase in the rate of closures, mainly because of a drop in orders and the high costs of borrowing on overdraft. So far the organisations representative of the small firms had welcomed the measures taken to help them and had been restrained in public criticism of the Government over the difficulties still facing them. It was however likely that their frustration over these difficulties would come increasingly to the surface, particularly if no concessions were made to them over the proposed transfer of the provision of sickness pay for the first eight weeks to the employer. There were four main components of the Government's policy towards small firms: to reduce the burdens facing new firms starting up and expanding; to give incentives through lower personal taxes; to increase resources within the firms; and to improve advisory services. The Government had already introduced a number of useful measures to help small firms but financing

remained as the major outstanding problem. Annex A to his note summarised measures currently under consideration; Annex B proposed some further measures; and Annex C listed the achievements in the Government's first fifteen months of office.

A: MEASURES UNDER REVIEW

Fiscal Measures

3. In discussion of the fiscal measures currently under consideration, and listed in Annex A to the note, the Chancellor of the Exchequer made the following points -

i. The Treasury's FASE Group, which now included five outside experts, were giving priority to examination of a limited scheme of tax relief for equity investment in small firms. Their aim was to make proposals by Christmas and he hoped that it would be possible to introduce a scheme in his next Budget. The Treasury were also looking at the possibility for the introduction of small business investment clubs, although it was uncertain whether any new measures could be introduced in the next Budget.

ii. It would be too costly to make any early changes in capital taxation, although he did not rule out the possibility of further changes later on in this Parliament.

iii. The proposal for a system of estimating quarterly payments of VAT by small firms had been thoroughly examined before, and ruled out as having considerable practical difficulties. He accepted however that the meeting would welcome some help to small firms in this direction and he would ask the Minister of State, Treasury, Mr Rees, to consider this further with Mr Mitchell.

iv. Mr Rees had recently visited America to examine fiscal incentives there, and in particular those aimed at high technology growth industries. He was now considering whether any of these ideas might be suitable for introduction here. Mr Rees would cover the possibility of a scheme of share options for employees but it would be necessary to avoid tax-free handouts and the Chancellor could not give an assurance at this stage that any such scheme could be included in the next Budget.

v. The Secretary of State for Trade, in his note of 13 October, had pointed to the case for following up the amendments to company law to permit companies to purchase their own shares by tax changes. Treasury Ministers were now considering this although he could not guarantee at this stage that changes could be made in the next Budget.

Training

4. The Secretary of State for Employment said that it might be possible to do something further for training of managers of small firms in the course of the current review of industrial training. This would not however necessarily be through the Industrial Training Boards, since it was likely that they would be reduced in number.

Rates

5. Rates were a considerable burden on industry but there was no early prospect of de-rating sealed parts of business premises. It would cost too much at a time when local authority finances were already under strain.

Gas Boards

6. The Secretary of State for Trade would make proposals later in the year when he had completed his consultations on the Monopolies and Mergers Commission's Report on Gas Boards.

Sick Pay

7. The Secretary of State for Social Services said that consultations were now completed on the Green Paper proposing the transfer of the provision of sickness pay for the first eight weeks to the employer. His provisional judgment was that to win support for the legislation to enable these changes it would be necessary to make some further financial concessions to firms, without losing the major staff savings which were in prospect. He would wish to discuss the options further with the other Ministers concerned and, on a confidential basis, with representatives of the employers. These discussions would cover, among others, the special problems of the small firms. He would then put proposals to the Home Affairs Committee, although it was unlikely that he would be able to do so by 21 October as had been hoped.

B. POSSIBLE FURTHER MEASURES

Corporation Tax

8. The Chancellor of the Exchequer said that a review of stock relief was well in hand. When it was completed he would consult other Ministers. He would be willing to consider any detailed proposals Mr Mitchell might put forward on the carry-back of first year allowances for investment and on start-ups. It would however be necessary to look carefully at the costs and practicality of any such schemes. He noted the meeting's view that it would be better to relate any reliefs to profits and to avoid the risks of giving what would effectively be grants to basically unprofitable companies.

Loan Guarantee Scheme

9. In discussion it was pointed out that, while the banks had made some progress in increasing their lending to small firms, they were still moving too slowly. In particular they were sometimes unhelpful in meeting the requirements of small firms wishing to expand. They demanded too high a collateral - often a pledge of the owner's house - for such lending. There should now be an urgent re-examination of the possibilities for introducing a scheme to deal with this problem. The scheme should not involve subsidies; and it was suggested that, with allowance for the costs of starting it up, it might be on the lines of the self-financing Agricultural Credit Corporation. The introduction of such a scheme, or even renewed discussion of its possibility, might well stimulate the banks to greater activity in this area.

Management Advisory Services

10. The Secretaries of State for Industry and for the Environment were discussing the case for combining the activities of the Department of Industry's Small Firms Advisory Service with that of the Department of the Environment's Council for Small Industries in Rural Areas (COSIRA).

11. THE PRIME MINISTER, summing up the discussion said that the meeting had taken note of a number of measures on which work was in progress. The possibilities for further fiscal concessions were constrained by the costs and if the Parliamentary Secretary, Department of Industry, wished to ask the

Chancellor of the Exchequer to consider any of his proposals further he should indicate what priority he attached to them. The meeting was particularly concerned that the banks were still failing to offer loans on reasonable terms to small and expanding firms. The Chancellor of the Exchequer and the Secretary of State for Industry should now consider this further and discuss the possibilities for introducing an unsubsidised loan guarantee scheme with the Bank of England, the clearing banks, and other lending institutions.

The Meeting -

1. Took note of the work in progress summarised in Annex A of the Parliamentary Secretary, Department of Industry's note of 6 October, and of the points made in discussion of it.

2. Invited the Parliamentary Secretary, Department of Industry to put to the Chancellor of the Exchequer any specific proposals he wished to make for further fiscal changes helpful to small firms, and to indicate the priority he attached to them.

3. Invited the Chancellor of the Exchequer, in consultation with the Secretary of State for Industry, to bring forward proposals as soon as possible, taking account of the points made in discussion, for the possible introduction of a new scheme of lending to small firms.

CIRCULATION: Those present.

18% earnings.
5% loss in profits

65,000. Econ Pol
500.

Ref: A03207

CONFIDENTIAL

PRIME MINISTER

£300m on stock relief
£200m to small business.

Small Firms Policy: 10.30 am Tuesday, 14th October

Mr. Mitchell's minute of 11th July to you records that you agreed to hold this meeting in order 'to shift some of the road-blocks which are holding up progress on small firms' policy'. In addition to Mr. Mitchell, the Ministers attending will be the Chancellor of the Exchequer and the Secretaries of State for Industry, the Environment, Employment and Social Services. The Secretary of State for Trade will be in Greece and he has set out his views in his letter of today's date. He is to be represented by Mrs. Oppenheim.

2. Mr. Mitchell's main theme in his minute of 6th October is that the raising of finance is now the major outstanding problem facing those wishing to start-up or expand small firms. The three annexes to his paper list:-

A. Work in hand.

B. Further measures which he would like examined.

C. The Government's achievements in this area over the last 15 months.

3. The Chancellor's office have circulated copies of a report by the Treasury's Interdepartmental Small Firms Working Group which sets out steps taken by the Government to reduce burdens on small firms. I do not think that the meeting will need to refer to this report since the ground is covered in Mr. Mitchell's Annex C.

HANDLING

1 4. After Mr. Mitchell has introduced his paper you might ask the
2 Chancellor of the Exchequer if he wants to make any general comments. He may well wish to set the scene for the discussion by warning that, although he has some useful fiscal initiatives in mind, the scope for introducing concessions is inevitably limited by the cost to the PSBR of tax reliefs and of direct public expenditure.

5. I suggest that you might then use Mr. Mitchell's Annexes A and B as annotated agenda for the main part of the discussion. The objective might be to go through the points listed and to identify any which merit further or swifter

action and any which should be ruled out. I doubt whether it is necessary to discuss Annex C, which summarises action already taken, but you might wish to conclude the meeting by asking whether there are any further points which Ministers think should be pursued. A number of the proposals are relatively detailed, and complicated, and I suggest that you should ask the Departments concerned to pursue them further outside the meeting.

Annex A

6. This is largely a list of work already in hand and you should be able to run through it relatively quickly. The items are conveniently grouped according to the responsibilities of the Ministers attending.

7. On the main points listed:-

(i) The Chancellor of the Exchequer will confirm that he is giving top priority to an examination of the feasibility and cost effectiveness of a scheme of tax relief for equity investment in small firms. The work is being carried out by the Treasury's FASE Group (Fiscal Aspects of the Strategy Exercise) and they have now recruited five outside experts, representative of the self-employed and those financing them, to help them on this work. I understand that they are likely to put proposals to Ministers by December.

(ii) The possibilities for management training for small firms can best be considered in the work which will follow the discussion in E on 15th October of the Secretary of State for Employment's paper on Industrial Training (E(80) 111).

(iii) De-rating of sealed parts of businesses premises has been considered before and ruled out. The main beneficiaries would be large rather than small firms. The loss of income would be a further burden on the local authorities unless the Government were to compensate them for it.

(iv) Mr. Mitchell's main complaint is likely to be against the proposed transfer of the provision of sickness pay for the first eight weeks to the employer. He will argue that if this applies to small firms it will negate most of the action which the Government has taken so far to help them. It may well be possible to do something to help small firms here but the Chancellor of the Exchequer will be anxious to avoid any major concessions - the proposals lead to DHSS staff savings of around 5,000 and to public expenditure savings in the order of £400 million a year (although the PSBR effect is broadly neutral because employers will be compensated by a reduction in their national insurance contributions). Consultations on this scheme have recently been completed and the Secretary of State for Social Services will be putting his proposals to H Committee on 21st October. In the meantime, and on the understanding that H will consider the problem of small firms, I suggest that the meeting should avoid pre-judging the question either way.

Annex B

8. The Chancellor of the Exchequer will be able to assure Mr. Mitchell that a review of a possible new scheme for stock relief is well in hand. He will probably be willing to agree that officials should look further at some of Mr. Mitchell's other proposals for tax relief, although with no assurance that they are all likely runners.

9. The proposal for a loan guarantee scheme has been examined before and the Chancellor and the Secretary of State for Industry have agreed that it should be left on ice. The Chancellor will probably remain of that view and argue that priority should be given to measures to encourage equity investment. As it is the banks have already increased their lending to small firms. It is questionable whether the introduction of the scheme would lead to additional lending and the Chancellor would not want to encourage the banks in that direction at this point in time. He will also want to avoid the risks of additional public expenditure which would occur to the extent that guarantees were called. There is however continuing pressure for the introduction of such a scheme and you will have seen that the Press have learnt of the fact that Ministers are to discuss it - eg The Times, October 10th, page 19.

10. Mr. Mitchell's third proposal for further action is that it might be sensible to merge the operations of the Department of Industry's Small Firms Service with those of the Department of the Environment's advisory service for manufacturing firms in the rural areas, COSIRA. I understand that the Secretaries of State for Industry and for the Environment are pursuing this, and so it should not be necessary for the meeting to discuss it.

CONCLUSIONS

11. In the light of the discussion you will wish to record conclusions:-

(i) Taking note of Annex A and Annex C and identifying any items on which Ministers would like to see swifter progress.

(ii) Identifying those proposals in Annex B which should be pursued further by the Departments concerned and any further proposals which might be put forward at the meeting.

RtA

(Robert Armstrong)

13th October 1980

Qa 05148

To: MR LANKESTER

From: J R IBBS

The Prime Minister's Meeting on Small Firms

1. Mr Mitchell's note sets out progress to date and suggests some new initiatives. We have two comments.

Financial Assistance

2. We believe that the private sector (clearing banks, local enterprise trusts, firms like Job Creation Ltd) has recently done much in response to Government interest to develop imaginative schemes to assist small firms. By contrast, it is clear that PSBR constraints will prevent Ministers from adopting all Mr Mitchell's proposals for extra financial help from the Government and that Ministers will need to be selective. Last year Ministers agreed to put tax relief for individual equity investment in small firms high on their list (objective i. in Annex A). At that time the Inland Revenue found it impossible to devise a relatively simple scheme without opening the door to massive tax avoidance. Ministers commissioned further work and, at our suggestion, outsiders were brought in to advise. Two meetings have now been held with the outsiders and a consensus appears to be emerging that the formidable difficulties of the original scheme could be overcome by adopting a more limited version concentrating on the area of greatest need. This would give relief for small sums (perhaps up to £10,000) of outside capital (i.e. provided by someone other than the entrepreneur) for a start-up (up to the first three years of a new firm's life). Although this will not be as generous a scheme as some Ministers originally hoped, the CPRS believes it would be a valuable incentive to individuals to provide finance for small firms at a critical stage of their development. We suggest the Prime Minister should encourage it as top priority for financial support. If it can be drafted to keep out the avoidance industry it is likely to cost some tens of millions of pounds, rather than around £100m. as envisaged in last year's scheme. It will, of course, be necessary to consider in the total Budgetary context whether even such a reduced scheme can be afforded.

F

Advisory Services

3. The most important non-fiscal proposal is the strengthening of the Department of Industry's Small Firms Service and its merger with COSIRA. We agree that the Small Firms Service could learn much from COSIRA and that some expansion to take on a more active role would be a good idea. We wonder, however, whether a merger is necessary to achieve this end. There is a risk that a merger would create a top-heavy bureaucratic structure and dilute COSIRA's effectiveness in the niche it has established so well without bringing large benefits to the Small Firms Service. If the Small Firms Service is expanded one problem it should concentrate on is helping firms find their way through the Government machine. Some local authorities have successfully set up industrial development officers who act as go-between for new small firms and the right people in central Government Departments, local government and the statutory undertakings (such as water authorities or electricity boards). Where possible the Department of Industry should encourage other local authorities to set up such contact points; if they do not the Small Firms Service should do so itself.

4. I am sending a copy of this minute to Sir Robert Armstrong.

JR

13 October 1980

CONFIDENTIAL

Prime Minister

Sally Oppenheim will come in John Nott's place.

MS

T 13/10

PRIME MINISTER

SMALL FIRMS POLICY

I shall unfortunately be abroad on 14 October, when you are to hold your meeting on this important aspect of our programme. Moreover, although I agree with their broad thrust, I have of course had little time to consider in detail the new measures and ideas raised in David Mitchell's note to you. I hope, therefore, that there will be subsequent opportunity to consider them more fully. In the meantime, there are some points which I should like to feed into the discussion at this stage.

2. David Mitchell's minute mentions my proposal to amend company law to permit companies to purchase their own shares. My Green Paper on this has had an extremely positive response and provisions in the next Companies Bill will be warmly welcomed. They will, however, merely clear the way for re-purchases. It is apparent from the response to the Green Paper that, unless we remove the tax disincentives, companies will be able to make little use of their new freedom. This would lose us all the kudos gained through the change in company law. I hope, therefore, that we can agree that a tax change in this area should be a necessary part of the next Finance Bill. Of particular concern in the context of your meeting will be devising, through a buy back of shares scheme, a means whereby entrepreneurs can repay loans used to start up a business out of the untaxed income of that firm. Now this can only be achieved by selling the firm or liquidating it - an obvious nonsense.

contd/......

3. The Companies Bill to be introduced in December will provide for a major reduction in the filing and public disclosure requirements imposed on small firms in the field of accounts. Around the same time, I shall be publishing a Green Paper to elicit views on whether the present system of incorporation under the Companies Acts best suits small enterprises, whether there are alternative forms which might be introduced or whether existing forms could be made more attractive. This may raise for discussion some quite radical departures from our traditional ideas about incorporation.

4. On a number of occasions in the past, papers covering various aspects of the work on encouraging small firms have tended to concentrate on the manufacturing sector and have failed to mention the parallel needs of the service sectors: David Mitchell's paper is no exception - it is the service sector, in the broadest sense, that will provide the majority of new jobs in the next decades - from software services to leisure industries. For instance, the hotel industry has almost exactly similar problems to those outlined in his note and its contribution to the economy is considerable.

5. In general, however, I agree with David Mitchell's useful note. The principal obstacles are planning (i.e. premises) and finance. On the latter, the clearing banks have made some limited but inadequate moves to assist small business formation. But the problem remains one of security for bank borrowings. We may have to look again at a loan guarantees scheme although, for all the obvious reasons, we rejected it in Opposition discussions.

contd/.......

6. Finally David Mitchell in this and earlier notes touches on the problems of small businesses in their post formation stage. Until we restrict the powers of the Revenue Departments and simplify the collection of VAT etc there can be no real incentive to build up a business. How we can educate "authority" to understand that it has an interest in encouraging small business as well as policing it, I do not quite know. They are two different worlds, and neither understands the other.

7. I am sending copies of this minute to David Mitchell and recipients of his minute.

J Hampson

J. N.
(dictated by the Secretary of State and signed in his absence)

Department of Trade
13 October 1980

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

9th October 1980

T. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

In your letter of 23 July to Tony Willis, you said that the Prime Minister thought it would be helpful if the report on reducing burdens on small firms produced by the Small Firms Working Group could be circulated to those attending the meeting on small firms which is to be held on 14 October.

Copies of the paper in question have already been circulated to members of MISC 14, and to Sir Robert Armstrong. Although it is more or less overtaken ...... by Annex C to Mr. Mitchell's own paper, I enclose a copy of the report for the Prime Minister.

I am copying this letter, together with the Working Group's report, to the Private Secretaries to the Secretaries of State for Trade, Employment and the Social Services.

Yours ever,

Richard Tolkien

R.I. TOLKIEN
Private Secretary

ELIMINATING UNDUE BURDENS ON SMALL FIRMS

Report by interdepartmental Small Firms Group

Reduction of burdens

Reducing paperwork

i. The statistical divisions providing a common service to the Departments of Trade and Industry have been reviewed by Sir Derek Rayner. A Committee has been established to ensure that the recommendations of the Rayner Report are carried out.

ii. The employment censuses for 1979 and 1980 have been cancelled: this results in a reduction of 1.6 million forms. Reductions are to be made in the monthly employment survey resulting in 50,000 fewer forms per year. Some cuts have also been made in Department of Employment earnings surveys. Some further reductions may result from the Rayner review.

iii. Consultants have been engaged to review the administrative forms used by the Department of Trade. They found that there was very little complaint by users of such forms, but recommended improvements in design, layout and content of such forms. These are being implemented.

Reducing disclosure and audit requirements

A Companies Bill is to be introduced in the next Session to implement the EEC Fourth Directive on Company Law. The Directive permits reduced disclosure and audit requirements for firms below a certain size. The Secretary of State for Trade proposes to take maximum advantage of the concession permitted for accounts filed, which will represent a major reduction in the information at present required of small firms who will need to file an extensively abridged balance sheet only.

Employment protection legislation

The Employment Act 1980 contains three provisions aimed specifically at small firms:

a. Industrial tribunals will in future be required to take into account the size and administrative resources of a firm when deciding whether a dismissal was carried out reasonably;

b. an extended qualifying period of two years for complaints of unfair dismissal in firms which have 20 or fewer employees for the duration of the dismissed employee's employment;

c. exemption of firms with six or fewer employees from the maternity reinstatement requirement where it is not reasonably practicable.

