



Federation of Small Businesses
The UK's Leading Business Organisation



Self-employment

Stimulating economic growth

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Foreword

Small businesses need a stable economic and business friendly environment in order to grow their business. The Federation of Small Businesses (FSB) has identified key areas where the Government must act decisively in 2011 to identify an agenda for stability and growth to enable small businesses to lead the recovery.

This paper on self-employment seeks to address the barriers that hinder those who want to start and run their own business. It makes recommendations that the Government should adopt to nurture stability, cultivate economic growth and bring about renewed confidence.

Self-employment is a key driver for growth. And while the focus remains on creating employment opportunities, we must not lose sight of the fact that wealth creation comes from people who have the desire to pursue ideas and turn them into a business. These innovators create wealth and are vital to the economic recovery, and more must be done to highlight self-employment as an attractive option.

We must target groups that have the potential to create this wealth. The rise in youth unemployment to almost one million people highlights the desperate need for self-employment to grow. Statistics show that over half of young people (52%) have considered setting up their own business, but less than one in 10 (7%) have actually done so.¹ And latest figures demonstrate that despite women making up 46 per cent of the economically active section of the UK, women constitute only 29 per cent of the self-employed in the UK.²

The Government has started to make the right noises on self-employment by announcing Enterprise Zones and the New Enterprise Allowance scheme. However, sound bites and action must go hand in hand which is why we urge the Government to lift the burdens on small businesses by cutting back on employment regulation that hinders business expansion.



Mike Cherry, National Policy Chairman

¹ Research commissioned by Virgin Media

² Helping small firms start, grow and prosper, January 2011 Department of Business, Innovation and Skills

The importance of self-employment

In the final quarter of 2010, the unemployment rate was 7.9 per cent and there were 2.49 million unemployed people in the UK. The global economic crisis has had a significant impact on the private sector, resulting in considerable cost-cutting measures in businesses of all sizes. The Government has also begun to reduce the public-sector headcount to help balance the deficit. Results from the Chartered Institute of Personnel and Development's (CIPD) Labour Market Outlook show that employment levels will fall notably in 2011. The CIPD found that 52 per cent of public-sector employers planned to make redundancies in the first three months of the year. In local government, 77 per cent of employers are planning to cut their workforce.³

Self-employed people contribute £21 billion in added value to the UK's GDP every year⁴ and have proved themselves by adapting and adjusting to changes in the marketplace. With 18 unemployed people chasing every job vacancy⁵ and the spotlight solely on securing

employment, there has been much less focus on the contribution that self-employment can make to the UK economy. This must change in order to guarantee a new wave of long-term economic growth.

An international workforce survey found that the economic downturn has resulted in a growing trend towards self-employment and entrepreneurialism. The Kelly Global Workforce Index found that the rise in self-employment was most pronounced in North America, with 26 per cent identifying themselves in this category, compared with 19 per cent in Asia Pacific, and 17 per cent in Europe.⁶ The number of self-employed people in the UK in the final quarter of 2010 was 3.98 million (12.6% of those who are economically active).⁷

As the economy is likely to remain unstable in 2011, self-employment is likely to increase and it is vital that Government provides the right conditions for people to start and run their own business. This document sets out the characteristics of self-employment,

the barriers that exist for people wanting to become self-employed, and steps that Government can take to create an environment in which self-employment can thrive. Throughout this paper the term 'self-employment' is defined as being in business on your own account.

3 Personnel Today, 14 February 2011 <http://www.personneltoday.com/articles/2011/02/14/57353/job-losses-set-to-rise-sharply-as-cuts-bite-says-cipd.html>

4 According to figures by Oxford Economics compiled for PCG in 2009

5 Totaljobs survey, November 2010 <http://www.birminghampost.net/birmingham-business/birmingham-business-news/other-uk-business/2010/11/09/18-people-chasing-every-job-vacancy-65233-27631938/>

6 Kelly Global Workforce Index, May 2010 <http://www.marketwire.com/press-release/New-Wave-Independent-Self-Employed-Free-Agents-Emerging-Around-World-Kelly-International-NASDAQ-KELYA-1160326.htm>

7 Labour Market Statistics, February 2011 <http://www.statistics.gov.uk/pdfdir/lmsuk0211.pdf>

Why do people become self-employed?

