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POLICY RECOMMENDATIONS OF THE

SMALLER BUSINESSES POLICY GROUP

Why we need a policy for smaller businesses

1.1 The Conservative Party must have and be seen to have constructive policies to encourage those who run small firms. Their votes are naturally ours but they are still disillusioned. The number of small firms in the UK is falling fast.

1.2 Small firms employ about ⅓ of the private sector and about ⅓ of all employees if 'unquoted' companies are included. They increase choice for consumer and industrial buyers. They have a higher return on assets than large companies. They account for about 25% of output of private sector. They are potentially a major growth sector of the economy.

1.3 The Party therefore should create a climate in which small firms can start up and grow. We want to ensure their place in the economy and to assist it by a new legal status appropriate to them which we call 'The Proprietory Company'. Our proposals are built around these themes.

Our Policy Recommendations

Company Law

2.1 A great deal of legislation appropriate to larger companies is quite inappropriate to the small eg the village grocer trading as a limited company or the one product company where disclosure provisions can put British firms at an economic disadvantage with overseas competitors (Appendix 1 contains one example).

2.2 We recommend that the Policy Group covering Company Law seek ways of exempting small businesses wherever possible from unnecessary and harmful legal requirements. To facilitate protecting small firms from such inappropriate legislation we recommend the concept of the Proprietory Company (designed by Mr John Cope and described in detail in Appendix 3) which is an adapted version of the old exempt private limited company with provisions which prevent large concerns from hiding under its umbrella. Companies which are eligible to become Proprietory Companies could be automatically excluded from legislation that is irrelevant or damaging to them.

Planning

3.1 We are very concerned that the traditional first rung on the ladder to starting up a business - the back garden or garage - is now generally prohibited by the all-pervasive nature of planning control. This affects rural as well as town industries. We recommend that the Party finds ways of relaxing planning control to enable the initial start up to be allowed almost anywhere (with suitable safeguards concerning noise and nuisance for neighbours and on numbers employed). We recommend further research into

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Industrial Allotments. We would like further research done into the possibility of the provision of premises with shared facilities available to firms until big enough for an industrial estate site. We see this as the first step after the converted garage.
We recommend that any planning application for consent to establish or expand a business employing 10 persons or less must be processed by the Planning Authority within eight weeks or permission granted by default.

Rates and Local Government

4.1 We are concerned by growth of commercial activities being undertaken by local government.

4.2 We recommend that a larger proportion of direct labour activities be subject to competitive tender and concealed subsidisation be prevented.

4.3 We endorse the views put forward by the Local Government Policy Study Group that payments of rates by installments should be encouraged and that discrimination against mixed hereditaments should be eased.

4.4 We are opposed to local income tax, in addition to rates.

Government Overheads

5.1 We are appalled at the extent of Government interference in the affairs of small businesses. The enterprise and initiative of managers and owners is being suffocated. The bureaucratic carpet of Socialism must be rolled back.

5.2 We recommend that the next Conservative Government should
a) direct all Government departments to cut by half the number and length of all forms,
b) that all forms should state clearly on the front page in same place whether they are compulsory or not, and to whom they apply,
c) whenever possible 'de minimus' provisions to be inserted in all legislation to exempt small firms (or Proprietory Companies),
d) before new forms are issued organisations representing small firms should be consulted.

Value Added Tax

6.1 We recommend a return to a single rate of VAT; we do not raise objections if this has to be higher since we believe spending not earnings should be taxed.

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6.2 We recommend lifting the minimum level for compulsory VAT registration to take account of inflation.

Finance and Taxation

7.1 Start-up Capital: Initial capital has to come from the savings/wealth of the enterpriser. We need a tax climate in which individuals can save. Therefore, we support the Tax Policy Group proposal that tax on middle to higher levels of managerial salaries be cut.

7.2 Expansion Capital: Finance for expansion can only come from retained earnings, overdrafts, loans, and additional equity capital.

7.3 Retained Earnings: These are the main source for long term expansion in the UK but they have become insufficient to cover replacement of existing capital let alone finance expansion. The squeeze on retained earnings is most destructive of small companies which unlike large firms cannot raise new money on the Stock Exchange.

7.4 Overdrafts and Loans: For expansion are normally only available in proportion to the proprietors' stake which has not grown fast enough. Money borrowed on overdraft is theoretically 'on call' and this inhibits tying such money up in investment. Bank loans with an interest rate of 15% and loans at 16% - 17% are too high to allow adequate margin for investment (such figures are far above the yield on assets in most of British Industry).

7.5 Additional Equity Capital is mainly provided by proprietors and most small firms find 'outside' stockholders an unacceptable dilution of independence.

7.6 There is simply a gap in the capital markets for the supply of long dated capital to small firms. Only two institutions are prepared to lend less than a minimum of £50,000 for a term in excess of five - seven years (ICFC and COSIRA), both of which have severe drawbacks (see Appendix 2).