In addition, changes to Industrial Tribunals procedures, incorporated in new regulations and aimed at saving time and cutting costs by sifting out unmeritorious cases, will particularly benefit small firms.

Rates

The Local Government, Planning and Land Bill contains provisions (a) giving small firms the right to pay rates by instalment, and (b) providing for a more flexible separation of the domestic and industrial proportion of rates for mixed hereditaments. (c) providing for suspension of the surcharge on empty commercial property, and (d) reduction of the maximum empty property rate on commercial and industrial property

Planning

i. A Development Control circular will be issued shortly setting out the Government's advice to Local Authorities on aspects of development control. This will state that where small scale commercial and industrial activities are proposed, planning permission should not be refused unless there are strong and specific reasons against it.

ii. Subject to the results of consultations and progress on the Local Government Bill, a General Development (Amendment) Order will be laid before Parliament relaxing planning controls over minor extensions to houses and industrial premises, and allowing changes of use between light industry & warehousing in small premises.

iii. A number of steps have been taken to speed up the implementation of planning procedures. These include publishing league tables showing the time taken by local authorities to process planning applications; proposals to speed up planning appeals and a new Code of Practice introducing a 28 day time limit on consultations with statutory consultees; ending of overlapping planning functions between counties and districts.

Building regulations

A consultative document on building regulations has been published. This proposes certification by competent private persons or bodies as an optional alternative to approval by Local Authority. This should help to speed up implementation of building regulations.

Rights of entry

Following a review of rights of entry into business premises, an interim report has been made by the DOI to the Prime Minister. A further report will be made in the autumn. The Committee on Enforcement Powers of the Revenue Departments, whose membership and terms of reference were announced on 17 July, will consider powers of entry of the Inland Revenue and Customs and Excise.

Health and Safety

The CPRS Report on Health and Safety recommends that the threshold for requiring firms to have a written safety policy and safety representatives should be raised from 5 to 25 employees. Other proposals for reducing the amount of new legislation, adopting codes of practice which are permissive but not compulsory; and being more helpful in giving advice should be of particular help to small firms. The detailed recommendations are currently being considered by an Interdepartmental Group of Officials under the chairmanship of Patrick Mayhew.

Measures designed to help small firms

1979 Budget

Reduction in the burden of income tax designed to provide continuing incentives for businessmen and to compensate for higher prices resulting from increases in VAT and indirect taxes.

1980 Budget

Enterprise package for small firms included the following measures:

i. Venture Capital Scheme

Losses incurred after 5 April 1980 on unquoted shares subscribed for in trading companies, may be set off against income instead of only against capital gains as before.

ii. Ending of Certain Close Company Restrictions

a. Abolition of apportionment of trading income of close trading companies, and of members of a trading group. For over 50 years such companies have had to show that the retention of profits in the company was needed for the business.

b. Increase in the threshold for apportionment of investment income from £1,000 to £3,000.

c. Abolition of close company restrictions on amount which companies may deduct for interest paid on loans from their directors.

iii. Interest relief on borrowing to invest in close companies

The conditions for income tax relief for interest paid on money borrowed for lending to a close company in which borrower has a material interest have been relaxed.

iv. Corporation tax on small companies

a. Rate of Corporation Tax on small companies reduced from 42% to 40%.

b. Profits limits (below which 40% CT rate applies) raised from £60,000 to £70,000 with increase in upper limit (above which 52% applies) from £100,000 to £130,000.

v. Stamp Duty: dealers in unlisted securities

Stock Exchange jobbers who transfer stock into their own names temporarily do so at a nominal 50p stamp duty. This treatment is to be extended to licensed and exempted dealers for similar transfers in unlisted securities. This facility will help in marketing shares in small companies.

vi. Retirement Annuity Relief

The raising of retirement annuity relief limits will counter an increasing disparity between generous tax relief available for occupational pension schemes and that available for the self-employed.

vii. VAT Registration Limits

Registration limit raised from £10,000 to £13,500 taxable turnover per annum.

viii. Sub Contractors tax deduction scheme - 714 certificates

Finance Bill will remove unnecessarily harsh features of existing scheme and ease administrative burden on industry. In particular, three year rule will be changed and Appeal Commissioners given greater powers.

Provision of Small Industrial Premises

The first comprehensive study into the availability of small industrial premises (2500 sq ft and below) commissioned by the Department of Industry from Coopers and Lybrand in conjunction with Drivers Jonas was published at the end of March. It concluded that the rigidity of past planning policies and the reluctance of the private sector to enter the small premises market had led to an acute national shortage. While acknowledging that most of the limited amount of small factory buildings over the past few years had been due to initiatives by the public sector, the report points out that this had the effect of distorting the market because of some direct or indirect subsidisation of rents and was one of the reasons for the reluctance of the private sector to become involved.

The report recommended that commercial criteria should apply to all small factory schemes both public and private and it demonstrated that significant opportunities existed for the private sector to play a substantial role in increasing the supply of small units either through their own initiative or in partnership with public bodies. It made the point that in the more depressed assisted, rural and inner city areas the public agencies will need to continue to provide, at least in the shorter term, a significant share of the financing of small factory developments.

As a result of the report the following measures (which were announced in the Budget) were agreed:-

a. 100% Capital Allowances for construction of Industrial Buildings of 2500 sq ft or less for next three years.

b. Industrial Buildings allowances for landlords will be given when construction expenditure incurred, instead of when tenancy begins.

c. Administration of industrial buildings allowance rules will be eased for estates of small workshops constructed for separate letting to small businesses.

d. The Department of Industry to provide £5m for the construction of small workshops in the assisted areas in partnership with the private sector.

e. The Secretary of State for the Environment is to begin consultations to amend the General Development Order to permit a measure of Use Class flexibility for small units. The consultation paper was circulated to outside organisations on 8 July.

f. The policy to encourage the private sector into the market has resulted in recent joint schemes between the English Industrial Estates Corporation, the CIN (National Coal Board Pension Fund), Barclays and Midland Bank in the Assisted Areas.

Public Purchasing

A booklet designed to help small firms understand Government purchasing procedures has been prepared in the Small Firms Service Series and is expected to be published shortly.

Company Law

It is intended that the next Companies Bill should include provisions relaxing the present prohibition on a company's ability to purchase its own shares. One object is to encourage investment in small companies and to facilitate the retention of family control of small businesses. A Green Paper has been published. The closing date for consultations was 30 September and the Department of Trade is now considering representations.

The Government's initiative has been generally welcomed, though decisions remain to be made about the exact operation of the power of companies to purchase their own shares.

Development of the Department of Industry Small Firms Service

A modest expansion was approved in November 1979. Response to national advertising in recent months has been satisfactory. The service is consolidating its programme of local promotion to develop awareness. It continues to make counselling available to redundant employees who wish to set up in business.

Links with financial institutions will continue to be developed on both formal and informal bases. A comprehensive national arrangement with a selection of investing institutions would replace the existing pilot regional arrangements with Norwich Union and the Post Office Staff Superannuation Fund, if justified by the results of these.

Training

The report of the special body set up by the Manpower Services Commission to review the operation of industrial training arrangements in Great Britain was published by the Commission on 31 July 1980. In relation to small firms the report recommended that the provisions of the 1973 Employment and Training Act relating to the exclusion of small firms from the payment of levy to Industrial Training Boards should continue on the present basis, as should the range of special facilities and services provided by Boards to meet the special training needs of the smallest firms. The Secretary of State for Employment has welcomed the report as a basis for public discussion of industrial training policy for the next decade, and the MSC has invited comment on the report's recommendations by 20 October. The MSC will then give the Secretary of State its considered views on the report's recommendations by the end of the month. The Government will place its proposals for future policy before Parliament as soon as possible thereafter.

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 Gov ernment 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 nmakes 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;

(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

Minute from Dr. Ashworth Flag B

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 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.

DM.

DM
6 October 1980

SMALL FIRMS POLICY

ANNEX A

OBJECTIVES STILL TO BE FULFILLED

OBJECTIVE / LEAD DEPARTMENT	PRESENT STATUS
Treasury	
i tax relief for equity investment in small firms ii introduction of Small Business Investment Clubs (SBICs)	under consideration in FASE Group; see covering note (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 payments 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	PRESENT STATUS
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.	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 proprieter 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 a 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 questionaires can be a time consuming burden as can disclosing detailed accounting information.

32 We have cut out over a million questionaires.

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.

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

Please note our new address and telephone number

CBI
CONFEDERATION OF BRITISH INDUSTRY

9 October 1980

The Duty Officer,
The Prime Minister's Office,
10, Downing Street,
London SW 1

Dear Sir, R.

Further to your conversation with Mr. Shrager from this office this afternoon I am enclosing a photocopy of the text of a booklet entitled "Smaller Firms in the Economy" which we intend to publish towards the end of next week. At that time a copy will be sent formally to the Prime Minister. In the meantime, bearing in mind current interest in this sector of the economy I thought it might be of help to the Prime Minister if an advance copy was available to her office.

Yours faithfully,

Sonia Elkin
Director for Smaller Firms

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 0002
SWITCHBOARD 01-212 7676

From the
Parliamentary Under Secretary of State

Tim Lankester Esq
10 Downing Street.

in mtgs folder for PM

Dear Tim,

The CBI have just handed us the attached document ahead of the Prime Minister's meeting. I believe Chapter 5 summarises their argument.

Copies also go to Private Secretaries of Secretaries of State involved.

Yours sincerely

Anthony Willis

CONTENTS

FOREWORD

CBI President, Sir Raymond Pennock

Since the start of my term of office as President, and through extensive contact with CBI's own smaller firms members, I have become increasingly aware of the importance of smaller firms to the economy.

I am certainly not alone in this respect. In the past few years there has been a growing public awareness of, and interest in, smaller firms. However, it is particularly important that this should be matched by a clear understanding of the problems of smaller firms and their position in the economy. I believe that this document makes a major contribution to this.

The CBI has of course always recognised the special needs of its smaller firms members and their interests are reflected in its policies. Thus for businessmen, policy makers and the general public, the subjects covered by "Smaller Firms in the Economy" are of great importance, and I commend it to you.

INTRODUCTION

Chairman of the CBI Smaller Firms Council, Fiennes Cornwallis

Smaller firms play a vital role in the British economy. For our national economic performance to improve in the future, a successful and growing smaller firms sector is essential. The achievement of this depends in part on there being the fullest possible understanding of the present position of smaller firms and their future needs. Therefore the late Sir John Methven and I agreed that the CBI staff should prepare a document drawing together the available material on smaller firms in the economy.

This document falls into three sections:

i At the outset it explains the difficulties of defining smaller firms, but goes on to present as full a statistical picture as possible of their current position in the economy; this forms a valuable point of reference for future work. Current CBI policy in relation to smaller firms is then summarised. These matters are covered in Chapters I and II.

ii The middle section of the document explores two especially important topical issues - the impact of smaller firms on employment, and their financing. This is set out in Chapters III and IV.

iii Finally in Chapter V there is a look into the future. What remains to be done for smaller firms in the light of existing CBI policy is spelled out, and questions on possible future directions of policy are raised for discussion.

I believe this document will help all who are involved in or concerned for smaller firms to understand better their actual and potential role in the economy. More importantly it will provide a sound basis for the examination and development of policies.

CHAPTER 1

DEFINITION OF SMALLER FIRMS AND THEIR PLACE IN THE ECONOMY

INTRODUCTION

1.01 The main body of knowledge about the role of smaller firms in the UK economy continues to be the Committee of Inquiry on Small Firms, more popularly known as the Bolton Committee. This Committee reported in 1971 but most of the statistics produced for it referred to the middle 1960s. Some more recent statistics have now become available and, in addition, another official body, the Wilson Committee(1), has devoted an interim report to the financing of smaller firms. Together these have made it possible to review and develop some of the conclusions of the Bolton Committee.

1.02 Two of the most important conclusions of the Bolton Committee were that the UK smaller firms sector in manufacturing industry was declining and that its contribution to output and employment was much below that of the smaller firms sectors overseas. As has subsequently become apparent, the declining trend had probably just begun to turn around by the time the Bolton Committee reported in 1971. Since then, in manufacturing industry, while larger firms have declined both in numbers and in contribution to UK employment, the number of smaller firms has risen sharply and their contribution to employment has ceased to decline and may also have increased. Meanwhile it is no longer so clear that the contribution of the UK smaller firms sector is as small as was earlier thought relative to other comparable countries.

DEFINING SMALLER FIRMS

1.03 What then are smaller firms? There is no single generally accepted definition of a smaller firm, either internationally or within the UK. The term "smaller firm" is commonly used to describe firms of varying legal and ownership structures, from different sectors of business, at particular stages of development as well as firms of a certain size. This means that there is a large number of firms, reflecting a wide variety of interests, which are varyingly regarded as small or smaller(2). The classification of firms as "smaller" is generally based on either size or qualitative criteria, or a mixture of both.

Size Criteria of Smaller Firms

1.04 The most widely used statistical definition of a smaller firm in the UK is that used by the Bolton Committee(3) in 1971. As Table 1 shows, the Bolton Report focused on a level of 200 employees in manufacturing as a threshold below which firms could be thought of as "smaller". However, the Report recognised that in some sectors, such as construction, a firm employing 150 people can be considered to be quite large in relation to its competitors because the nature of the business means that firms tend to be organised in smaller units than in manufacturing. This led the Bolton Committee to produce different thresholds of numbers of employees for particular sectors (for example the Committee set the thresholds for mining and construction at 25 employees or less) which provided a measure of the <u>relative</u> size of firms in comparison with the sector as a whole. However

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(1) Committee to Review the Functioning of Financial Institutions.

(2) Generally this document uses the term "smaller firm", but except where specifically stated no attempt is made to distinguish between this and the term "small firm". The terms "firm" and "business" are used interchangeably to cover both companies and unincorporated enterprises.

(3) Report of the Committee of Inquiry on Small Firms (Bolton Committee) Cmnd 4811, HMSO 1971.

TABLE 1

BOLTON COMMITTEE'S DEFINITION OF SMALL FIRMS

Manufacturing	200 employees or less
Retailing	turnover of £250,000 pa or less*
Wholesale trades	turnover of £990,000 pa or less*
Construction	25 employees or less
Mining/Quarrying	25 employees or less
Motor trades	turnover of £500,000 pa or less*
Road Transport	5 vehicles or less
Catering	all excluding multiples and brewery managed public houses.

* Figures for turnover have been revised to allow for inflation and relate to the RPI at July 1980 prices. Bolton's original turnover definitions were based on 1963 prices.

Source: Interim Report of the Committee to Review the Functioning of Financial Institutions (Wilson Committee) Cmnd 7503, Appendix 1, p 43

TABLE 2

DEFINITIONS OF SMALL AND MEDIUM-SIZED FIRMS IN EIGHT EEC COUNTRIES

Belgium	1 to 50 employees
Denmark	6 to 50 employees
Federal Republic of Germany	1 to 499 employees
France	6 to 500 employees
Eire	1 to 50 employees (small business)
Italy	1 to 500 employees
Netherlands	1 to 100 employees
United Kingdom	1 to 200 employees (small business)

Source: Council of Europe: "Report on the Future of Small and Medium-Sized Business in Europe".

in absolute terms, firms employing less than a certain number of people might be thought of as sharing common characteristics arising from their common size, even though their relative size varied with the sector of the economy in which they operated.

1.05 Agreement on a statistical definition of a smaller firm, based on the number of employees, is not, however, widespread. Table 2, for example, shows the accepted definitions of small and medium sized manufacturing firms in eight EEC countries. The range of definitions is a reflection that any cut-off point is likely to be arbitrary.

1.06 Returning to Table 1, the Bolton Committee also felt that it was more appropriate in certain cases to use a threshold based on turnover, or a combination of turnover and employees, rather than simply a threshold based on the number of people employed by a firm. For example, in a business such as wholesaling levels of employment may vary widely for a given level of turnover, as the degree of capital intensity varies with the type of product. In this instance the level of turnover would be a better guide to the relative impact of firms within that sector than the number of people that they employed.

Qualitative Criteria

1.07 The Bolton Committee clearly recognised the difficulty in finding a statistical definition of a smaller firm which adequately reflected what it regarded as the most important qualitative characteristics common to smaller firms in general. More important than simply the size of its labour force or its turnover, the Bolton Report defined the "true" smaller firm as having three essential characteristics:

- a small market share and therefore only limited power to influence trading conditions;

- personalised management with the owners themselves actively participating in all aspects of management; and

- financial independence, with the owners having effective control of the business.

Firms satisfying these criteria might vary considerably in their number of employees. In policy terms an independent firm with 500 employees might therefore have more in common with one employing only 10 people rather than with other firms of comparable size which did not share these essential characteristics.

Defining Smaller Firms for Policy Purposes

1.08 Defining what is meant by a "smaller firm" becomes critically important when considering what policies are necessary for the health of the smaller firms sector of the economy. There is at least agreement that the smaller firms sector, however defined, is extremely diverse. Varying influences affect the position of different groups of smaller firms and as a result particular categories of smaller firms may have differing, though not necessarily competing, interests. For example, the significance of policies designed to improve the financing of smaller firms varies considerably between relatively capital intensive businesses, often in the manufacturing sector, which may be interested in finance for fairly large fixed investment projects, and smaller outlets such as some shops, which are mainly concerned about finance for their routine operating costs.

1.09 Because of this, no single definition of "smaller firms" is sufficient when looking at policy issues. The appropriate definitions in individual cases will need to take account of some or all of the following factors:

i Legal and Ownership Structure: Whether a business is incorporated or not, and whether it is a private or public company or even a partnership or sole trader, its legal structure will influence the motivation to seek, and the capacity to raise, finance. The tax regime associated with different legal forms of business will affect the continuity of ownership and/or the capacity and desire to expand the business. The legal conditions governing membership of a firm - a partner in a partnership or a shareholder in a company - also affects continuity, control and the ability to attract outside investors.

ii Number of Employees: The number of issues with which a smaller firm is likely to have to deal may be a consequence of its number of employees. Some legislation, concerning, for example, employment, is drafted to have different effects on firms with differing numbers of employees, irrespective of their structure.

iii Turnover: Some legislation, such as that relating to VAT, affects differently firms with differing levels of turnover. The financing requirements of some companies may well largely reflect the scale of their turnover. Turnover is, therefore, sometimes another factor of importance for smaller firms policy.

iv Nature of Business: Access to finance can be of significance for smaller firms, particularly in certain types of business. Where firms are capital intensive, this affects both the scale and the nature of their financing requirements, and is yet another relevant factor for policy purposes.

v Stage of Development: The final point to be considered is the distinction between new and established smaller firms. Nearly all new firms are small, but the reverse is certainly not true. This distinction can have relevance for policy. For example incentives or disincentives to the formation of new firms may not have any direct effect on smaller firms generally and conversely, measures affecting smaller firms as a whole may have only an indirect effect on the establishment of new firms.

1.10 Although there are common problems and opportunities within the smaller firms sector, and indeed within the business community as a whole, the many variations of interest that there are should not be overlooked for policy purposes. Therefore there is a need to recognise that whatever the validity of a definition for one particular purpose, it is likely to be of only limited general value. For different purposes an inevitably arbitrary definition will have to be drawn at different levels, and it may be that for many purposes qualitative, not quantitative, distinctions can be more important. But for discussion purposes, it is necessary to accept some general definition, however imperfect.