Self-employed status is very different from that of the employed. Annex A outlines the different forms that self-employment can take. No day or job is the same for someone who works for themselves. There is not always regular work, and often work falls outside conventional working hours. Politicians, regulators and fiscal authorities need to factor this into their decision-making and acknowledge that the current one-size-fits-all approach, which focuses on high-growth businesses, does not work.

Each self-employed person has their own motivation for starting their business or joining the family firm. For many it can be a temporary, but positive, response to unemployment.

For some it may be a lifestyle choice, to fit around family commitments or volunteering work. For others, it comes from a desire to have complete responsibility for the choices and profits they make.

Self-employment is particularly attractive to older businesspeople and can also be more appropriate than conventional employment

for individuals with certain family situations or health concerns. Among many ethnic groups and in some rural areas, self-employment is double the average UK rate.⁸

Just as motivations for self-employment will vary, so will turnover. While some people will make more money than they did as employees, work is not guaranteed and late payments can have a significant impact on business sustainability. In addition, self-employed people do not receive employment protection such as holiday, sickness and redundancy pay. They also have to cover all their business costs out of their fees. It is also important to note that, at the same time, many self-employed people will just about break even until they establish their reputation. They will also constantly struggle against a lack of resources. Often the greatest challenges that self-employed people have to deal with are personal isolation and developing a method of updating their skill sets.

However, frequently the benefits of being self-employed outweigh not

⁸ *Self-help and mutual aid: re-thinking microfinance. Market feasibility study and business plan model for a self-employed women's mutual*, New Economics Foundation 2008. <http://www.neweconomics.org/publications/self-help-and-mutual-aid-re-thinking-microfinance>

working for yourself, and anecdotal evidence indicates that once a person has become self-employed he or she are unlikely to return to employment.

The Government must recognise the contribution that self-employed people make across all sectors and supply chains, and must create a positive environment to support these businesses of the future.

FSB recommendation:

- The Small Business Minister's portfolio must specifically include responsibility for self-employment and entrepreneurship. This will send a positive message to the self-employed community that their concerns are being heard and that self-employment is considered to be as important as employment. It would ensure that there is a specific policy focus to supporting self-employed people as leaders of economic growth

Barriers to self-employment and recommendations for combating them

To secure self-employment as the key to economic growth, the UK requires a nationwide cultural change.

The skills to be self-employed

Few people are equipped by their education or experience as an employee to produce an adequate business plan, which is essential if they are to attract external funding. The skill set required to run a business is broader than that for any employed occupation other than at senior managerial level. In addition, the 'hands-on' culture of self-employment is very different from employment in a larger business.

A focus group of FSB members earlier this year indicated that people are discouraged from starting a business by: lack of confidence; lack of access to a bank account; complexities surrounding insurance cover; buying and managing IT; and hiring an accountant and dealing with VAT in the later stages. The group also indicated that having a family background in self-

employment had encouraged them to start their own business.

The same focus group said that financial security is the key. Some went as far as to say that for those starting up a business it is important to accept that they will run for the first year without a profit. Participants in the same group said that one of the reasons why people gave up too quickly was that they were unaware of the tax credits available, and so they tended to go back onto benefits.

A freeze on the advertising and marketing of non-essential government campaigns will have a negative impact on the number of people considering self-employment. Government currently hosts an online click-through section on steps to take when starting your own business and where to look for funding opportunities (England: www.businesslink.gov.uk). The site also provides the necessary regulatory and licensing information for businesses. However, this information is not very clear, nor is it well known.

“The skill set required to run a business is broader than that for any employed occupation”

FSB Recommendations:

- An increase in promotion by the Department for Business, Innovation and Skills (BIS) of self-employment would be a cost-effective and useful tool for those considering self-employment. The government-funded BusinessLink.gov website, which will be re-launched later this year, must provide easy to follow advice and guidance.
- The National Mentoring Portal which will be rolled out by Government in June 2011 must have a strong focus on the needs of the self-employed. Mentors who forge long-term relationships with small businesses impart wisdom and skills and offer advice to businesses in need of assistance
- There must be a cultural change at Jobcentre Plus (JCP)⁹ to better recognise self-employment. The JCP must continue its work to actively encourage suitable new jobseekers to consider self-employment and to positively endorse entrepreneurship. This must take place in all JCP outlets and there should be a dedicated self-employment specialist available to each JCP