7.7 As can be seen from our analysis small firms depend overwhelmingly for expansion finance on retained earnings. Our recommendations therefore are aimed at increasing these funds.

7.8 We recommend small firms be exempted from price and profit limitations.

200 employees.
Increase profits upto £30,000 → £100,000.

7.9 We recommend corporation tax be substantially eased by:
a) extending definition of small firms for purposes of smaller companies' rate of Corporation Tax to £100,000 pre-tax profits,
b) lowering the rate of smaller companies' Corporation Tax to three quarters of the rate applying to large firms.

3 yrs.

7.10 We recommend that small firms (or Proprietory Companies), the self-employed and partnerships should be allowed to accumulate funds for five years in a 'special reserve' free of Corporation Tax to enable them to undertake an investment/expansion in the business.

7.11 We recommend that 'Close Companies' with a future need for investment should also have relief from forced distribution of profit provided the funds are used within five years.

Continuance

7.12 Small firms are now faced with the prospect of break-up on transfer to the next generation.

7.13 We welcome the policy commitment 'to draw the teeth of Capital Transfer Tax'.

7.14 We would welcome the Tax Policy Group proposal that where a liability to Capital Gains Tax and Capital Transfer Tax arises on a transaction, only one of these taxes be payable.

7.15 We recommend that the right to pass £2,000 free of CTT per year be cumulative, to benefit small firms which in the early years have no free funds to pass on.

Retirement Annuities

8.1 We recommend that the self-employed should be allowed to contribute higher amounts towards a retirement pension and that sums which would have been allowable if contributed in earlier years should be able to be accumulated for payment in the latter years of working life or when the business is sold.

Government Purchases, Innovation and Exports

9.1 We recommend that research be put in hand as to ways in which a larger proportion of Government purchases might come from small firms. We recommend that the cost of taking out a patent be reviewed and that Government agencies concerned with research and innovation be examined to see how effective they are. We recommend a general review of exports to see that small firms be provided with every encouragement and aid in their export effort.

Costing our Proposal

10.1 In our view the cost of all policy recommendations need to be divided between a) those which will add to consumption, and b) those to increase investment in productive assets.

Our proposals have been so costed and show the following net costs:

a) Consumption - Nil
b) Productive assets - £50m

10.2 In our costing no credit has been taken (nor charge accepted) in respect of policy recommendations already known to be covered by the recommendations of other policy groups.

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APPENDICES

APPENDIX 1

The Effect of Disclosure Provisions on a Small One Product Company

Take the case of a small company making only fork-lift trucks. Under the present disclosure provisions it would be possible for a larger multi-product competitor to work out the smaller company's profit margins on its fork-lift trucks in a specific market. (The smaller company could not carry out this calculation for the larger multi-product company).

The larger company could then under-cut at a point just under the smaller company's viable profit margin so driving the smaller company out of that market.

APPENDIX 2

Credit Gap for Small Firms

1. The Committee on Finance and Industry 1931 highlighted the lack of provision in the capital markets for credit supply to small and medium sized firms - the so-called Macmillan Gap. This gap has, in part, re-appeared since effectively only two institutions are prepared to lend less than a minimum of £50,000 for a term in excess of five - seven years.

2. ICFC

One institution concerned, ICFC, had in 1975 under 1,500 customers borrowing sums below £50,000; its interest rate for medium size companies for a loan for 10 years plus (June 1976) was 16% and for smaller firms 17%. Its highpowered approach might appear daunting to the average small company and it expects either a share in the equity or asset backing to its loan which must depend in the case of the small firm on the amount of previous profit retentions.

3. COSIRA

The other institution, COSIRA (Council for Small Industries in Rural Areas), is limited by its constitution to towns with a population of 10,000 or less. It adopts a much more 'folksy' approach, lends up to £30,000 on mortgage for up to 20 years and dovetails the provision of funds with financial and technical services.

4. The availability of Expansion Finance is therefore limited by the size of the proprietor's stake which is overwhelmingly represented by the 'plough back' of retained profits.

APPENDIX 3

The Proprietory Company

1. This note discussed a new form of incorporation for the smaller business between a limited company and a partnership.

2. Object: The object is to provide an organisational structure suitable for a small business which, would be a different legal entity from Limited Companies. Proprietory companies could then be left out of legislation designed for large public limited companies (such as recent and proposed legislation for employee and investors protection) which is complicated, unnecessary and damaging for the smaller company. The tax regime for Proprietory companies would be designed to cater for their needs instead of being a compromise special arrangement in a basically hostile regime. It would be possible to achieve this through modifications to partnership law, but many partnerships are of very large sizes with hundreds of thousands of employees and their freedom to continue should remain.