1.11 Therefore unless otherwise stated, subsequent references to smaller firms are based on the definition that a smaller firm is an enterprise with less than 200 employees. Such a definition yields the "best" statistics; however, particularly for policy purposes, more limited and specific definitions are sometimes more appropriate, and where this is the case what is meant by the term "smaller firm" in that context is made clear.

THE ECONOMIC CONTRIBUTION OF SMALLER FIRMS

1.12 One assessment of the contribution of smaller firms to the economy can be made using data from the 1976 Census of Employment. The Census excludes agriculture, forestry and fishing, but covers the remainder of the economy. The Census is based upon "Census of Employment Units". A "unit" is defined as an address at which an employer holds pay records. It follows that the unit does not always correspond to a single business, but this is commonly the case when the units are small(4). In 1976 the number of such "units" with less than 200 employees was 1,019,798. Table 3 shows the breakdown of employment "units" by size. It

(4) Further references to "units" in this chapter use this definition.

TABLE 3

DISTRIBUTION OF EMPLOYMENT BY SIZE OF FIRM* IN 1976

Size of Census of Employment Unit (numbers employed)	Number of Census Employment Units	Percentage of GB Employment Covered by Census	
1-99	1,001,458	45.5)	57.2
100-199	18,340	11.7)	
200+	15,650	42.8	
All Units	1,035,448	100	

Source: CSO Regional Statistics (1980 Edition)

* Employment Unit as defined in para 1.12

TABLE 4

SMALLER FIRMS' CONTRIBUTION TO EMPLOYMENT BY REGION IN 1976 (PER CENT)

	(1)	(2)	(1 + 2)
	Size of Census of Employment Units		
	1-99	100-199	1-199
Great Britain	45.5	11.7	57.2
England	45.3	11.7	57.0
South West	54.0	12.1	66.1
East Anglia	50.2	11.6	61.8
South East	47.2	12.2	59.4
Yorks and Humberside	46.3	12.4	58.7
North	43.4	10.6	54.0
East Midlands	41.4	11.2	52.6
West Midlands	40.9	10.6	51.5
North West	39.5	11.3	50.8
Wales	43.5	11.8	55.3
Scotland	46.8	11.8	58.6
Northern Ireland*	53.1	11.6	64.7

Source: i CSO Regional Statistics (1980 Edition)

ii Northern Ireland Digest of Statistics (March 1980)

* These figures relate to 1978.

TABLE 5

SMALLER FIRMS' CONTRIBUTION TO EMPLOYMENT BY SECTOR IN 1976 (PER CENT), GREAT BRITAIN

	(1)	(2)	(1 +2)
	Employment Size of Census Units		
	1-99	100-199	1-199
All Manufacturing Industries	25.5	12.1	37.6
Service Industries*	55.8	11.3	67.1
Mining and Quarrying	13.9	3.1	17.0
Food, Drink, Tobacco	21.2	11.6	32.8
Coal and Petroleum Products	15.2	7.2	22.4
Chemicals and Allied Metal Manufacture	13.8	8.4	22.2
Mechanical Engineering	29.6	11.9	41.5
Instrument Engineering	28.9	14.0	42.9
Electrical Engineering	14.1	8.9	23.0
Shipbuilding and Marine Engineering	13.2	4.8	18.0
Vehicles	7.6	4.4	12.0
Metal Goods not elsewhere specified	42.9	14.0	56.9
Textiles	24.2	19.7	43.9
Leather and Fur	57.9	20.4	78.3
Clothing and Footwear	41.8	21.7	63.5
Bricks, Pottery, Glass, Cement	32.0	14.4	46.4
Timber and Furniture	57.1	18.5	75.6
Paper, Printing and Publishing	34.1	14.2	48.3
Other manufacturing	30.4	14.0	44.4
Construction	67.1	14.8	81.9
Gas, Electricity and Water	22.9	15.3	38.2
Transport and Communication	37.0	13.3	50.3
Distributive Trades	76.3	9.8	86.1
Insurance, Banking, Finance and Business Services	62.0	10.9	72.9
Professional and Scientific Services	41.9	10.7	52.6
Miscellaneous Services	78.6	8.8	87.4
Public Administration and Defence	38.4	18.9	57.3

Note: This Table was compiled from data given in Table 2A of the article "How Big is British Business" which was published in the January 1978 issue of the Department of Employment Gazette.

* "Service industries" comprise transport and communication, distributive trades, insurance, banking, finance and banking services, professional and scientific services, miscellaneous services, and public administration and defence.

TABLE 6

CONTRIBUTION OF SMALLER ENTERPRISES* IN MANUFACTURING TO EMPLOYMENT AND OUTPUT** IN THE UK

	Employment	Output
1971	20.9	17.9
1972	21.5	18.4
1973	20.7	17.1
1974	21.5	na
1975	21.9	18.0
1976	22.6	18.2

* Enterprises employing less than 200 people.

** Output is defined as total sales and work done minus the cost of purchases and industrial services received.

Source: Reports on the Census of Production.

See note to Table 7 for definition of an enterprise.

TABLE 7

NUMBER OF PRIVATE SECTOR ENTERPRISES IN UK MANUFACTURING, 1963-1976

	Enterprises (thousands)			
	Less than 200 employees	More than 200 employees	Total	Small* as percentage of total
1963	61.5	4.1	65.6	93.8
1968	58.2	3.5	61.7	94.3
1971	71.4	3.5	74.9	95.3
1972	69.0	3.3	72.3	95.4
1973	74.1	3.4	77.5	95.7
1974	81.1	3.3	84.4	96.0
1975	83.4	3.2	86.6	96.2
1976	86.3	3.1	89.4	96.5

* "Small" is defined as less than 200 employees

Sources: i Reports on the Censuses of Production
ii Historical Record of the Census of Production 1907-1970

Note: An "enterprise" is defined as a business consisting of either a single establishment of two or more establishments under common ownership and control. An establishment is the smallest unit which can provide the information normally required for an economic census, for example, employment, expenses, turnover, capital information. Typically the establishment embraces all the activities carried on at a single address.

sug[illegible]s that over half of those employed in Great Britain work in "units" employing less than 200, and more than two employees out of every five work in "units" employing less than 100.

1.13 Table 4 presents figures broken down by region. The table shows that the contributions of smaller businesses to total employment vary from 66 per cent in the South West to 51 per cent in the North West. It seems likely that, although the inclusion of agriculture, forestry and fishing would increase the proportions of employment accounted for by smaller firms, it would not alter the conclusion that relatively greater proportions of the population work in smaller firms in the South West, Northern Ireland and in East Anglia and relatively lower proportions in the Midlands and North West.

1.14 Table 5 gives a breakdown by size of "unit" for the different industrial sectors. It confirms the general impression that employment tends to be most concentrated in relatively smaller businesses in the construction, distribution and service sectors, and least concentrated in manufacturing, gas, electricity and water and mining and quarrying. However it also demonstrates that within the manufacturing sector there are areas where smaller establishments predominate. In the "leather and fur", "clothing and footwear", "timber and furniture" and "metal goods not elsewhere specified" industries, more than half the employees are employed in "units" with less than 200 employees. In manufacturing as a whole, "units" with less than 200 employees account for over 37 per cent of employment, and in service industries for 67 per cent.

Contribution of Smaller Firms to National Output

1.15 There are no comprehensive figures comparable to those for employment in Table 5 which illustrate the contribution of smaller firms to production for the whole economy. However such figures are available for manufacturing industry and are given in Table 6. This shows that the contribution of smaller firms to output in manufacturing has been lower than their contribution to employment. This should not, of course, be taken as implying smaller firms are inefficient; it is likely to reflect a connection between capital-intensive types of manufacturing business and large-scale undertakings - smaller firms tending to be more labour intensive.

Recent Trends in the Number of Smaller Firms

1.16 The trends in numbers of smaller firms have differed from industry to industry. For example in the retail sector, which largely consists of smaller firms, the actual number of businesses fell fairly sharply during the 1961-76 period, from 374,000 to 297,000 (on a definition of turnover below £50,000 at 1963 prices). In the construction sector the trend in size of firm is difficult to identify because of statistical coverage changes in the census for the industry. It appears that there has been a decline in the number of firms in the industry, with the proportion of smaller firms remaining about constant; but there has been a decline in the proportion of output and employment attributable to smaller firms since 1973.

1.17 In manufacturing, however, the trends have been different. This is illustrated by the numbers of manufacturing establishments with 10 employees or less. Between 1930 and 1970 the number of such establishments fell from 160,000 to some 38,000. Since then the number has risen sharply, reaching 57,000 by 1976. The number of private sector enterprises operating in the manufacturing sector is set out in Table 7; in this table "smaller" is defined as those enterprises (see note to Table 7) with less than 200 employees. The figures show that the actual number of smaller enterprises has risen by over 18,000 between 1968 and 1976 and that as a proportion of the total number of enterprises, smaller ones have increased by over 2 per cent.

1.18 Another indication of the recent trend in numbers of smaller businesses is given by the figures for new companies registered in Table 8. Many businesses of course do not register as companies and some newly registered businesses can

TABLE 8

REGISTRATION OF NEW COMPANIES IN THE UK

1970	30603	1975	46246
1971	39827	1976	56701
1972	55148	1977	55966
1973	68063	1978	64378
1974	43070	1979	67207

Sources: i Department of Trade Annual Reports.

ii Company Registrations Office, Belfast.

TABLE 9

THE CONTRIBUTION OF SMALLER ENTERPRISES TO EMPLOYMENT IN MANUFACTURING (PER CENT)

	Employment Size	
	1-99	1-199
Denmark+ (1973)*	36.3	52.1
Ireland+ (1968)*	33.0	49.8
Italy (1971)*	na	47.3
Netherlands+ (1973)	36.0	47.8
Belgium (1970)	33.2	43.4
Germany (1970)	28.8	37.0
France (1976)	25.2	34.2
Luxembourg (1973)	19.1	28.2
UK (1976)	17.1	22.6
Japan (1970)	51.6	na
USA (1972)	24.8	na

Sources: i Small and medium-sized Enterprises and the Artisanant, Commission of the European Communities January 1980

ii 1976 Report on the Census of Production.

\+ include energy and water industries.

* figures for these countries exclude employment in very small enterprises and therefore understate the contribution of small enterprises.

be quite large; therefore the statistics of registrations cannot be used as a comprehensive guide to new activity. There are no comparable statistics on business closures. At the end of 1979 there were 795,946 registered companies in the UK of which some 59,340 were in liquidation or in course of removal. The effective number on the registers was therefore 736,606. New companies as a proportion of the effective number on the registers at 31 December rose from 5.8 per cent in 1970 to 11.2 per cent in 1973. The corresponding figure for 1979 was 9.1 per cent.

International Comparisons

1.19 There are considerable difficulties in making reliable comparisons between statistics for different countries. Most comparisons refer soley to the manufacturing sector, which contains only a small proportion of the total number of smaller firms. In any case coverage in the different countries is by no means consistent; UK experience has indicated that minor coverage variations can have considerable effects on figures for smaller firms. It does appear, however, that smaller firms in the UK are still relatively less important in terms of employment and output in the manufacturing sector than in most other developed countries. Table 9 must be interpreted with the greatest caution as there is a marked absence of consistency in the data presented.

1.20 There has been a general decline over time in the relative importance of smaller firms in manufacturing in other EEC countries. For example, the contribution of enterprises with less than 500 employees in German manufacturing industry fell from 54 to 50 per cent between 1961 and 1970. However these comparisons over time date from the early sixties to the early seventies and it is not known whether the decline has continued since then. In contrast, the number of small manufacturing establishments in the USA has been rising, and their share of employment remained stable in 1963 and 1972 at about 43 per cent (using a definition of less than 250 employees).

ECONOMIC BEHAVIOUR OF SMALLER FIRMS

1.21 Official statistics can only give a limited picture of the economic behaviour of smaller firms. But the information available from the CBI Industrial Trends Survey gives a little more depth to the understanding of what has been happening to smaller firms, at least in manufacturing industry. Charts A to E illustrate the impact of certain economic trends on firms participating in this survey, and results have been shown for firms employing more and less than 200 employees.

1.22 In general it is clear(5) that small and large firms have reacted in much the same way to the changing business conditions of the last decade. Chart A indicates a virtually identical outlook among firms of different size on business optimism. Chart B shows that a greater proportion of large firms have intended to increase their capital expenditure than have smaller firms. Chart C suggests that smaller firms experience relatively higher levels of capacity utilisation, while Chart D points to their running up against skilled labour shortages a little more often than large firms. Finally Chart E shows that smaller firms in manufacturing have been more hopeful about their levels of employment than large firms, which is consistent with the official evidence in Table 6 of a growth in the relative contribution of smaller firms to employment in manufacturing.

1.23 The economic importance of smaller firms cannot just be measured in terms of crude statistics or the amount of production or number of jobs they provide, and recent research(6) has supported the Bolton Committee's conclusion that "there can be no substitute for the dynamic influence of new firms in preventing the ossification of the economy".

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(5) All these survey results have to be treated with caution, as the questions are of a qualitative not quantitative nature; there are also statistical limitations on the validity of comparisons between a large sample of smaller firms, and a smaller sample of large firms.

(6) Including "The Job Generation Process", by David L Birch.

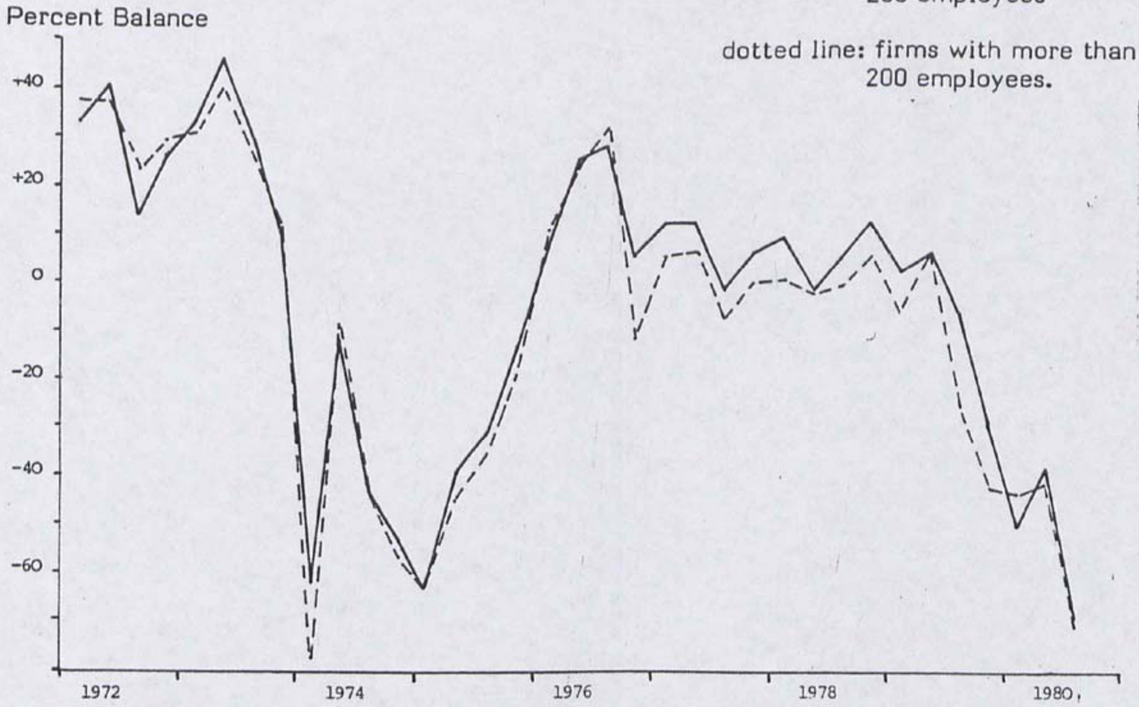
CHART A

In all charts

heavy line: firms with less than 200 employees

dotted line: firms with more than 200 employees.

BUSINESS OPTIMISM*



* percent replying "more optimistic than four months ago" less percent replying "less optimistic than four months ago".

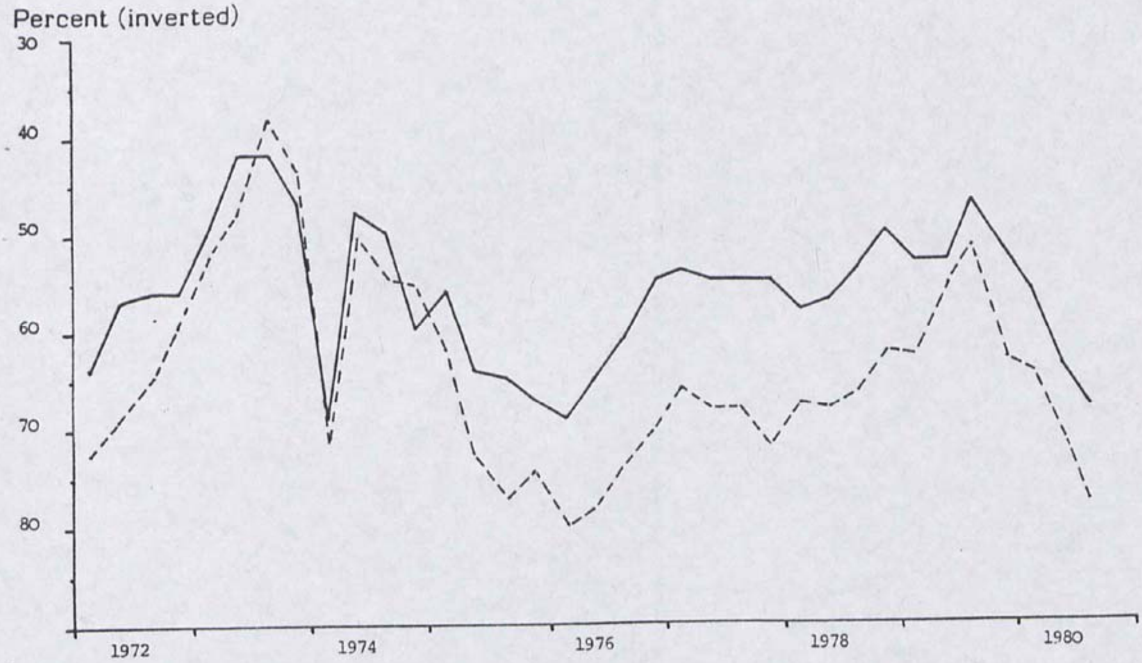
CHART B

INVESTMENT INTENTIONS (PLANT AND MACHINERY)*

* percent expecting to authorise more minus percentage expecting to authorise less capital expenditure in next twelve months.