Better targeting of the New Enterprise Allowance Scheme (NEAS)

The NEAS (for England, Scotland and Wales) that was announced in 2010 by the Government is similar to the Enterprise Allowance Scheme of the 1980s. Then the rate was £40 a week for a year, which was more than Jobseeker's Allowance (JSA) at the time.¹⁰ The scheme closed in 1991 and was declared by the National Audit Office (NAO) to be good value for money.¹¹

Under the NEAS, financial support will consist of a weekly allowance payable at a level broadly equivalent to JSA payments for three months, and then at half that rate for a further three months. If start-up capital is needed, a loan up to £1,000 may be available.¹²

Currently the NEAS is only available to people who have been unemployed for six months or more. However,

- People who became self-employed in the first six months of unemployment are more likely to survive two years after start-up than those who remained unemployed for longer

Those who benefited from the Enterprise Allowance Scheme included Alan McGee (Creation Records), Jeremy Deller (2004 Turner Prize Winner), Julian Dunkerton (Superdry), Tracy Emin (artist) and the founders of *Viz* magazine.

- Those who were previously unemployed for three–six months before joining the scheme had a 78 per cent business survival rate. Those who were previously unemployed for six–twelve months only had a 59 per cent chance of their business surviving¹³

In January 2011, the Government announced that the scope of the NEAS would be expanded to create up to 40,000 new businesses by 2013. It is now anticipated that the scheme will be available to twice as many people as was originally planned.¹⁴ The FSB supports the concept of the NEAS however, we are concerned that many budding entrepreneurs will be excluded from the scheme in its current form.

An FSB member said:

“Researching a business is the most important thing. People do not do enough research these days. Everything must be researched: prices, customers, footfall. There is no copyright on ideas. Someone could be doing it better than you.”

⁹ JCP's remit excludes Northern Ireland.

¹⁰ *Make a Job Don't Take A Job*, New Deal of the Mind. February 2011

¹¹ *ibid*

¹² New Enterprise Allowance, DWP: <http://www.dwp.gov.uk/adviser/updates/new-enterprise-allowance/>

¹³ *ibid*

¹⁴ Boost for would-be entrepreneurs as New Enterprise Allowance expanded, The Guardian, 5 January 2011 <http://www.guardian.co.uk/money/2011/jan/05/new-enterprise-allowance-expanded>

FSB recommendations:

- The Government must ensure that access to the NEAS is available to all potential applicants. It is welcome news that the scheme has been expanded, but the FSB seeks reassurance that its availability is not dependent on where applicants live. FSB research indicates that the scheme will be available only in certain regions that are identified as 'deprived', thus excluding many areas¹⁵
- The NEAS must be made available as soon as an applicant has proved themselves to be capable of starting their own business. Currently it is only available to those who have been claiming JSA for six months or more
- The FSB calls for full JSA equivalent payment to be made for one year under the NEAS and

for a guarantee of a loan of up to £2,000 for all credible applicants if required

- Government must ensure that the self-employed are not disadvantaged by the benefit system throughout the life cycle of their business. This is of particular importance with the impending move to a universal credit system

The problem of IR35

IR35 came into force in April 2000.¹⁶ It was introduced to tax 'hidden employment' at the same rate as employment. 'Hidden employees' are workers who receive payment from a client via an intermediary company and who are doing the equivalent job to an employee of the client.

Government is right to question the status of *some* who call themselves self-employed. However, IR35 has been strongly criticised owing to its complexity and its impact on honest small businesses. While IR35 can in theory cover everyone who is self-employed, the regulation has been primarily targeted at those professionals in industries such as IT and management consultancy.

Self-employed people must ensure they make their own personal provisions for adverse scenarios. They take much more of a risk than standard employees, and income is not always guaranteed. Under IR35 the self-employed are taxed as if they were employees, yet they do not receive some of the legal, state and other benefits received by genuine employees. In addition

it has been argued that IR35 makes small businesses uncompetitive with large consultancies, and encourages offshoring.¹⁷

The Coalition Government's 'Programme for Government' announced a commitment to review "IR35, as part of a wholesale review of all small-business taxation, and seek to replace it with simpler measures that prevent tax avoidance but do not place undue administrative burdens or uncertainty on the self-employed, or restrict labour market flexibility".¹⁸ This is under way, with an announcement expected in the 2011 Budget, and must lead to the establishment of the right to be self-employed for all who are genuinely self-employed, and to a clarification of the level of tax and National Insurance an individual must pay.