3. Essential Features: The essence of the proposal is that it should be a vehicle for the person or people who want to run their own independent business - to be the proprietors of the business. It follows from this that the proprietor or proprietors should be both owners of the equity and directors of the business.

But it is important that a venture capital organisation or a rich aunt should be able to risk money in the business and share the upside potential by participation in equity growth.

It is also important that the proprietors should be able to allow all or some employees to share in the equity growth they help to create.

Limited liability should be preserved as otherwise the more risky type of business will want to remain a limited company, but some are exactly the kind of enterprise which needs help and encouragement.

Simplicity must be the keynote of the formalities involved. The incorporation documents and annual returns should be designed primarily to enable the business and its proprietors to be traced.

The documents need, however, to include a register of charges, and charges should not be valid until on the public register.

4. Features to be Considered

a) Main Definition: The most crucial decision is on the limits to the definition. If too large companies become

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proprietory companies or vice versa it will mean that either the vehicle is likely to be a tax or regulation dodge or else that the tax and regulatory advantages are wittled down to be worthless. Any limit based on a cash figure of turnover or profit will mean that Proprietory Companies who have a good year's trading suddenly become ineligible (although averaging over several years might mitigate this). A limit on proprietors' capital might tend in due course to make them under capitalised, but is perhaps the best. The definition must include reserves (the possibility of a proprietory company near the limit being forced above the line as a result of an unexpectedly good year would be avoided, if wished, by distribution - with tax consequences). Views will differ on the maximum size but for discussion say £250,000.

b) Further Restrictions: In order further to preserve the essential character of the system, any individual might only be allowed to be a proprietor in one proprietory company, and the maximum number of proprietors might be limited to, say, ten. No proprietory company should be able to own shares in a limited company or partnership, nor have an interest in another proprietory company. Only individuals could be proprietors.

c) Participation: It is important that the system is flexible enough to allow outside providers of capital and employees to participate in the growth of the company's equity if desired. One way is to keep the proprietors' capital separate from that of the other equity participators. So when the profit at the end of a year was split a proportion might go into the proprietors capital account, a proportion to the account of a venture capital institution and the rest to the employees capital account, divided in accordance with whatever formula was agreed. Capital profits might be divided on a different formula from revenue profits. Participators would have votes only when their rights were affected.

d) Management: It is inherent in the above arrangement that the management should remain firmly with the proprietors - for good or ill. Thus if in time the proprietory shares passed into the hands of idle, useless or sleeping proprietors the others involved would have to make their judgement of the situation and withdrawn their capital, if necessary at the expense of breaking up the business. However, at every stage short of liquidation the proprietors would remain the directors and would appoint and supervise the management. In a liquidation the rights of the participators would rank before those of the proprietors and alongside the general creditors.

e) Tax: The best arrangement from the business point of view would be if tax was only payable (as income tax or capital gains tax as appropriate) on cash taken out of the business. This would give the company maximum incentive to retain profits. It would mean that up to the limit of proprietors' capital the proprietory company could be a "cash box". But if distributions were as a result bunched into one year then the progressive nature of the income tax would penalize the payments. If the proprietor died or gave away his share any capital tax payable might be paid by the

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company and debited to his capital account, provided the other proprietors and the participators approved (which if it kept the business going they usually would). The same could apply to wealth tax.

f) Accounts and Disclosure: Consideration needs to be given to whether any compulsory disclosure is required to the public, employees or creditors. The simplest position would be no compulsory disclosure except where there were participators. Participators, whether employees or outsiders, would need a right to receive audited accounts. It might in addition be thought necessary to make all proprietory companies submit basic audited accounts with their annual return to police the restriction on proprietors' capital. Such accounts need not, however, be detailed except as regards profit and loss appropriation and movements of capital.

g) Effect on Government: Depending on the tax arrangements and the degree that existing limited companies changed to proprietory forms, there could be a loss of corporation tax and income tax to the Revenue. However, from the resources point of view all the revenue lost would go, by definition, into capital formulation. There would be a saving of manpower and money at the Companies Registration Office, particularly as the new system could be designed from the start of mechanisation.

5. The Point

The passing of the Joint Stock Companies Act of 1844 and the Limited Liability Act of 1856 provided convenient machinery for the tremendous growth of railways and other industry which was in progress. Between them these two Acts, the basis of modern Company Law, enabled capital to be available for risk and investment to back the English mechanical genius and natural resources and provide the foundation of Victorian prosperity. But today for the smaller company all is complication, restriction and taxation. The British are best at working in small groups, yet today the whole emphasis of Government (as well as technology) is to force people into even larger groups, and to frustrate the man who would use his own drive and skill and be master of his own destiny. The proposal for a proprietory company is intended to cut through the complications and provide a new vehicle for the development of individual initiative. The hope behind it is the revival of the smaller industrial and economic unit, as a contribution to the vigour of the economy and the preservation of freedom.