CHART C

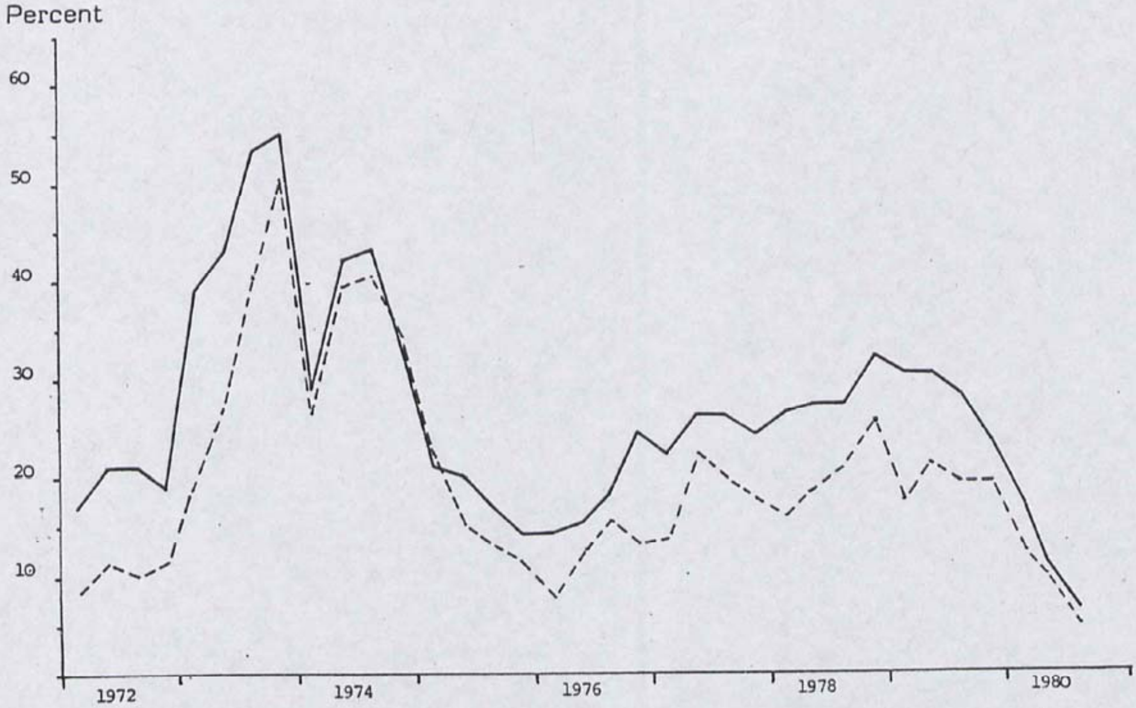
CAPACITY UTILISATION*



* percent replying that their level of output is below their satisfactory full rate of operation.

CHART D

SKILLED LABOUR SHORTAGES*

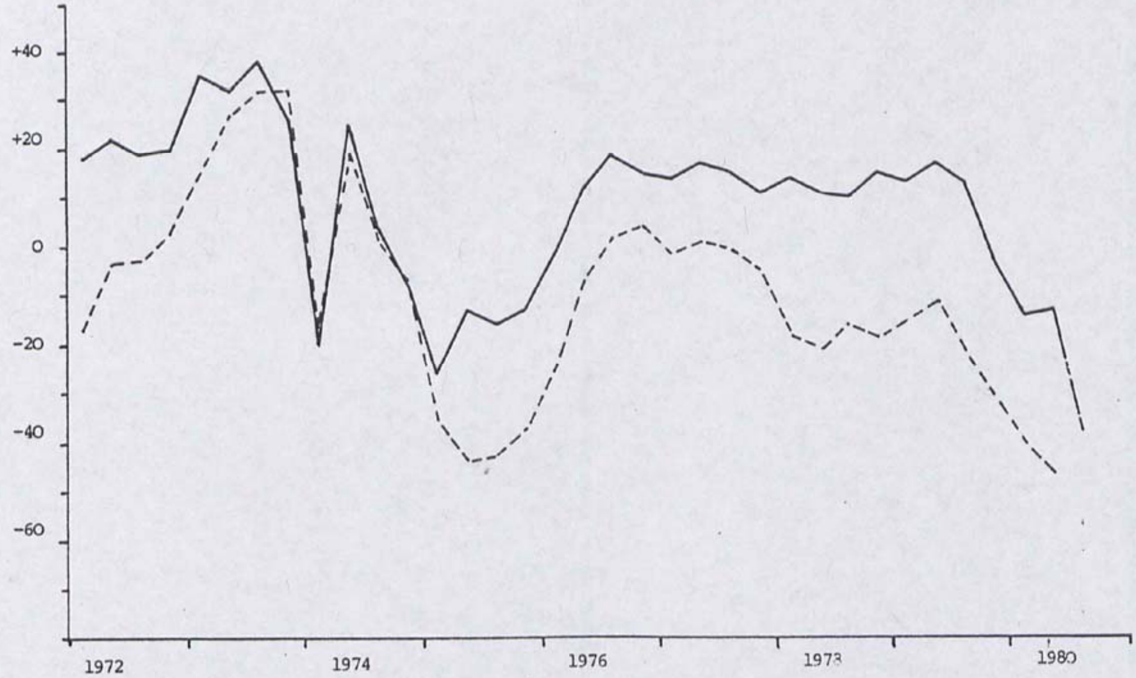


* percent citing skilled labour as likely to limit output over the next four months.

CHART E

EXPECTED CHANGE IN EMPLOYMENT*

Percent Balance



* percent expecting to employ more minus percent expecting to employ less over the next four months.

CHAPTER II

CBI POLICIES AND THE SMALLER FIRM: RECENT PROGRESS AND FUTURE NEEDS

THE ECONOMIC BACKGROUND

2.01 Smaller firms, like all firms, need and want a healthy and expanding economy. In the CBI's stated view no amount of subsidy or special incentives can alter the fact that the principal requirement for a successful, growing smaller firms sector in the UK is for government to create the general economic climate in which all business can prosper.

2.02 The cornerstone of CBI's policy for smaller firms has therefore been to encourage government to pursue a sound economic strategy. The main objectives of which must be (1):

i Control of Inflation - through effective monetary and fiscal policies, including the containment of public expenditure and the development of a more responsible attitude to pay increases both in the public and private sectors.

ii Steady and Maintained Economic Growth - for which it is necessary to restore real company profitability, to strengthen tax incentives to work and to entrepreneurial activity, and to reduce government interference in business.

iii Improved Competitiveness - by reversing the dramatic increase in our unit costs compared with those of our main international competitors, strengthening the position particularly of manufacturing industry in domestic and foreign markets, and thus improving the prospects for employment.

2.03 Since the election of the Government in 1979 many of the economic policies that the CBI has been advocating for a long time have been accepted. For example the Government is committed to the control of inflation as its prime objective; to reductions in the share of national wealth accounted for by public expenditure; to ending excessive interference in industry and to increasing incentives by cuts in income tax.

TAXATION

2.04 The CBI has often argued that the overall burden of taxation in the UK has been excessively high. The consequences of this have been felt most acutely by smaller firms where high marginal rates of income tax and heavy capital taxes have stifled individual risk-taking and thus the growth of new businesses and the expansion of existing ones.

2.05 In a paper presented to the incoming Government in 1979(2), the CBI's Smaller Firms Council called for a major overhaul of the tax system. Many of the recommendations made then, and subsequently, have been acted on by the Government. But more remains to be done.

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(1) See in particular: "The Road to Recovery", 1976; "Britain Means Business", 1977 and 1978; "Enterprise into the Eighties", 1977 and "Jobs: Facing the Future", 1980.

(2) "Policy Priorities for Smaller Firms", a paper by the Smaller Firms Council, 1979.

Taxation on Income

2.06 Over the years the CBI has called for a substantial reduction in the burden of taxation on income(3), and in particular:

- a reduction in the basic rate;
- a cut in the highest marginal rate, initially to 60 per cent and subsequently to 50 per cent (4), and
- an increase in the thresholds and widening of the bands to, at least, make full allowance for past inflation.

2.07 In the two budgets since the change of government, the Chancellor has gone a long way towards adopting these proposals and thus restoring incentives to work and to enterprise. In particular he has reduced the basic rate of income tax to 30 per cent, cut the highest marginal rate to 60 per cent and increased bands and thresholds to compensate for inflation.

Capital Taxation

2.08 The CBI maintains that the means and levels of taxing capital are especially important for smaller firms, not least because the ownership of such firms is generally concentrated in the hands of a few individuals. Excessive capital taxation may force money to be taken out of businesses, leading to reduced investment and business expansion, and inhibiting the formation of new enterprises.

2.09 The CBI has therefore urged the present Chancellor to give careful consideration to the outright abolition of Capital Transfer Tax (CTT) and to the reform of Capital Gains Tax (CGT) to take account of both the effect of inflation and of the principle that the tax should not be charged on assets held in the longer term(5).

2.10 Since the CBI made its recommendations on capital taxation the Government has announced two major reductions in the impact of capital taxes:

- raising the threshold of CTT from £25,000 to £50,000; and
- raising the exempt slice on CGT from £1,000 to £3,000.

2.11 Although these measures have been welcomed by the CBI, a great deal still needs to be done to relieve the burden of capital taxation on smaller firms. The most pressing matters outstanding are:

Capital Transfer Tax	Capital Gains Tax
substantial increase in the annual exemption	reduction in the standard rate to to 25 per cent
introduction of consanguinity relief	indexation or tapering to take account of the effect of inflation
abolition of lifetime cumulation	some increase in the exempt threshold
widening of the rate structure, and reduction of rates.	

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(3) See in particular, "CBI Budget Representations", 1977, 1978 and 1979.

(4) "CBI Budget Representations", 1980.

(5) Ibid.

Company Taxation

2.12 The CBI has in the recent past been particularly concerned with three areas of company taxation as they affect smaller companies(6). These are:

- corporation tax where the lower rate band for smaller companies has been helpful so long as the bands are adjusted periodically to take account of inflation;

- stock appreciation relief where uncertainty about its future has caused concern and where the CBI has advocated that tax relief be given on a fixed percentage of the increase in value of stocks held by smaller companies; and

- the close company apportionment provisions; the CBI has urged their abolition.

2.13 In his 1980 Budget the Chancellor went a considerable way to meeting CBI's recommendations. The Government has also announced a complete review of company taxation which the CBI has welcomed.

National Insurance Surcharge (NIS)

2.14 The reduction first, and then speedy abolition, of this tax has been one of the CBI's priorities and was strongly re-emphasised in the 1980 Budget Representations. With companies under severe cost pressures the case for reducing NIS is at its strongest and should be implemented as soon as possible.

Rates

2.15 In the face of an increasing burden of rates on industry, the CBI has launched a campaign to challenge high levels of local authority spending and the resulting increases in business rates and to seek better value for the money spent. It has called for a ceiling to be imposed on business rates, based on the Government's own calculations of reasonable local expenditure. This could be particularly helpful to smaller firms as it would reduce the proportion of their pre-tax profits which are taken in rates.

FINANCING OF SMALL FIRMS

2.16 The problems associated with the financing of smaller firms are dealt with more fully in Chapter 4; this section merely summarises CBI's current policy in this area. In its evidence to the Wilson Committee the CBI argued that the financing of smaller firms could only be improved within a better business climate(7). Public expenditure and taxes were too high and company profitability too low to make investment in high risk or new ventures an attractive proposition. It has therefore sought to encourage government to recreate the conditions in which the role and potential of the personal investor can be restored so that smaller companies can operate from a sound equity capital base.

Equity Finance

2.17 The CBI has argued that past taxation policies have hampered the accumulation and retention of capital and made it difficult for the owners of a business to maintain adequate capitalisation(8). The present Government has made some progress

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(6) See "CBI Budget Representations", several years.

(7) "Industry and the City", CBI first stage evidence to the Committee to Review the Functioning of Financial Institutions (Wilson Committee), 1977.

(8) Ibid.

removing these obstacles; the proposals in the 1980 Budget, for example, relating to tax relief on costs of raising loan capital and on pre-trading expenses are likely to be of particular benefit to new and smaller firms. However, more still needs to be done, particularly in the field of capital taxation (see previous section).

2.18 For the personal investor the disincentive effects of taxation and low profitability are obvious. In many cases "Aunt Agatha" is better off with her money saved in a bank or a building society rather than invested in a high risk venture. Furthermore, the shares in small companies, the majority of which are unquoted, do not offer a high degree of liquidity to the investor who may find his investment "locked-into" the company almost indefinitely. This is also an unattractive proposition for the proprietor who may be discouraged from taking equity finance because he fears dilution of his control over the company in the long-term. With its concern for making personal investment more attractive the CBI has supported(9):

- the idea that private companies should be permitted to repurchase their own ordinary equity;

- the idea of special tax provisions for Small Firm Investment Companies;

- allowing initial company losses to be offset against the personal tax liability of shareholders;

- allowing personal investment in smaller firms to be made out of pre-tax rather than post-tax income; and

- giving greater encouragement to employee investment and profit sharing schemes.

2.19 In general terms the CBI believes that personal investment in smaller firms can be accelerated further by giving tax treatment comparable to that available for other investment choices such as pensions or mortgages.

Loan Finance

2.20 The most common form of loan finance for smaller firms consists of bank overdrafts. At a time of high interest rates, smaller firms which are heavily dependent on loan finance find it difficult to survive. The CBI has pressed the present Government to bring down interest rates as soon as this is compatible with money supply targets. A general fall in interest rates within a non-inflationary monetary stance would ease the position for business generally. The CBI has not hitherto advocated a system of two-tier interest rates; when this subject has been discussed in the past it has generally been felt that discrimination between different types of borrowers would be impracticable.

2.21 The CBI has, however, welcomed changes by the banks and other commercial financing bodies in their provision for, and services to, smaller firms. This is something that needs to continue and to be widely applied and publicised. It accepts that such institutions must, of course, continue to judge their provisions of finance to smaller firms on commercial criteria.

2.22 The CBI's policy for the financing of smaller firms reflects its general view that the role of government in business is most valuable and cost-effective when concentrated on creating a favourable economic climate in which business can prosper. Improved company profitability and more favourable tax treatment for both firms and investors will do more to improve the financing of smaller firms than any amount of government aid or subsidy. It will also help in the creation of new enterprises.

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(9) See in particular "CBI Budget Representations" 1980 and "Repurchase of Own Shares by Private Companies" a paper by the CBI Smaller Firms Council, 1980.

GOVERNMENT ASSISTANCE TO INDUSTRY

2.23 The CBI has not advocated special subsidies for smaller firms but has consistently argued for less government intervention in and regulation of business(10). However, it has said that smaller firms should be fully eligible for assistance schemes where they exist(11).

Financial Assistance

2.24 The CBI argues that government financial assistance to industry should be reduced as and when company profitability increases. This assistance usually takes several forms, including:

i Investment Assistance - in the form of grants, loans and other incentives to industry to relocate or invest in the economically depressed regions of the country or in particular sectors of industry.

ii Selective Assistance - which aims at accelerating or helping to develop special projects within particular businesses.

iii Export Assistance - including certain financial schemes to encourage the growth of new export markets and the general services provided by the British Overseas Trade Board (BOTB) and the Export Credit Guarantee Department (ECGD).

iv Research and Development - schemes which provide finance and assistance for projects involving a new and improved product or process.

2.25 In general the CBI has supported those government policies which have sought to promote or encourage the process of industrial change and realignment and opposed those policies, applied for purely defensive reasons, which have retarded industrial change. While assistance continues, the CBI has advocated minimum selectivity and discretion in order to reduce distortions to fair competition and maximise continuity in the form of aid, so that businessmen do not discount assistance because of uncertainty over its availability or form.

2.26 Recent government policies have broadly adhered to these principles. The National Enterprise Board has had its interventionist powers reduced and its role has been consolidated in a limited "casualty" and "nursery" function as the CBI advocated. Similarly the Government has reduced employment subsidies, including the abolition of the small firms employment subsidy, and concentrated resources on encouraging the growth of new industry in the more deprived areas of the country. The CBI has welcomed these moves while stressing the need for existing financial assistance to industry to continue while company profitability remains severely depressed.

Practical Assistance

2.27 The CBI has emphasised that government does have a role to play in encouraging the growth of new and small firms by giving advice, information and other forms of practical assistance(12). In this respect the CBI welcomed the creation of regional Small Firms Information Centres and the strengthening of the Small Firms Division of the Department of Industry. It has also supported the role of government agencies, such as the Council for Small Industries in Rural Areas (CoSIRA) which provides counselling, and in certain cases funds, to support the development of smaller firms in rural areas.

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(10) See in particular "Enterprise into the Eighties", 1977 and "Policy Priorities for Smaller Firms", 1979.

(11) Ibid.

(12) Ibid.

2.28 The CBI has urged the Government to reduce some of the administrative burden on smaller firms which results from regulation and legislation(13). The present Government has taken some significant steps towards this end. In particular the form-filling burden on smaller firms has been reduced, especially with regard to the provision of statistical data. A review recently undertaken within the Department of Trade has also resulted in a substantial decrease in the number of forms issued while many existing forms have been simplified. The Government has also relaxed planning controls over minor developments and attempted to speed up planning procedures. Plans to set up "Enterprise Zones", where businesses will be exempt from many detailed regulations, are an example of an experiment which might prove valuable in regenerating business in depressed areas.

2.29 The present Government is committed to withdrawing from excessive intervention in business life. Much direct intervention, for example pay, price and exchange control, has been ended and the CBI has welcomed the adoption of its own policies in this sphere. However, as government withdraws from interference in business, the private sector has seen the need to respond to the challenge to do more to encourage the growth of new and smaller firms. In recent years there has been a growing recognition by large companies of the importance of smaller firms to them, both as customers and suppliers, and to the economy as a whole. Several large companies have taken practical steps to encourage the growth of the smaller firms sector of the economy, not through subsidy but by providing tangible assistance to enable new firms to start up and smaller firms to help themselves. The CBI has welcomed those initiatives and sought to encourage the process of large firm/small firm co-operation. In particular it has frequently argued that large companies should not use their small customers and suppliers as banks but should pay their bills promptly. This point was strongly emphasised at the CBI's 1979 National Conference in Birmingham. With this in mind a CBI working party, consisting of large member companies, has been set up to examine ways in which prompt payment can be encouraged throughout business.

INDUSTRIAL RELATIONS AND EMPLOYMENT LAW

2.30 The interdependence, between firms of all sizes and all sectors, of the modern economy makes industrial harmony a key ingredient for the success of the smaller firms sector. Positive industrial relations, in which unrest, disruption, strikes or other forms of industrial disruption are reduced to an absolute minimum and a matter of the last resort, are therefore urgently needed. Because they rely so heavily on large companies as both suppliers and customers, smaller firms are particularly vulnerable to the "knock-on" effect of disputes in major industries. They are forced to face, often at short notice and great inconvenience and expense to themselves, the consequences of industrial disruption in key sectors of the economy. They therefore have a vested interest in seeing an effective framework of industrial relations law in the UK.

Industrial Relations and the Law

2.31 The main direction of CBI policy in this area in recent years has been to restore the balance of power between employers and unions in collective bargaining within a coherent framework of industrial relations law which commands the support of an overwhelming majority of people. Smaller firms have played a key role in developing CBI policy which has aimed at:

- restricting picketing to own premises;
- restricting trade union immunities with respect to secondary industrial disruption;
- encouraging the greater use of secret ballots before or during strike action;

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(13) "Policy Priorities for Smaller Firms", 1979.

- making changes in the way that strikes are financed; and

- extending the rights of the individual operating under a closed shop agreement.