FSB recommendations:

- Action must be taken on IR35 policy after the Office of Tax Simplification has completed its review. This must eliminate the costly and lengthy disputes between HMRC and the self-employed over contract work. Clarity in this area would encourage more people to start their own business, becoming the employers and the wealth generators of the future. If Government is serious about helping small businesses lead the next wave of economic growth, then it must ensure that HMRC does not stand in the way
- There must be a rationalisation of the application of criteria for determining self-employed status. This would remove the need for

15 FSB press release, Government Enterprise Scheme Excludes Local Jobless Says Essex FSB, 19 January 2011 <http://www.fsb.org.uk/News.aspx?loc=101&rec=6881> Further examples available on request.

16 The Intermediaries legislation was introduced on 6 April 2000. It was first proposed by the Chancellor in the 1999 Budget and details were given in the Budget press release numbered IR35. Following extensive consultation, revised proposals were announced in a new press release dated 23 September 1999. However, the legislation is now commonly referred to as 'IR35'. Source, HMRC <http://www.hmrc.gov.uk/ir35/>

17 For example a business may engage the services of a consultant at £500 per day via a large consultancy firm. That consultant will be paid a much lower salary through payroll, giving a profit that will be drawn by the directors of that consultancy as a dividend without paying National Insurance. A small business would have to declare the majority of their fee under IR35.

18 The Coalition our programme for government, May 2010 http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf

Special focus:

The failure to comply with the Services Directive

The objective of the Services Directive is to release the untapped growth potential of services markets in Europe by removing legal and administrative barriers to trade in the services sector.¹⁹ Both FSB research and a recent report from SOCITM²⁰ (the Professional Association for Public Sector ICT Management) confirmed that in June 2010 the majority of competent authorities' websites were not complying with the spirit of the Services Directive. FSB research found that only five per cent were complying fully, 18 per cent were rated as satisfactory, and 59 per cent were rated as poor. This is illustrated by a member who said that he had given up going online for his paperwork as the websites were too difficult to navigate through. The new European rules aimed at cutting red tape for businesses are being ignored to a large extent by local councils.

We are aware that significant cuts have been made to Government budgets for advertising regulatory changes, making it even more difficult for small firms to find out how regulation affects them.

as many as eight different tests to ascertain the tax status of a particular activity

- Given the confusion surrounding the status of the self-employed, the FSB calls for a statutory definition of self-employment. The FSB is willing to work closely with Government on this definition
- The FSB would like to see the establishment of the right to decide to be self-employed. This could work through creating a simple register to eliminate the need to provide evidence of self-employed status to HMRC every year. Those who feel that they are genuinely self-employed would be able to define their status, once and for all, on this register, which must be developed and maintained by HMRC. To avoid error or misreporting, HMRC must check within a six-month

period whether the criteria for self-employment have been met. After this period it must be accepted that the applicant is self-employed until further notice

The regulatory burden

For someone becoming self-employed for the first time, it can feel as if they are entering uncharted waters alone. They will need to work out how they will finance themselves until they secure their first client or contract. They are also legally obliged to register with HMRC within three months of becoming self-employed, or risk a fine. In addition, they will need to choose a legal structure and an insurance policy, to keep good records and to register for VAT if their turnover is likely to exceed the VAT registration threshold (currently £70,000).

¹⁹ http://ec.europa.eu/internal_market/services/services-dir/index_en.htm

²⁰ *Better Connected for business: implementation of the EU Services Directive in the UK in 2010*, SOCITM insight, June 2010.

The complication of complying with numerous, and in many cases disproportionate and expensive, regulations acts as a disincentive for those thinking of starting their own business. National Audit Office research has clearly indicated that it is the constant flow of and changes to regulation that is the most burdensome aspect for all small and micro businesses.