2.32 Significant progress has been made in this area since the present Government took office in May 1979. The Employment Act 1980, if operated sensibly, will, the CBI believes, have moved the country further down the road to a saner and fairer balance in the collective bargaining process. Further measures are required to restrict trade union immunities and to remove some of the worst abuses of the closed shop, particularly the practice whereby smaller firms, taking on sub-contracting work, are sometimes forced to use unionised labour. But the direction of government policy is clear and both the CBI and the Government are currently examining the scope for further reform.

Employment Law

2.33 The CBI recognises that the objectives behind much recent employment legislation have been generally sound and commendable. It wholeheartedly supports the principle of equal opportunity in employment and opposes all forms of discrimination on the grounds of sex, creed, colour, race or nationality(14). However, in some cases the practical implications for business, and especially smaller firms, of such legislation have been ignored. The CBI has, on several occasions, highlighted the disincentive effect that increasingly complex regulation can have on the smaller firm(15). As a result its priorities for amending employment law have included:

- repeal of most of schedule 11 of the Employment Protection Act;

- significant amendment of the terms of reference of ACAS;

- improving industrial tribunal procedures;

- making the onus of proof in unfair dismissal cases neutral as between employer and employee; and,

- raising the length of time in employment before an employee can claim unfair dismissal.

2.34 The present Government has shown itself to be aware of the problems faced by firms, especially smaller ones, when dealing with this type of legislation. Regulations enacted shortly after the Government took office raised the length of time before an employee could claim unfair dismissal from six months to one year. In addition the Employment Act 1980, provides that for firms with 20 or fewer employees, the qualifying period for new employees, before they can claim unfair dismissal, will be two years. Special dispensation was granted to very small companies from the maternity provisions in the Employment Protection Act; the onus of proof in unfair dismissal cases was made neutral and industrial tribunal procedures have been improved.

Employee Communication

2.35 The CBI's "Guidelines for Action on Employee Involvement" reflect the firm view that it is in a company's interests to involve its employees in the affairs of the company and to establish channels of communication which can win employee commitment in the interests of a more efficient business.

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(14) "Equal Opportunities: A CBI Statement and Guide", 1979.

(15) See in particular, "Enterprise into the Eighties", 1977 and "Policy Priorities for Smaller Firms", 1979.

2.36 The inherent informality of so many smaller firms is an undoubted advantage in involving employees. It offers plenty of opportunity for people to know how the business is doing, to have information on matters affecting them personally and to contribute their views on how work can be done more effectively. As firms grow larger it is often less practicable to rely solely on the personal approach. What matters is getting the right balance between the advantages of the informal, personal approach and the consistency provided by a more systematic approach. This is a matter which the CBI believes it is for each individual company to decide and is not a problem that can be solved by legislative imposition.

2.37 Employee communication should not be confused with the political debate of earlier years about so-called "industrial democracy". Involving employees in business life is today a matter of industrial survival and is a process which the CBI has sought to encourage.

COMPANY AND COMMERCIAL LAW

2.38 Increasing demands are being placed on smaller companies by the current harmonisation programme of EEC company law. There are presently well over 20 company law directives being generated by the EEC and the CBI is particularly concerned that smaller companies should be relieved of some of the more onerous requirements resulting from these.

2.39 In its response to the Government's 1979 Green Paper on "Company Accounting and Disclosure" the Smaller Firms Council(16), through the CBI Council, urged that full advantage be taken of the exemptions available for small and medium-sized companies under the EEC Fourth Directive. These included some derogation from accounting and filing requirements and relaxation of the audit requirement for smaller companies. In general, the CBI has taken the view that company law requirements should be less onerous for private companies than for public ones.

2.40 In addition the CBI has been examining closely other areas where smaller companies have a particular interest.

Product Liability

2.41 There is an increasing danger that the proposals currently emerging from the EEC could impose excessive costs on industry and stifle innovation. The CBI has been pressing for substantial revision of the EEC Draft Directive on Product Liability, particularly the provisions which make manufacturers responsible for defects in their products which could not have been foreseen given the current state of technical knowledge.

Share Repurchase

2.42 Following an investigation by the Smaller Firms Council, the CBI has advocated that independent private companies should be permitted to repurchase their own shares as a means of encouraging equity holdings in private companies. The CBI has made recommendations about how the law should be changed to permit private companies to "buy-back" their own shares while protecting the interests of minority shareholders and creditors against possible abuse.

Unlisted Securities

2.43 The original proposal put forward by The Stock Exchange to create a formal market in unlisted securities was generally welcomed by the CBI as a means of making the shares of small and medium - sized companies more marketable. However, the CBI set out what it regarded to be essential modifications to The Stock Exchange's

(16) "Company Accounting and Disclosure", a paper by the CBI Smaller Firms Council, 1979.

original plan, including the suggestion that the USM should not necessarily be transitional in nature, and should not oblige companies to move towards a full listing as was proposed. The Stock Exchange's revised proposals for the USM have incorporated all the main modifications suggested by the CBI.

INTERNATIONAL TRADE POLICY, INDUSTRIAL CHANGE AND INNOVATION

International Trade Policy

2.44 Like any other trading nation Britain must export to survive. In increasingly competitive international markets British business needs to improve its productivity and efficiency if the country's future prosperity is to be secured. In a major policy document the CBI has firmly rejected the idea of a siege economy with across-the-board controls on imports(17). The document, approved as policy by CBI members, large and small, supports a liberal framework of fair competition in international trade.

2.45 However, it also suggests that the Government and the EEC should take steps both:

- to shield industry from manifestly unfair international competition (especially in sectors like textiles, footwear and cutlery); and

- to relieve the social cost of adjustment for hard-hit industries by giving them time to reorganise to meet new market conditions, in accordance with agreed international rules.

2.46 Within the EEC the CBI has said that more needs to be done to eliminate unfair trade between member states. In particular subsidised competition and non-tariff trade barriers, such as differing standards and testing requirements, should be eliminated as these can weigh heavily on existing or potential exporters. The EEC itself has an important role to play in ensuring that other industrialised countries, such as Japan, ease non-tariff barriers to our exports, and that the advanced developing countries should be encouraged to open their markets to more imports in return for the relatively open access that they have to the EEC market, on the basis of reciprocity(18).

2.47 Finally, the CBI believes there must also be a role for government in providing export promotion services which are as full and as effective as those enjoyed by our main competitors. These services are particularly important for smaller firms which often lack the resources and contacts necessary to establish overseas markets but which can nevertheless make an important contribution to the balance of trade.

Industrial Change and Innovation

2.48 Industrial change, involving the birth of new industries, products and processes and the decline of traditional and historic industries, is a continuous process. The CBI supports policies designed to speed this up, which at the same time ameliorate some of the worst social problems that arise as a result of the decline in traditional industries. Thus, it has been particularly concerned that the opportunities for innovation and for the application of important new technologies should be taken up. Only then will UK firms be able to benefit fully from the new markets being opened up and create the new jobs which will go with them.

2.49 The CBI recognises that smaller firms have an important role to play in this respect because their dynamic nature often makes them a convenient and

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(17) "International Trade Policy for the 1980's", published by the CBI, 1980.

(18) Ibid.

efficient vehicle for the development of new products and ideas. A recent CBI report concluded that smaller firms were good at innovating but that their potential for the creation of new employment and national wealth was not being fully realised(19). Among the constraints operating on them were:

- difficulties in raising capital in a period of high inflation and low company profitability;

- lack of sufficient incentives as a result of high rates of personal taxation and the erosion of differentials caused, in part, by past incomes policies; and,

- an acute shortage of suitably technically qualified employees.

2.50 The CBI report concludes that exploiting known and new technology is a valuable means of increasing the country's wealth and speeding up the process of industrial realignment(20). Yet this will only happen if sufficient progress is made towards improving the general economic climate in which all business operates.

MANPOWER AND THE SMALLER FIRM

2.51 The CBI recognises that the quality and output of the education system is of vital importance to industry and commerce and therefore to the nation's degree of economic success in the future.

2.52 However, it seems that in many cases there is a serious mis-match between the products of our education and training system and the needs and requirements of industry and commerce. For example, at a time of rising unemployment it may seem paradoxical to talk of shortages of labour but employers in general, and smaller firms in particular, frequently complain of the difficulty of finding skilled labour.

2.53 CBI policy in this area has therefore concentrated on strengthening and developing links between employers and the education system, particularly at the local level. A better understanding of and the closest possible reconciliation between the needs and aims of both can only benefit the business community.

2.54 With this aim in mind the CBI has supported:

- closer links between employers and schools at all levels aimed at reconciling broad educational aims with employment needs and opportunities;

- introducing general vocational preparation before the last year at school to complement similar preparation made either in further education, employment or in schemes for the unemployed;

- changing the apprenticeship system so that it is based on the attainment of standards rather than the passage of time as a means of ensuring that industry can meet its changing needs for new skills and qualifications arising from technological change; and

- the role of government agencies (like the Manpower Services Commission and Industrial Training Boards) in encouraging employers to develop effective training methods, provided that such support is both cost-effective and does not impose excessively onerous requirements on companies, especially smaller firms.

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(19) "Innovation and Competitiveness in Smaller Companies", a CBI report published in 1979.

(20) Ibid.

2.55 One issue of particular concern to smaller firms has been the suggestion that certain sizes of firm should no longer be exempted from the training levy imposed in their sector by Industrial Training Boards. For the most part the exclusion from training levy applies to firms which are small in relation to the general run of their industry. The CBI has consistently opposed discontinuing such exclusions and indeed has argued that in certain sectors the exemption levels should be raised or periodically reviewed to take account of inflation.

CHAPTER III

SMALLER FIRMS AND EMPLOYMENT

INTRODUCTION

3.01 In the last few years three reports have been produced that throw some light on the job generation process and the role of smaller firms within it. One study was based on American experience; the other two on British experience. There is nonetheless still insufficient data from which to draw firm conclusions although it is possible to make some comparisons, between Britain and the USA, and to identify some implications for policy planning.

BIRCH STUDY

3.02 In terms of its impact the most important study was "The Job Generation Process" by David Birch which has been interpreted by some people to suggest that British industry could be regenerated and unemployment reduced if only more time and effort was spent encouraging smaller firms. It is important therefore to look in detail at exactly what Birch in fact said and the applicability of his conclusions to Britain.

3.03 The study was carried out by the Massachussets Institute of Technology as part of its Programme on Neighbourhood and Regional Changes and looked at employment change in 5.6 million business establishments in the manufacturing and private service sectors in the United States between 1969 and 1976. It was estimated that the statistical data gave it an overall coverage of about 80 per cent of all business establishments.

3.04 The major findings of this study were:

- the rate at which jobs disappeared through failure, contraction or migration was fairly uniform throughout the USA at about 8 per cent per annum;

- about 50 per cent of new jobs came from newly-formed enterprises and 50 per cent from the expansion of existing enterprises;

- two-thirds of net new jobs created over the period were attributable to firms employing 20 or fewer employees; and

- the firms which were most likely to generate new jobs were the most volatile as the largest gains over the period were by firms which had experienced the sharpest contractions in earlier years, but had survived.

3.05 The Birch study created substantial interest in the job creation potential of smaller firms, particularly the finding that two-thirds of employment growth between 1969 and 1976 came from small firms(1). However this finding has been widely misunderstood and has tended to obscure the role larger firms play in the job creation process.

3.06 The confusion over the Birch findings has resulted from the failure to distinguish between gross and net changes in employment. In simple terms, jobs are created through the expansion of existing firms and through the opening of new establishments. These are gross job gains. Jobs are lost through company closures and through contraction and are gross job losses. As shown in Table 10, it is the difference between gross gains and gross losses which gives the net change in employment.

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(1) In this Chapter specific references to "small" firms relate to those with under 20 employees.

TABLE 10

THE JOB GENERATION PROCESS

OPENINGS + EXPANSIONS	=	GROSS JOB GAIN (gross new jobs)		
			=	NET JOB CHANGE (GAIN or LOSS)
CONTRACTIONS + CLOSURE	=	GROSS JOB LOSS		(Net new jobs)

TABLE 11

TOTAL EMPLOYMENT IN '000s IN AREA X

Year	Firms employing 0-20	Firms employing more than 20	Total employment
1969	10	100	110
1976	20	105	125
Total Change	+10	+5	+15

10/15: $\frac{2}{3}$ of NET new jobs are created by small firms

TABLE 12

NEW JOB CREATION AND LOSS IN AREA X IN 000'S

	Firms employing 0-20	firms employing more than 20	Total employment
Openings	+10	+100	+110
Expansions	+20	+150	+170
Gross Job Gains	+30	+250	+280
Contractions	-5	-190	-195
Closures	-15	-55	-70
Gross Job Losses	-20	-245	-265
Net change	+10	+5	+15

30/280: 11 per cent of ALL new jobs are created by small firms

TABLE 13

MANUFACTURING EMPLOYMENT CHANGE BY SIZE IN BRITAIN AND UNITED STATES, AS A PERCENTAGE OF TOTAL MANUFACTURING EMPLOYMENT IN BASE YEAR

	SIZE					
	0-20	21-50	51-100	100-500	500+	Total
USA 1969-76	+3.2	+0.5	-0.2	-1.5	-2.9	-0.9
East Midlands* 1968-75	+2.7	+2.3	+1.5	-2.2	-5.9	-1.5

*NOTE: Openings for East Midlands are placed in 1975 size band, but in-situ plants and closures according to 1968 size. The procedure is assumed to be identical to that adopted by Birch.

Source: East Midlands : Fothergill and Gudgin (1979)
USA : D L Birch (1979)

.07 [illegible] illustrate, Dr D J Storey has produced a hypothetical example to show he difference between net and gross job generation. Table 11 shows that in Area (in 1969 employment was 110,000 of which 10,000 jobs were in small firms. y 1976, employment in the area has increased by 15,000 to 125,000. Of the increase, mployment in small establishments grew by 10,000, accounting for two-thirds r 66 per cent of the increase in net employment between 1969 and 1976. It is his net employment gain to which the Birch findings relate.

.08 Table 12 identifies the flows underlying the picture given in Table 11. Over he 1969-1976 period, small firms generated 30,000 jobs. Larger establishments ccounted for 250,000 job gains. In total then, small firms provided only 30,000 ut of the total 280,000 new job gains or 11 per cent. However, large firms also xperienced a large number of job losses (245,000 out of 265,000 or 92 per cent) vhereas small firms lost only 20,000 jobs so that in net terms, small firms accounted or a substantial number of net new jobs.

3.09 The policy implication is that while small firms make a significant contribution o the net creation of jobs, this must be viewed in the context of the more substantial ole large establishments play in the gross job generation process.

3.10 Another point needs clarification. Birch found that although two-thirds of new job gains in the US were attributable to small firms this was in all sectors of the business economy, not just manufacturing as is sometimes quoted. In fact 80 per cent of the net job gains were in non-manufacturing sectors, mainly in the service sector. This was a consequence, not a cause, of economic development as employment in the non-manufacturing sectors is primarily a response to the wealth generated by the manufacturing sector, and the economy cannot therefore be regenerated simply by stimulating service employment in small firms.

3.11 In addition there are a number of cultural and social factors that should be borne in mind when considering the applicability of conclusions drawn from a USA study to Britain. For example, it has been suggested that in the USA entrepreneurs are held in higher regard than in Britain and there is greater general approval of careers devoted to the acquisition of wealth. Also compared with Britain, there is a relative absence of constraints on the movement of labour and this is reinforced by an economy which is geared to a greater degree of social mobility, both upwards and downwards(2).

THE BRITISH EXPERIENCE

3.12 Two British studies have attempted to look at the role of smaller firms in the job generation process in Britain and to compare their results with the Birch findings. The study by Fothergill and Gudgin(3) is based on information on 10,000 individual manufacturing establishments in the East Midlands, covering the period 1968-1975 although for one area, Leicestershire, records go back to 1947. The Storey(4) study draws on this work but together with studies undertaken in the county of Cleveland and in Glasgow and Birmingham. It should be emphasised that these studies refer only to manufacturing, unlike the Birch report which covers all sectors. Comparisons between the two countries therefore can only relate to the manufacturing sector.

Contribution of Small Firms to Manufacturing Employment

3.13 The Birch study and the East Midlands study both found that small manufacturing firms employing less than 20 people showed a net growth in employment; in the

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(2) Views expressed by Professor Birch at a seminar at the Department of Industry, November 1979.

(3) "The Job Generation Process in Britain" - B Fothergill and G Gudgin, 1979.

USA between 1969-76 net employment in such firms increased by 3.2 per cent and in the East Midlands from 1968 to 1975 by 2.7 per cent (see Table 13). In both studies manufacturing firms employing more than 100 people showed an aggregate decline in employment, whereas firms employing less than 100 people had an aggregate increase. At the time total employment in manufacturing was falling by 0.9 per cent in the USA and by 1.5 per cent in East Midlands.

3.14 There is however a bias in these results. Existing firms are categorised according to their "base" year employment whereas new firms are categorised according to their most recent year's employment, thus over-stating the impact of new firms. Storey suggests that a better method is to examine net employment change in different sizes of firm, categorised according to a base year. Using this method on the data for Cleveland, Storey found that it was firms employing less than 50 people that were responsible for a net job gain in the period 1965-76. These results suggest that such smaller firms show an aggregate tendency to increase employment in manufacturing, although the numbers involved are small compared to total employment in manufacturing.

The Role of New Firms in Manufacturing Employment

3.15 Birch stated that over eight years about 25 per cent of gross new jobs in all sectors were created by independent "free standing" entrepreneurs. Storey has estimated from the British data that, in a decade, wholly new establishments created no more than 15 per cent of gross job gains in manufacturing. The data for the East Midlands show that 15.1 per cent of gross new manufacturing jobs were created by wholly new firms, and in Cleveland about 12 per cent. There are problems in making comparisons between countries because the Birch study has more "spurious" new firms because of less rigorous checking and it covers three short periods rather than a continuous seven year period. However it is necessary to re-emphasise that the British studies refer only to manufacturing, and hence any conclusions drawn need not be applicable to the service sector.

3.16 Storey concludes that merely raising the formation rate of wholly new firms in manufacturing may not lead to a rapid increase in employment in Britain because employment levels in the majority of wholly new firms remains fairly low, even after a decade. For example the data from Clydeside showed that only 1.4 per cent of wholly new firms employed over 100 people after nine years.

3.17 When the burden of direct taxation has been increased, many have thought that high levels of income tax acted as a disincentive to entrepreneurs to start their own businesses, and that reduced income tax would enable individuals to save more of their take home pay until they eventually had enough capital to start up their own business. However, as company registrations increased significantly since the war, this lead Storey to doubt this hypothesis. He suggests that high marginal tax rates entice entrepreneurs to start part time businesses in the "black economy" which then often lead to legitimate full time small businesses. It is however an oversimplification to say that as the burden of direct taxation had been increasing since the war, firm conclusions can be drawn from this about the relationship of direct tax to the growth of new firms. More research on this subject is needed before any conclusions or policy implications can be made.

Regional Dimension

3.18 Studies of the entrepreneur have shown that there is a much higher probability that a man forming his own company for the first time will have worked previously in a smaller rather than a large company. Johnson and Cathcart(5) have estimated that an employee in a firm employing fewer than 10 people is 15 times more likely

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(4) "Job Generation and Small Firms Policy in Britain" - D Storey.

(5) P S Johnson and D Cathcart "Founders of New Manufacturing Firms: A Note on the Size of Incubator Plants" Journal of Industrial Economics 1979.

to start his own business than a person working in a firm employing more than 500. Other studies(6) have suggested that the successful entrepreneur often has previous managerial experience and tended to be well educated. This would suggest that any incentives to encourage the establishment of smaller firms would have their most positive effect on areas with a high proportion of well educated managers and a large number of smaller firms. However, the concentrations of smaller firms and managerial expertise are disproportionately distributed amongst the regions. In the North, 6.4 per cent of those employed in manufacturing, work in establishments employing less than 50 people, whereas in the South East the proportion is 15.4 per cent. The North has only 7.7 per cent of the population in the administrative and managerial class whereas the South East had 10.4 per cent. Since most new firm founders tend to establish their business close to home any general incentives to encourage new and smaller businesses can be expected to have a varied regional impact and might not help those regions in greatest need of sustained employment growth as much as the more prosperous areas of the country. Storey concludes from this that if unemployment blackspots are to be helped through the growth of new firms, there must be a regional dimension to incentives to encourage new and smaller firms.

3.19 This view is supported by Bannock and Doran in "Small Firms in Cities: A Review of Recent Research". They concluded that smaller firms breed other firms so that their role in the process of growth or decline in manufacturing employment is cumulative. Birth rates are highest where there are already concentrations of smaller firms and where economic growth is most rapid. If, as the research suggests, smaller firms are dependent on the general economic health of an area, it is unlikely that areas of industrial decline, whether inner cities or regions, can be regenerated merely by stimulating smaller businesses. Indeed without incentive measures for business as a whole it is unlikely that smaller firms would be able to make a substantial contribution.

GENERAL CONCLUSIONS

3.20 The implications drawn by some from the Birch study were that the performance of the smaller firms sector in Britain was poor in comparison to the USA and if resources were concentrated on this sector British industry could be regenerated and employment increased. The role of small firms in job generation in the USA is, however, primarily in the service sector and this results from having a strong wealth creating manufacturing sector. Both the USA and British studies suggest that it is the smaller firms that do make a positive contribution to net employment growth in manufacturing at a time when total employment in manufacturing is falling. However, as a proportion of total manufacturing employment their contribution is small and employment growth is slow. Unfortunately, there is insufficient information on the role of smaller firms in the service sector in Britain and it is not possible to generalise the conclusions from Birch's USA study or the British manufacturing studies.

3.21 Although the evidence may be incomplete what is available suggests that smaller firms can make a positive contribution to employment growth. It is important however not to overestimate the present, potential, and past performance of new and smaller businesses in this respect because this might create unreasonable expectations that cannot be fulfilled.

3.22 The success of any policy specifically designed to encourage smaller firms should be measured in terms of its contribution to economic growth and the general health of the economy and not just in jobs created. Smaller firms can play an important role in providing job opportunities at a time when large manufacturing companies are becoming more capital intensive and reducing the size of their workforces, and they are essential to help provide a more varied employment base in a community; but their role is complementary to that of large firms, not a substitute for them.

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(6) N R Smith: "The Entrepreneur and His Firm".

CHAPTER IV

SMALLER FIRMS AND FINANCE

INTRODUCTION

4.01 Finance is one of the major policy issues for smaller firms; indeed, the Wilson Committee felt it was of sufficient importance to warrant an Interim Report(1). The financing of any business involves seeking to match a firm's need for money with the terms on which it is available. Therefore to consider the financing of smaller firms requires an examination of what sort of money smaller firms need, where such money may come from, and what may affect whether or not they get it.

USES OF MONEY BY SMALLER FIRMS

Start-Up Finance

4.02 The launching of a business needs money. The significance of this can depend on the capital-intensity of the firm's planned activities, but start-up finance is always needed to meet the cost of acquiring the initial assets of a business and to meet any cash flow deficits in its early life.

4.03 The businessman and his financial backers will have to make a financial commitment to the business, which if it is started as a company will normally be in the form of equity. Loan finance will also be appropriate, provided the business is able to generate funds sufficiently early to meet its servicing costs. Some of the immediate need for start-up finance may be reduced through use of credit, and the renting, leasing or hire purchase of premises and equipment.

Development Finance

4.04 An established business has a continuing need for funds to maintain and expand its productive assets. Smaller firms often grow at irregular rates, and periods of accelerated growth can put considerable strain on a business. A strong equity and capital reserve position can therefore be essential to smaller firms, particularly when interest rates are high.

Operating Finance

4.05 The income and expenses of a business are not always synchronised and therefore periodic needs for finance to meet cash flow deficits can arise. There is also an inevitable time lag between incurring costs and obtaining subsequent revenue; this can create a need for working capital. Funds for these purposes are typically either short-term borrowing or the reserves of the business.

Venture Capital

4.06 While financing business always involves risk, some ventures can involve particularly high risk where the product or production process is highly innovative. Such undertakings need backing by money whose owners accept the high risk of failure in return for the prospect of high reward in the event of success. For the money to be entirely tied to the long-term success or failure of the venture, it normally has to be provided in the form of equity; where it is loan capital its servicing will have to be structured around the expected timing of the venture's success.

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(1) "The Financing of Small Firms". Interim Report of the Committee to Review the Functioning of Financial Institutions (Wilson Committee), Cmnd. 7503, 1977.

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POSSIBLE SOURCES OF FINANCE FOR SMALLER FIRMS

Individuals

4.07 Wealth and income held by individuals are the ultimate sources of finance for all purposes. Although economists disagree on exactly what determines the quantity and patterns of investment, it is generally recognised that the higher the proportion of an individual's income taken up meeting basic needs such as food, shelter and clothing, the lower the proportion available for saving and, potentially investment; thus higher incomes will create greater opportunity for investment as the proportion of income required to meet basic needs falls.

4.08 As far as the pattern of investment by individuals is concerned, the distribution of incomes between members of the population may be as important as the average level per head. The patterns may differ between a relatively small number of individuals, each having large amounts of money to invest, and a relatively large number of individuals each having small sums to invest. While the exact effects on investment of different income distributions are difficult to predict, it is reasonable to expect that the larger the sums held by individuals, potentially the more risk they will feel able to take in some of their investment choices; while with only a small sum to invest the greater the concern of the individual with the security of the investment. Chart F shows the decline since the war of the share of total personal after-tax income taken by the top ten per cent of income earners. Broadly similar shifts have also been seen in the pattern of wealth distribution.

4.09 Changes in the distribution of income and wealth may be partly responsible for changes in the pattern of investment, such as the major shifts in the ownership of listed securities. Chart G shows a marked reduction in the proportion of shares held directly by individuals, which is matched by a marked increase in the holdings of financial intermediaries.

4.10 Recent years have also seen a marked increase in the proportion of personal income being saved (see Chart H), but this has been accompanied by individuals reducing their net holdings of company securities while increasing their net acquisition of funds in life assurance and superannuation funds (see Table14).

Financial Institutions

4.11 The shift of personal savings into financial institutions such as insurance and pension funds has important implications for smaller firms, not only because it has diverted funds away from direct investment by individuals, but because it makes such financial intermediaries a potential source of finance in their own right. The flow of net savings to financial institutions from the rest of the economy has grown from around 5½ per cent of GDP in the 1958-62 period to over 11 per cent since 1973(2). This increase is largely explained by the personal sector's increased propensity to save and to use such financial intermediaries as a more secure form of investment, and by the growth of self-administered pension funds - the market value of whose assets has increased from just over £2 billion in 1957 to £31 billion by 1978(3).

4.12 The growth of life and pension funds has had a marked impact on the pattern of investment, with such funds investing 69 per cent of their resources in long-term government and listed industrial securities by 1978(4). By 1975 it has been tentatively estimated(5) that pension funds and insurance companies accounted

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(2) Final Report of the Committee to Review the Functioning of Financial Institutions (Wilson Committee), Cmnd 7937, 1980 para 230.

(3) Ibid para 255.

(4) Ibid para 256.

(5) Royal Commission on the Distribution of Income and Wealth, Report No 7.

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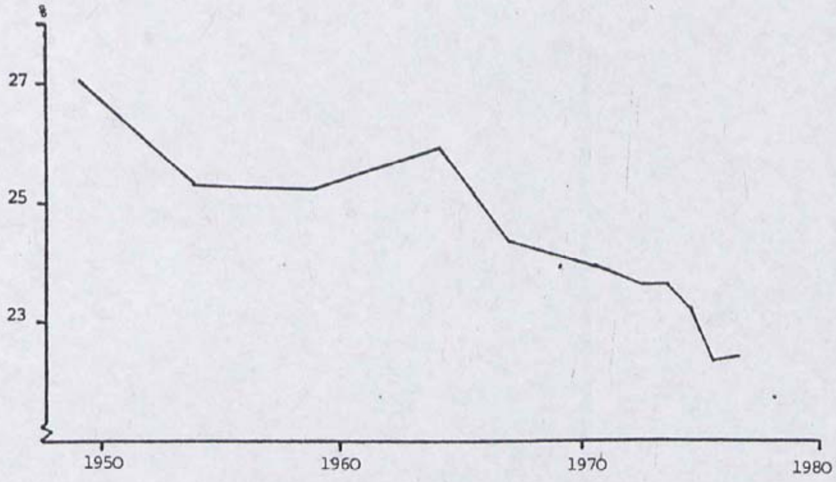
CHART F

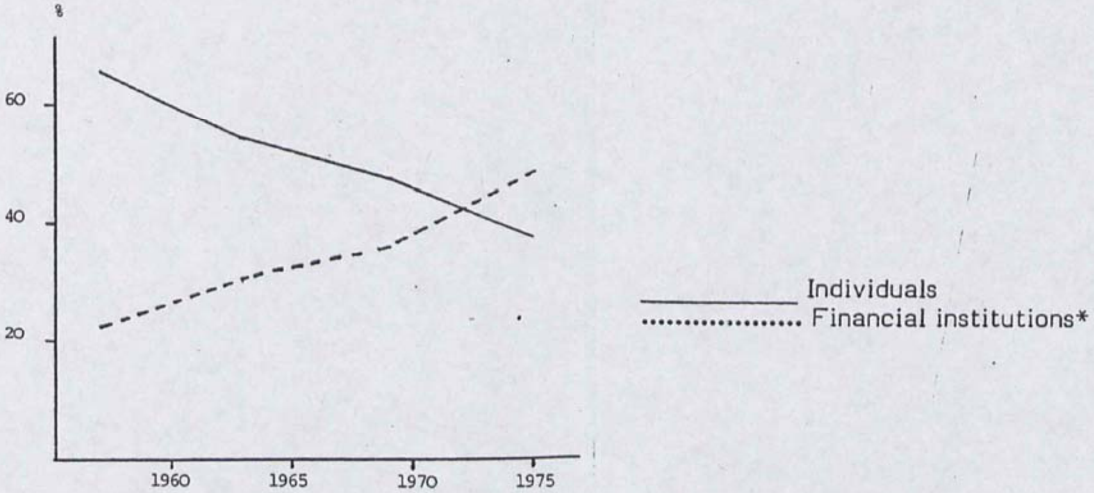
SHARE OF NATIONAL INCOME TAKEN BY TOP 10% OF INCOME EARNERS



Source: Royal Commission on the Distribution of Income and Wealth Report No.7.

CHART G

PERCENTAGE OF TOTAL UK LISTED SECURITIES HELD BY INDIVIDUALS AND INSTITUTIONS

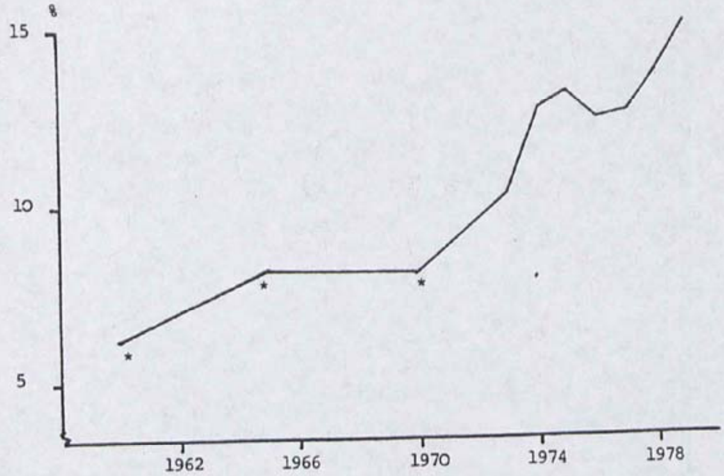


* includes brokers, jobbers, banks, insurance companies, pension funds, unit trusts and investment trusts.

Source: As in Chart F.

CHART H

PERSONAL SAVINGS RATIO^{+} 1958-79



* average of 4 year period

\+ personal saving as a percentage of personal disposable income (after deducting stock appreciation but before depreciation and additions to tax reserves).

Source: Wilson Report (Cmnd 7939).

TABLE 14

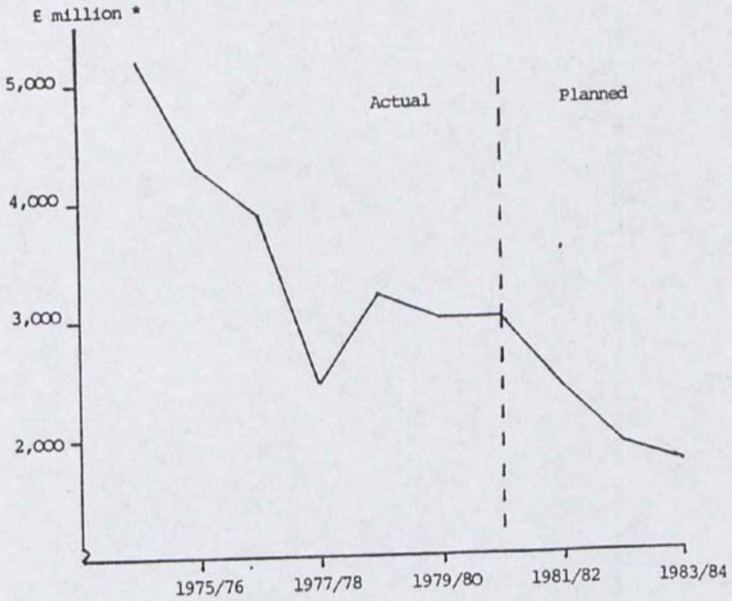
INDIVIDUALS' HOLDINGS OF COMPANY SECURITIES AND LIFE ASSURANCE AND SUPERANNUATION FUNDS

	Net reductions in holdings of company securities in each year	Net acquisition of life assurance and superannuation funds in each year
	£m	£m
1971	-1244	+1930
1972	-1193	+2935
1973	-2022	+3354
1974	-1229	+3695
1975	-887	+4549
1976	-1483	+5663
1977	-1827	+6366
1978	-1449	+7706
1979	-2408	+9400

Source: Financial Statistics Table 10.2

CHART I

TOTAL PUBLIC EXPENDITURE ON INDUSTRY, ENERGY, TRADE AND EMPLOYMENT

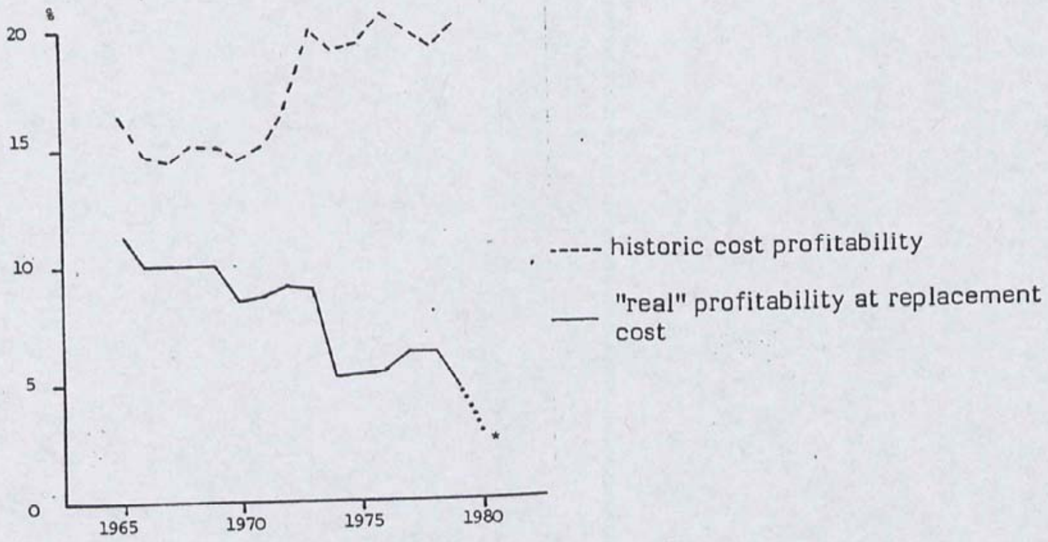


* constant 1979 survey prices

Source: Government Expenditure Plans 1980/1-83/4 Cmnd 7481, March 1980 Table 1.6

CHART J

PROFITABILITY



\+ industrial and commercial companies' rates of return, excluding North Sea related activities.

* CBI forecast

Sources: CSO and CBI estimates

for just 3 per cent of the holdings by market value of all unlisted securities, though this was an increase from 0.4 per cent in 1957. Over the same period the percentage of unlisted securities held by the personal sector is estimated to have fallen from 80 per cent to 52 per cent.

4.13 Historically, the clearing banks have concentrated on providing short-term loans to business. While this continues to be the dominant financial activity of the banks in relation to smaller firms, the terms on which loans are provided is becoming more flexible, and equity is being provided on an experimental basis. The clearing banks together with the Bank of England own the Industrial and Commercial Finance Corporation (ICFC) which concentrates on providing packages of medium and long-term finance, usually involving both loans and equity.

4.14 In addition to ICFC there are a number of specialist development capital companies, generally concentrating on equity finance, but often including loans in a financial package; many of them have minimum thresholds often at about £50,000, though there are some as low as £5,000. Many merchant banks are also interested in supporting smaller firms in similar ways, and will sometimes consider new ventures.

Government

4.15 As a source of funds to business, government is acting as an intermediary for the taxpayer. Most government assistance is aimed at the manufacturing sector in order to stimulate capital investment and research and development, and in support of employment and training. While some of the direct assistance of the Development Agencies(6) is concentrated on selected smaller manufacturing firms, little government aid is specifically directed towards smaller firms as such. The effect of minimum thresholds and the capital orientation of much of the assistance may mean that for smaller firms as a whole government financial aid is a relatively less significant source of funds than for large firms. Direct government financial support to industry has fallen in recent years and this trend is expected to continue, as shown in Chart I.

Internal Funds

4.16 A vital source of finance for any business is its capacity to generate profits; without adequate profits it cannot finance the replacement of its plant and machinery, its investment in expanded capacity, and thus its prospects for growth are affected. The profitability of businesses over the past decade calculated on the prevailing historic cost accounting basis has been around 15-20 per cent. However, this measurement of the rate of return is positively misleading as an indication of a company's capacity to re-invest, because no account is taken of the impact of inflation on the cost of replacing the company's plant and machinery.

4.17 As Chart J shows, in recent years British companies have experienced a dramatic fall in their "real" profitability, ie their rate of return calculated on a replacement cost basis. The immediate prospects are of a further deterioration. This low level of profitability affects smaller and larger firms alike and seriously prejudices their ability to remain competitive, let alone expand. This has consequential implications for employment and incomes.

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(6) Including, the Scottish, Welsh and Northern Ireland Development Agencies, the NEB the Development Commission, and its counterparts in rural Scotland and Wales and in Northern Ireland.

INFLUENCES ON THE CAPACITY OF BUSINESSES TO ATTRACT FINANCE OF THE APPROPRIATE TYPE

4.18 The influences on the capacity of businesses to attract finance, include the following:

- the rate of return to the investor;
- marketability of equity investment;
- risk; and
- information.

The importance of these influences will vary between investors. For example, the personal investor may be more concerned about the risk associated with an investment rather than securing a high rate of return. A large financial institution may have quite different priorities.

Rate of Return

4.19 Chart J has shown how real profitability has fallen in recent years. Besides having an effect on the availability of internal funds for investment, the level of business profitability will be compared by the investor to the return being generated by other investment opportunities - government debt, property, financial institutions - and under present circumstances this comparison may well be generally unfavourable.

4.20 The investor will not only compare the financial performance of different forms of investment, but will also consider the tax treatment of a given level of return on the investment. Mortgages for owner-occupiers, contractual saving through life assurance and pensions, and lending to Government all attract favourable tax treatment, including allowing the initial investment to be made fully or partly out of pre-tax income, and fully or partly exempting from tax the income from or capital gain on the investment.

4.21 The Wilson Committee explored the argument that the tax treatment of investment in business compared unfavourably to that available on other forms of investment. The Committee felt that industry received an offsetting benefit from tax relief on its capital investment and the indirect benefit of investment via insurance and pension funds. However true this is of industry generally, it nonetheless seems likely to be less true of smaller firms. They have attracted relatively less finance from the insurance and pension funds, and their generally lower capital intensity, especially outside manufacturing industry, means that they tend to derive less tax relief on investment.

Marketability

4.22 Amongst the factors that an investor will consider in making an investment choice is the marketability of the investment. To varying degrees, investors will be concerned with the ease with which they can realise their investment, perhaps in reaction to changing personal circumstances, changes in the relative attraction of different forms of investment, and the prospect of obtaining a capital gain. The ability to get the money out in the future will influence the readinesss of the investor to put the money in at the present.

4.23 In looking at a private company, the potential investor will generally find that there is not a ready market in the firm's shares. Among the reasons why the owners of a firm choose to trade as a private company is their wish to maintain control, and therefore they seek to have a right to restrict the transfer of shares. Until recently, the only general market for a firm's shares was via a listing on The Stock Exchange. Many owners of smaller businesses have found it an unattractive option as, besides a minimum turnover threshold, it involves a dismantling of all restrictions on share transfer, as well as increased disclosure and expense.

4.24 M J H Nightingale and Company Limited has established an "over-the-counter" market in the shares of a number of companies, and there is the prospect of a formal unlisted securities market at The Stock Exchange as well as the possibility of further private "over-the-counter" markets. This points to private companies having a greater opportunity to accept equity from the capital market without losing private company status, yet offering the outside investor a more readily marketable asset. In this way, outside investment in private companies should become more attractive.

Risk and Uncertainty

4.25 Risk and uncertainty together represent another factor that the potential investor is likely consider. Depending on their circumstances, individuals will have varying attitudes to risk. For someone thinking about a small investment, security may be a prime consideration; an individual with more substantial savings may be prepared to seek more risky investment opportunities with part of his savings if the prospects of reward are sufficiently attractive. All financial institutions have a responsibility to their investors and shareholders, and consequently have limitations on the degree of risk they can accept in their investment strategies. There have been recent steps, particularly by the clearing banks, to adopt a more flexible attitude to security, but it appears this is a continuing issue at the margin of smaller firm financing decisions.

4.26 Investing in new and smaller firms tends to involve more uncertainty and risk than other forms of investment. Their performance, good or bad, tends to fluctuate because of the likelihood of their concentrating on a limited market - either in product range or a particular geographic area. This is a consequence of their small scale, and they are thus more vulnerable to factors outside their own control than larger firms tend to be. In addition, their relatively small asset base means that generally they have only a limited capacity to offer collateral as a means of reducing or removing risk.

4.27 New firms are at the inherent disadvantage of not having a track record, and even when they are based on a sound business proposition, there can be considerable uncertainty about the timing of a venture's success. Not all potential investors can withstand this, particularly if they lack the resources to invest in a number of smaller firms. If they are confined to, say, only one or two firms, then there is little capacity to spread risk.

4.28 Devising means to overcome this problem has led to calls for:

- loan guarantee schemes, designed to encourage the banks to expand their lending to smaller firms through the provision of government financed guarantees against most of the risk involved(7);

- Small Firm Investment Companies (SFICs), designed to channel additional investment into smaller firms, by the attraction of tax incentives and the capacity to spread risk(8); and

- direct government financial investment in smaller firms specifically designed to provide long-term finance that it is not attractive for the private sector to provide(9).

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(7) Interim Report of the Wilson Committee, Cmnd 7503.

(8) Ibid.

(9) As discussed by Professor John Mitchell, Three Banks Review, June 1980.

Information

4.29 The absence of information can create a barrier to investment. At one level investors may be unaware of investment opportunities, and businesses of where to turn for the right sort of finance. At another level any shortage of information might easily be overcome but at an unacceptable cost. In this latter regard financial institutions can find that the costs involved in assembling the necessary information to make an investment appraisal are out of proportion to the size of the investment being considered. In a number of cases this has lead to institutions (and government) only considering projects above a certain size.

4.30 The information barrier, such as it is, is probably less evident at a personal level. Individual investors may wish to back someone known to them, and, indeed, decisions on the financing of smalller firms are as often based on an assessment of the owner/managers of the firm as on formal investment analysis. Attempts to diminish any information barrier have concentrated on greater "signposting" by banks, government agencies and the business and financial community generally. The government's Small Firms Counselling Service is also providing initial appraisal service for some institutional investors on an experimental basis.

CONCLUSION

4.31 Smaller firms need a variety of forms of finance, reflecting their stage of development and type of business. Potential investment finance held by individuals has become more diffuse, and over time it appears the holding of direct investment in companies has become relatively less attractive. Yet with such high savings in the personal sector, individuals are still vital and potentially a much larger source of funds for smaller firms. While the clearing banks have a long-established role in relation to smaller firms, the growth in the resources held by many other financial institutions has not been matched by a corresponding increase in their investment in smaller firms.

4.32 Smaller firms face a number of difficulties in finding the money they need. Their internal sources have been severely squeezed in real terms, and an improvement in their profitability is vital. To attract outside equity investment, they need legal and institutional changes to improve the marketability of their shares, and desirable changes seem in prospect. High risk and uncertainty are inherent features of smaller firms financing, but are not matched by comparable reward. The absence or excessive expense of information and advice has a widespread impact, and needs involvement by businesses, financial institutions and government to be overcome.

CHAPTER V

SMALLER FIRMS: ISSUES FOR ACTION AND DEBATE

INTRODUCTION

5.01 The preceding chapters have highlighted a number of unfulfilled requirements and unresolved issues. Chapter II pointed to the progress that has been made towards implementing the policies which the CBI feels are essential for the growth and prosperity of smaller firms. While much has been achieved, there are some areas where the CBI's objectives remain to be met, and these are set out in the first part of this chapter. The second part looks at some as yet unresolved issues to which the CBI, government and other organisations need to address themselves in the future.

UNFULFILLED REQUIREMENTS

The Economy

5.02 For the smaller firms sector to grow and prosper, government must provide the conditions for sustained economic growth. Above all, this requires the control of inflation, which would allow low interest rates and the restoration of company profitability.

Taxation

5.03 High marginal rates of income tax and heavy capital and company taxation can stifle entrepreneurial activity and reduce the incentives to start-up new businesses as well as to expand existing ones. Therefore government should:

- reduce the burden of direct taxation;
- relieve smaller firms from the adverse impact of capital taxation;
- reduce the National Insurance Surcharge now as a step to its aboliton; and
- impose a ceiling on business rates related to estimates of reasonable local expenditure.

Industrial Relations

5.04 Because of the interdependence of the modern economy smaller firms have a particular interest in industrial harmony. They therefore need an effective framework of industrial relations and employment law. Significant steps have been taken towards this objective with the Employment Act 1980 but the CBI would like to see:

- further discussion on the extent of Trade Union immunities;
- a re-examination of the legal status and rights of Trade Unions; and
- further protection for both individuals and firms against the worst abuses of the closed shop.

Company Law

5.05 The current EEC company law harmonisation programme runs the risk that smaller firms might be forced to comply with regulations which are inappropriate for their circumstances and size. Therefore the CBI wants:

- substantial revision of the EEC Draft Directive on Product Liability; and

- the exemption of small companies from certain accounting, disclosure and audit requirements when the EEC Fourth Directive on Company Law is implemented in the UK.

Company law requirements should be less onerous for private companies than for public ones, and government policies should reflect this.

Government Assistance

5.06 Although the CBI has not advocated special subsidies or assistance for smaller firms, it expects government:

- to reduce further the administrative burden on smaller firms resulting from regulation and legislation;

- to continue existing financial assistance to industry as long as real company profitability remains so depressed;

- to ensure that existing schemes of assistance do not discriminate against smaller firms and that the effectiveness of aid is not devalued because of delays or uncertainty;

- to continue to provide practical assistance to smaller firms through the Small Firms Information Centres and other relevant government agencies; and

- to encourage the development of new high technology industries.

5.07 While the CBI has welcomed government withdrawal from excessive intervention in business life, at the same time it it also recognises the need for the private sector to do more to aid the growth of new and smaller firms. This process of large firm/small firm co-operation must be further encouraged.

International Trade

5.08 Smaller firms make a significant contribution to Britain's exports and, as a whole, business is aware of the need to improve productivity and efficiency in order to compete effectively in international markets. Government has a role to play in this respect by:

- eliminating unfair trade barriers;

- shielding certain sectors of industry from manifestly unfair international competition; and

- providing exports services as full and as effective as those enjoyed by our main international competitors.

Manpower and Education

5.09 The CBI is concerned that our education system should be geared more towards the needs of industry and commerce, with particular regard to the growing impact of technological change. For this reason:

- links between employers and the education system should be strengthened;

- general vocational preparation should be introduced before the last year of school as a basis for complementary schemes in further education and employment;

- the apprenticeship system should be based on the attainment of standards rather than the passage of time; and

- government agencies should encourage employers to develop effective training methods which do not impose onerous costs and administrative requirements, especially on smaller firms.

UNRESOLVED ISSUES

5.10 On a number of issues important to smaller firms, there is a need for further discussion before policy can be developed. Many of the following issues have been identified in earlier chapters.

Government Intervention

5.11 It is of course accepted that the actions of government will affect smaller firms. However the exact purpose and effect of particular government policies and actions is open to debate. It has been argued that government's objective should be to create a sympathetic environment in which firms can run their own affairs, but this leads to certain questions:

- should this simply involve the removal of hindrances and disincentives, or should there be deliberate features to make the legal and economic setting positively favourable?

- if there are to be "positive" policies, should there be priorities between encouraging more start-ups, reducing the number of failures, or stimulating the growth of existing firms?

- what account should government policies take of the different contributions to the economy made by smaller firms in the manufacturing and non-manufacturing sectors?

5.12 The government operates a number of schemes of financial and other assistance from which smaller firms benefit. As long as this is the case it leads to the question:

- can the number of official agencies involved be sensibly rationalised?

Public Purchasing

5.13 An inevitable area of government involvement in business affairs is through its own business dealings as a purchaser of goods and services. As a consequence, the following questions arise:

- do smaller firms have fair commercial access to public purchase contracts?

- should government - local and central - go out of its way to direct contracts to smaller firms as part of a deliberate smaller firms policy?

Regional Policy

5.14 Earlier discussion(1) focused on the backgrounds of businessmen who establish new firms, particularly in terms of their education and past employment experience, and referred to studies suggesting that the geographical distribution of potential entrepreneurs tends to be concentrated outside the AssistedAreas(2). This prompts some questions:

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(1) See Chapter III.

(2) Those regions of the country eligible for special industrial assistance because of their depressed economic condition.

- should regional policies be developed that will specifically foster new firms so that there is a more even distribution of smaller firms throughout the country?

- should resources be concentrated on the general development of an economically depressed area in the expectation of new and smaller firms responding to the improved local economy?

- do smaller firms have appropriate access to current regional incentives?

Taxation

5.15 The field of taxation has been shown to be the area where there is greatest scope for government quickly to influence the environment of smaller firms. On income and capital taxes the objectives have been clear and there has been progress in recent budgets; but there are two other areas where a number of questions remain.

i Tax treatment of the smaller firm itself:

while the structure of corporation tax is known to be under government review, the potential impact of this on smaller firms is not clear:

- can it be argued that corporation tax has become effectively regressive, because of the greater benefit large profit makers often obtain from capital allowances?

- is there a case for making the tax liability of small profit makers deliberately less burdensome?

ii Tax treatment of potential investors in smaller firms:

while the CBI has felt the tax treatment of direct investment needs to be made more attractive, unanswered questions remain:

- should tax incentives concentrate on the personal or institutional investor or be neutral between the two?

- should investment incentives be concentrated on particular types of business, by size, structure, sector or age?

- should investment incentives be focused on equity or loan finance, and if equity, on capital growth or dividend yield?

Finance

5.16 The private sector, personal and institutional, is the dominant provider of finance for smaller firms and operates in the expectation of a commercial return. Within the notion of commercial return, finance can be provided in different forms and on varying terms, and the availability of finance in a particular form will be influenced by the tax climate. Within this framework more institutions are taking an interest in providing finance for smaller firms and on more flexible terms. Yet the questions remain:

- is there scope to push out further the commercial frontier of financing decisions so that more risky business is seen as acceptable?

- where changes have been made recently in the type of money available, is there scope to speed up the effect on individual business financing decisions?

5.17 It has been suggested that more money might be forthcoming from the banks for smaller firms if a government-backed loan guarantee scheme was introduced. The guarantee would cover a substantial part of the risk of loans to smaller firms that otherwise would not have been made because of inadequate security. The following questions arise:

- how will the lending decisions of the banks be affected by the availability of a government guarantee?

- is it possible to ensure that guarantees will only be provided on additional lending?

- as defaults would lead to a call on public expenditure, is this the most cost-effective way of the government helping smaller firms?

- is a shortage of loan finance the most pressing difficulty in smaller firm financing?

Information, Advice and Education

5.18 Government agencies together with a number of large firms and professional organisations are involved in the provision of information and advice to varying degrees. Government is involved primarily to provide information that otherwise would not be available and to meet some of the cost of initial commercial advice:

- is the availability of these services well understood and are they provided at an appropriate level in different parts of the country?

- is there scope for better organisation of the agencies involved?

5.19 Generally large firms are involved in assisting new and smaller firms through the provision of information and advice and other ways from a sense of enlightened self interest - smaller firms are the suppliers and customers of many large firms, and the health of the smaller firms sector will affect the health of the overall economy and thus the market opportunities of large firms.

- is it desirable and is there scope to draw more large firms into this type of activity?

5.20 More generally smaller firms depend on their professional advisers to deal with financial and legal matters, such as raising money, in what form and from what source, and on changes in the legal structure of their businesses:

- is advice of good quality readily available and do small businessmen appreciate its importance?

- if there is a need to improve the availability of good quality advice, where does responsibility for this rest?

5.21 The education system as a whole can have an indirect but pervasive influence on the smaller firms sector. Two questions of interest are:

- does the general education system create sufficient opportunities and an appropriate background to enable people to start their own business?

- are sufficient resources being concentrated on providing the owner/managers of smaller firms with opportunities to improve their business skills?

Motivation

 5.22 Smaller firms are currently a focus of much attention and, in many quarters of hope. While the general and particular economic setting will have a considerable influence on the future of smaller firms, as much if not more will depend on what people in the "front line" actually running their businesses are trying to achieve. This leads to the question:

- should a lot more thought, study and public discussion be focused on the motivation of the owner/manager of smaller firms - the balance of their aspirations to independence, growth of their business, and personal financial reward - and the extent to which direct taxation influences the decision to start up or develop a business?

LIST OF TABLES

LIST OF CHARTS

Mr. Pattison, No 10.

27/8.

With the Compliments of

John Arbuthnott.

CENTRAL POLICY REVIEW STAFF

You may be interested in this note. Dr. L Rotherham is a member of ACARD.

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RECORD OF DISCUSSION WITH MR G TAYLOR, MANAGING DIRECTOR, TDC LTD - 19 AUGUST 1980

PRESENT

Mr Taylor
Dr L Rotherham
Dr J M Ashworth
Dr R H Aram
Mr R G Courtney

Mr Taylor said that in the United Kingdom there was no lack of creativity or of finance for new ventures. But not enough ideas were turned into profitable products and there was a tendency to philosophise about the problems of innovation rather than work out immediate steps to bring products to the market.

The City did not investigate thoroughly the companies that it invested in, unlike American venture companies. It relied more on an examination of track records. Rather than being risk-averse, it could be said that the City took large risks, since it invested large sums on insufficient information.

A major deterrent to venture capitalists in the United Kingdom was the lack of an "over-the-counter" market for shares in new, small companies. In the United States of America, there existed 3 stock exchanges, the New York, the American and the over-the-counter exchange. The criteria for listing varied among the 3, but the existence of the over-the-counter exchange enabled a company to attract investment from the public because it provided a mechanism for shares to be sold and profits to be realised. Venture capitalists wished to withdraw their funds after 5-7 years; because of the Stock Exchange's rules, however, even the most successful of new companies would not be listed for 10 years. The Stock Exchange rule 163/2, which was designed to help small firms, did not work effectively.

Innovators who were motivated by the prospect of large financial rewards were therefore discouraged from creating a new company in the United Kingdom. By contrast, those who wanted prestige or personal gratification went ahead. There were, of course, other ways of realising the worth of a company - for example by selling-out to another concern or by selling private equity to an institution - but these were not as effective in stimulating investment as an over-the-counter market. A further difficulty was the absence of a regular listing for new small firms. Approximately 2,500 were listed daily in the Wall Street Journal. By contrast, the Financial Times on a Saturday gave details of the transactions that had taken place under Rule 163 in the previous week. If the shares of a particular company had not been traded in that week, no information on the current share value was available. The shares of these companies were not marketable through the broker system.

This lack of an over-the-counter market occurred because it was not in the Stock Exchange's best interests to establish one. It enabled companies to gain all the benefits of listing more quickly and cheaply. Estimating purely on the ratio of pupulations, perhaps 500 firms in the United Kingdom might be able to take advantage of the market if it existed.

most?

Mr Taylor considered that private investors were still able to provide substantial sums of patient money. The rate of return on capital in a new firm typically dropped from a very high figure to perhaps 20 per cent as the firm matured. TDC sought to withdraw its investment once the figure decreased below 30 per cent or so. This usually happened after 5-10 years. In assessing projects, a return of 40 per cent had to be potentially available to give TDC an overall return of 20 per cent on its capital, taking failures into account. Its money was borrowed at 15-17 per cent from ICFC and investments were approved by a small committee of ICFC under Viscount Caldecote.

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The growth of new firms in the United Kingdom was constrained by the size of the domestic market. American firms had a market of 250 million people available to them; the EEC did not act in the same way. It was thus harder for United Kingdom companies to get a return on their investments. Firms needed to make full use of "soft money", eg government regional grants, in order to provide TDC with the return that it needed. It was difficult to say whether United Kingdom customers were more or less conservative than those overseas; there were cases when United Kingdom firms had been early purchasers of innovative computer products.

Compared with the United States of America, there was in the United Kingdoma a shortage of technically competent business managers. We had reasonable specialists in the different parts of the business but not good Managing Director material. This was partly the result of insufficient business education - in the United States of America, forces existed to give all levels of executive management education and firms welcomed and paid for their employees' attendance at courses. But there was also a difference in management styles; decision-taking was more corporate in the United States of America and so each specialist came to appreciate his colleagues' business problems. This was perhaps a reflection of different attitudes towards ignorance; in the United Kingdom people did not like their own ideas examined as vigorously. The American system placed great weight on the "product champion" who would argue the merits of an idea through a company.

Relationships between TDC, NRDC and NEB were good; each had their own role and there did not seem to be excessive overlap. TDC would welcome competition from other bodies provided that the ground rules were all the same - eg that all borrowed money at the same rates. Although TDC was centralised, it used the ICFC regional offices as its local outposts.

Mr Taylor considered that publicly-financed inventions should be open to anyone to exploit, rather than just NRDC and the Patent Office might be given a more active role in ensuring that patents were exploited rather than bought as a defensive measure. In general, patents were not serving their intended purpose. Firms infringed them when they had to and often the infringements were not challenged since the cost of defending a patent were large.

New firms would be encouraged by a government purchasing policy that gave preference to small firms. Government encouragement to the import of technology and key innovators (as was carried out by the Invest in Britain Bureau) would also assist but the United Kingdom taxation system did not attract.

In conclusion, it was suggested that Mr Taylor might seek an opportunity of putting his views to Sir Keith Joseph.

Econ Pol

Sup

10 DOWNING STREET

BF 13/10/80

MR. HOSKYNS

RE YOUR MINUTE TO MR. LANKESTER ABOUT PETER CROPPER

There is to be a meeting to discuss small businesses. It is in fact due to take place on Tuesday 14 October at 1030 and is being organised by the Cabinet Office (David Wright).

CAROLINE STEPHENS

12 August 1980

E. R.

11 August 1980

MR LANK~~E~~STER CAROLINE ??

MS 12/8

Peter Cropper rang me to find out something more about a meeting the Prime Minister wants to hold about small businesses, with a possible date of 10 September. I know nothing about this and, although we talked at length about small businesses at dinner on Friday, she did not mention this particular meeting.

What is the state of play?

JH

pps please

JOHN HOSKYNS

14 Oct.

10 DOWNING STREET

Please return
to the Prime

With the compliments of

[illegible]

[illegible]

DAVID MITCHELL MP

HOUSE OF COMMONS
LONDON SWIA OAA

August 1980

MG

Dear Colleague

SMALL BUSINESSES

During the Recess you may have meetings with small businessmen so I thought it might be useful for you to have an aide memoire on:

a) what has been done by our Conservative Government for small firms during the first 15 months in office, and

b) some defensive material on the points they are likely to raise.

I enclose this herewith and hope it may be helpful.

Yours ever

David

SMALL BUSINESSES

GOVERNMENT ACHIEVEMENTS IN THE FIRST 15 MONTHS

(N.B. This note does not cover the Government's attack on inflation nor the consequent high cost of borrowings, both of which are strategic economic questions. Inflation and MLR have pre-occupied small firms so that few have noticed the progress so far made on other aspects of Small Business Policy)

THIS POLICY HAS 4 MAIN COMPONENTS

a Reducing the hurdles and burdens facing new and small firms.

b Improved motivation, encouraging start ups and growth by lower personal taxes.

c Increasing resources within firms enabling them to weather inflation and to grow.

d Improved councelling services to help start ups and to reduce failures.

A HURDLES AND BURDENS

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

1. Swifter planning decisions, right of appeal after 8 weeks with many decisions announced at public enquiries, not months later.

2. A new Circular on Development Control due 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-instaitment waived for firms of 5 employees or less, if re-instaitment 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 arebeing 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 $17\frac{1}{2}\%$ the tax allowed contribution.

25. Removed the ceiling of £3000 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 & 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 simple rate

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

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

32. We have cut out over a million questionaires.

33. 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 Councelling 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 COUNCELLING SERVICES

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 councelling service now covers all main towns with a system of clinics and personal appointments.

DEFENSIVE NOTES

1 The Self Employed are awaiting the review of their National Insurance and pension position promised by the Government in its manifesto (to be undertaken with representatives of the self employed).

A working paper is being prepared as a basis for the review expected to commence later this year.

This became a burning issue when the last government increased the Class 4 NI contribution of the Self Employed from 5% to 8% of relevant earnings. They subsequently reduced it to 5% but it remains a live issue.

2 The Government's Green Paper seeking views on its proposal to make employees liable to the first 8 weeks of sickness benefit is likely to be raised. It is useful to recall that if enacted this proposal would:

a save 5,000 civil service staff

b enable sickness benefit to be taxed through PAYE in the same way as normal pay.

c for illustrative purposes a fixed £30 per week benefit is proposed and ½% cut in employers NI contribution

The purpose of a consultation paper is to learn the views of those who will be affected and no decisions have yet been taken.

David Mitchell
august 1980.

Ri B

Econ Pol.

10 DOWNING STREET

From the Private Secretary

8 August 1980

Mr. Mitchell asked me whether I had done a record of the discussion at the lunch which the Prime Minister gave for small businessmen on 21 July. I am afraid it was not the sort of occasion where it was possible to take detailed notes. But the following are some of the points which I recall were raised:

I There was criticism of the Government's proposals on sickness benefit from Mr. Tombs, who has since sent us his comments in writing (I enclose a further copy for ease of reference).

II It was argued that we should introduce a loan guarantee scheme for small businesses on the lines of the US and Dutch experience.

III There was criticism of the industrial training boards, which it was argued turned out inadequately trained people and did not provide a real working experience. Industrial apprenticeships were a far better method of providing training and introducing young people to a work environment. But the trade unions too often insisted on inflexible arrangements for apprentices, and redundancy pay and unfair dismissal provisions inhibited the taking on of apprentices.

IV There was criticism of secondary education. It was argued that we needed more vocational training in the last year of school.

V Corporation tax: it was argued that the provisions for small businesses should be relaxed further with, for example, special relief on industrial buildings.

VI Falmouth docks. The question of loan availability on projects in Falmouth was raised, and you have written to us about this (your letter of 23 July).

TPL

A.C.S. Willis, Esq.,
Department of Industry.

GC.

CABINET OFFICE

With the compliments of

D. J. L. MOORE

70 Whitehall, London SW1A 2AS
Telephone 01 233

RESTRICTED

CABINET OFFICE
70 WHITEHALL
LONDON SW1A 2AS

01-233 7020

5 August 1980

A C S Willis, Esq,
Private Secretary to
the Parliamentary Under Secretary of State,
Mr David Mitchell, MP,
Department of Industry,
Ashdown House,
Victoria Street,
LONDON SW1

12

Dear Willis

Tim Lankester's letter of 23 July records that the Prime Minister has agreed to hold a meeting on Small Businesses to which your Minister, the Chancellor of the Exchequer and the Secretaries of State for Industry, Trade, the Environment, Employment and Social Services are invited to attend.

This is to confirm that the meeting will be at 10:30am on Tuesday 14 October at 10 Downing Street.

The Chancellor of the Exchequer will be circulating a copy of the Report by the Interdepartmental Committee of Officials chaired by the Treasury - and I suggest that this should be up-dated if necessary to take account of any developments between now and the end of September - and your Minister will be circulating his own paper. I should be grateful if copies of both these papers could be sent to Sir Robert Armstrong.

I am sending copies of this letter to the Private Secretaries of the other Ministers who will be attending, and also to Tim Lankester for information.

Yours sincerely

D J L Moore

D J L MOORE

RESTRICTED

FILE

RA

10 DOWNING STREET

From the Private Secretary 25 July, 1980

The Prime Minister has read your letter of 23 July reporting on the question of land availability for industrial purposes at Falmouth and Penryn. She has asked me to say that she is grateful to Mr Mitchell for pursuing this matter.

T. P. LANKESTER

A C S Willis, Esq
Department of Industry

OC

Econ Pol

jfh

B/F 25-7-80

MR WRIGHT

You will have received a copy of a letter from Tim Lankester to Tony Willis, (Department of Industry) about a meeting of small businesses in the early autumn. You will remember we discussed this some weeks ago and can you please confirm that this meeting will be set up by the Cabinet Office?

CS

24 July 1980

TR

2

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212
SWITCHBOARD 01-212 7676

From the
Parliamentary Under Secretary of State

Prime Minister

This was mentioned at Monday's lunch – David Mitchell is trying to get the problem solved. TL.

Thank you. I am grateful to David Mitchell.

Tim Lankester Esq
Private Secretary
10 Downing Street
LONDON SW1

23 July 1980

Dear Tim,

LAND AT FALMOUTH AND PENRYN

I understand that the subject of hold ups on the availability of land for job creating projects in Falmouth was raised at the Prime Minister's lunch with small businessmen on Monday. Mr Mitchell undertook to report on the situation.

24/7

The availability of land in Falmouth is a long standing problem, and although the English Industrial Estates Corporation was authorised to acquire land there in 1978, it has not yet been able to do so. There now seem to be four possibilities.

(i) EIEC has a site at Penryn, only 4 miles from Falmouth. They have secured, but have not yet signed, an agreement with the National Coal Board Pension Fund to finance the construction there of about 25,000 sq ft, mainly in the 500-1,000 sq ft range. A comprehensive announcement on this and other sites is expected shortly and work could start in two or three months.

(ii) After strenuous local objections, planning permission has now been granted to build factories on the former British shipbuilders' sportsground in Falmouth, an 11-acre site. We hope, but cannot yet be certain, that funds will become available within the EIEC budget which could enable work on a programme of 2,500 sq ft to 7,500 sq ft factory units this year. This has not yet been announced because we are trying to find funds within the EIEC budget which was pre-empted by decisions taken by the previous administration.

(iii) The EIEC are negotiating with British Rail for the 2-acre site which was formerly the station at Falmouth. This site would be ideal for an NCB-type development, assuming the first venture at Penryn proves successful.

(iv) There is a large 23-acre site at Bickland Water Road which has been declared Grade 2 agricultural land. Its use for industry would be a departure from the development plan and the question is under discussion between MAFF and DOE. Cornwall County Council are anxious to develop the land and attract a private developer for large factories, but the Department would not be involved, partly because of fears of flooding the market. EIEC already have a 10,000 sq ft factory which has been vacant at Penryn since 1976, a second-hand 48,000 sq ft factory at Pool near Camborne which has been vacant for 8 months and a 46,000 sq ft factory in Falmouth is likely to be vacated by Alfred Herbert Ltd shortly.

Mr Mitchell has contacted David Mudd again about these issues since the Prime Minister's lunch and is anxious to achieve progress as fast as possible.

Yours sincerely

Anthony Willis

A C S Willis
Private Secretary

File

cc: Ch/Ex.
S/S — Ind.
Trade.
Env.
Emp.
Social Services;
C. Stephens.

TCP

10 DOWNING STREET

From the Private Secretary 23 July 1980

The Prime Minister has agreed with your Minister to hold a meeting on small businesses in the early autumn. Mr. Mitchell mentioned to the Prime Minister that he would prepare a paper for this meeting covering what the Government had achieved so far and the "road blocks" preventing further progress. The Prime Minister understands that the inter-departmental committee of officials chaired by the Treasury is about to report on small firms to MISC 14, and she thinks it would be helpful if this paper could be circulated to those attending the meeting. Mr. Mitchell's paper could then concentrate on his ideas for further work and for removing the "road blocks".

I am sending copies of this letter to the Private Secretaries to the Chancellor of the Exchequer and the Secretaries of State for Industry, Trade, the Environment, Employment and Social Services, all of whom the Prime Minister would like to attend the meeting. We will be in touch to arrange a time for the meeting, and I would be grateful if the Chancellor's office would arrange for the official committee's report to be circulated in advance of it.

I am also sending a copy of this letter to David Wright (Cabinet Office).

T. P. LANKESTER

A.C.S. Willis, Esq.,
Department of Industry.

10 DOWNING STREET

MISS STEPHENS

Please could you arrange a meeting for the early autumn on small businesses for Mr. David Mitchell and all the Ministers mentioned in paragraph 2 of the attached letter.

Tim

23 July 1980

Cabinet Office will probably set this up if you want.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212
SWITCHBOARD 01-212 7676

From the
Parliamentary Under Secretary of State

22/July/80

Prime Minister

PM seen
T 24/7

Dear ~~Margaret~~,

Your lunch for small business-men was enormously appreciated and I wanted to say 'thank you'.

I hope it yielded something of value to you and I am following up a number of points which were raised. In addition your interest in the sector they represent will do a great deal of good in the various parts of the country they come from.

With renewed thanks for having me as well.

Yours ever
David

1

Prime Minister
This is the 'small firms' meeting which you promised Mr Mitchell.
Do you want to keep it small as suggested at X, or have a large meeting as at Y?
TL 21/7

CONFIDENTIAL

Ref. A02681

Small group - X.

MR. LANKESTER

Small Businesses

The Prime Minister is to take a meeting in the early autumn on the position of small businesses. In his minute to her of 11th July Mr. David Mitchell said that he would prepare a working paper for this meeting covering what the Government had achieved so far and the 'road blocks' preventing further progress.

Yes X

2. The Ministers to be invited to this meeting should certainly include the Chancellor of the Exchequer, the Secretaries of State for Industry, Trade, the Environment and Employment, and Mr. Mitchell himself. Mr. Mitchell would like the Secretary of State for Social Services to be given an opportunity to come, if he so wishes, because of current discussions of the impact of the sick pay scheme on the self-employed and of their national insurance contributions.

No Y

3. Unless the Prime Minister wishes to confine the discussion to a small group, there would also be a good case for inviting the Secretaries of State for Scotland, Wales and Northern Ireland and the Minister of Agriculture. Their Departments are all involved in current work on small firms.

4. An Interdepartmental Committee of Officials, chaired by the Treasury, is about to report on small firms to the Chancellor of the Exchequer's Ministerial Steering Group on Government Strategy, MISC 14. This report will summarise the action taken so far, and the work still in progress, to help small firms. It could usefully be circulated to the Prime Minister's meeting, and Mr. Mitchell's paper could then concentrate on his ideas for further work and for removing the 'road blocks'.

Agreed

5. If these arrangements are acceptable to the Prime Minister I suggest that you so inform Mr. Mitchell's office and ask the Chancellor of the Exchequer's office to arrange for the report of the Official Group to be circulated in due course to those Ministers who will be attending the Prime Minister's meeting.

D J Wright

(D. J. Wright)

21st July, 1980

JH

Prime Minister

2

Econ Pol

cc. D. Wright (Cabinet Office).

Prime Minister

I was glad of the opportunity of listening to the suggestions of the Smaller Business Committee and I thought it might be helpful to put on record the points they raised to which I have added some personal comments.

I understand from subsequent conversations that the Officers were very pleased with the hearing which you gave them and the obvious interest which you showed.

It is extremely helpful of you to have proposed a meeting in the Autumn to shift some of the "road blocks" which are holding up progress on small firms policy, for most of the problems lie outside of the Department of Industry's own remit. Meanwhile, I will prepare a working paper covering both what your Government have achieved and the road blocks preventing further progress.

DM

D M

11.7.80

JH

NOTE OF POINTS RAISED AT PRIME MINISTER'S MEETING WITH OFFICERS OF THE PARLIAMENTARY SMALLER BUSINESS COMMITTEE - 8 JUNE 1980

Management Education

Owing to inadequate status and reward for small businessmen, much of the sector lacks adequate education for management.

Minister For Small Firms

It was suggested that the Minister for small firms should be transposed to the Treasury, to which you responded that this would be change for its own sake.

COMMENT - Significant contributions have been made by Treasury Ministers to help small firms, but there is still a great deal to do. Sophisticated small firms can largely avoid paying tax. Per Contra, the less sophisticated probably pay the highest average rate of Corporate tax.

Corporation Tax

Small firms rate of Corporation Tax applies at 40% up to pre-tax profits of £70,000. The standard 52% rate applies above £130,000. The transitional arrangements mean that between £70 and £130,000 the tax on the additional profit rises to 66%. No price tag was put on the concession requested.

Loan Guarantee Scheme

A loan guarantee scheme to encourage more adventurous bank lending was proposed. Keith Joseph pointed out the danger that banks might transfer their existing riskier lending to the scheme without any additionality.

COMMENT - LGS operate in the USA, Holland, Germany, etc; in these countries gearing is higher and lending is more linked to the business project rather than proprietor's collateral. I hope a pilot scheme with an additionality criterion on a near self financing basis need not be excluded.

Visitors Of Inspectors

A spate of examples were produced ranging from Keith Joseph's Southwark example of 26 visits, to one requiring repainting to a changed specification of the walls of the factory. I pointed out that both my Departmental and Commons offices would not pass the Inspector were they used by a small businessman.!

COMMENT - You have asked a Junior Minister in each Department to examine, with a view to eliminating wherever possible, inspectors' powers of entry. I am collating the findings and the report will be with you by the end of the month.

Equity Investment

The need for more equity investment, for investment clubs was raised, with praise for the Budget steps to encourage the private backer.

COMMENT - It is not economic for large pension funds to investigate small investments. So the Small Firms Counselling Services of the DOI is now carrying out assessments and introducing approved investment propositions to two institutional funds (Norwich Union and Post Office Pension Fund) in the North West and Eastern Regions; it is planned to extend the system to the whole of England.

Enterprise Zones

The fear was expressed that these will be large business dominated, and there was a call for special steps to encourage small business workshops. It was not suggested how this should be done and you will be aware that such workshops already have 100% tax allowance.

National Insurance Surcharge

This was portrayed as a barrier to job creation. It was suggested that for school-leavers, or those undergoing training, either the surcharge or the National Insurance contribution might be waived.

Wages Councils

Wages Councils were condemned because blanket wage awards failed to take account of the diversity between the busy supermarket check out in Uxbridge, the slow moving village shop or the depressed areas such as Sunderland. You asked Michael Shersby to write further. You drew attention to the damage from high rates.

COMMENT - In the past 12 months, Sunderland Council has taken on over 400 extra employees. The rates are now 140p in the pound.

Econ Pol.

10 DOWNING STREET

NOTE FOR FILE

I spoke to David Wright in the Cabinet Office this morning and he will be coming back to me regarding a meeting in the Autumn to discuss small businesses.

9 July 1980

PRIME MINISTER

Apparently you said to David Mitchell this morning that you wished to have a stock-taking meeting regarding small firms in the autumn.

a) Is this correct? Yes - with all the relevant Ministers

b) If so, what sort of meeting have you got in mind?

We must get all Ministers together (David will say who) to resolve some of the problems - through the Cabinet Office

8 July 1980

PART 1 ends:-

PM to Cockeram MP 20/6/80

PART 2 begins:-

CS to PM 8/7/80.