Regulation is a hidden tax on business. FSB research suggests that one third of small businesses still rate regulation as the greatest barrier that their business faces, coming right behind cash-flow problems and the recession. Previous Governments have failed to make tangible reductions in regulation. Given the huge amount of time it takes to comply with regulation, this is no longer acceptable and must be addressed if we are to give more people the confidence to start their own business.

An FSB member said:

“Earlier this year I was one of a group of businesspeople that went into one of our comprehensive schools and we each had a group of students to talk to about business and explain what running a business entailed. We had five groups each and I chose to talk to my groups about whether they had ever thought of being self-employed or working in a small local company and to answer their questions and explain to them all about it. These children were Years nine and ten and they were not very receptive at all in the main. As we live in a country area all they want to do is get out into the city as soon as possible, although there were some exceptions to this and some who had experience of self-employment from their parents.”

FSB recommendations:

- Government must abide by Article 153 2b of the European Treaty: this requires Government to avoid passing laws that impose administrative, financial and legal constraints which hold back the creation, growth and development of SMEs
- Government must put pressure on European institutions to ensure that the 10 principles of the Small Business Act for Europe are implemented and adhered to by decision-makers, with a special focus on the ‘Think Small First’ principle²¹
- There must be no statutory requirement to register with a chamber of commerce. The FSB is concerned that the UK may follow a similar route to France, Germany, Italy, Spain and Japan. In these countries, start-up businesses have to wait until their application to register with their local chamber of commerce has been approved before starting work. This creates a significant regulatory barrier to business growth. It can be an extremely

lengthy and bureaucratic process. These bodies can restrict competition by preventing a competitor from opening in a small village, for example

Strengthening enterprise within the education system

It is a recognised problem that education leavers are not equipped with the skills businesses need. While there is a significant and correct focus on how to be a good employee, there is concern that this is not complemented by the same level of input at key life stages (school, college and university) on how to start your own business and how to be an entrepreneur. Currently, there is little awareness or belief that starting your own business or being an entrepreneur is a positive desire.

Encouraging behavioural change towards a culture of entrepreneurship crosses into all elements of society. For example,

²¹ European Commission: http://ec.europa.eu/enterprise/policies/sme/small-business-act/think-small-first/index_en.htm “The ‘Think Small First’ principle requires that legislation takes SMEs’ interests into account at the very early stages of policy making in order to make legislation more SME friendly. Various tools and techniques could lead to an effective implementation of the principle. These include the application of an SME test to forthcoming legislative proposals, the use of specific SME provisions in legislation in view of avoiding disproportionate burden on SMEs, the consultation of the SME stakeholders, the work of the SME Envoy, the use of Common Commencement dates for legislation relevant for business etc.”.

“Local schools should be reaching out to the wider business community”

the children’s TV programme *LazyTown* is now a successful entertainment and lifestyle brand, which has a unique edge in promoting healthy lifestyles. A similar principle could be applied to promoting entrepreneurship through children’s media.

Anecdotal evidence from FSB members indicates that the focus should be on viable business start-ups and learning lessons for the future. In America it is acceptable to have failed in business and to learn from it and be successful the next time. There is less of this culture in the UK.

Education and business partnerships need to operate effectively for small business owners to engage positively in the education system. Small business owners are deterred from engaging with education as they feel that the time away from their business is not fully utilised.

FSB recommendations to boost education on enterprise:

- Local schools should be reaching out to the wider business community, including micro

and small businesses, giving employers the opportunity to inform local schools of exactly what business requires of the education system

- The FSB recommends that teachers spend a period of time each year in businesses, including small and micro businesses, so that they can help their students acquire a wider appreciation of employment and self-employment
- All schools and further and higher education institutions must develop a culture of entrepreneurship, with focused teaching on the basics of starting your own business at each educational stage. Government must ensure that the opportunities provided by incubation hubs at UK universities are not diluted by budgetary constraints. Self-employment must also be strongly factored into all careers guidance by properly experienced and trained advisors

Conclusion

In the current climate, Government must ensure that self-employment and the concerns of small businesses are given the same status as high-growth businesses. It is essential to make the connection between the self-employed people of today and the wealth generators and job creators of tomorrow.

An FSB member said:

“About three years ago, I did a Dragon’s Den type event at our local comprehensive school with Year 10 students. They had been working in groups on developing a new product and bringing it to market and I was asked to go in and ask them some pertinent questions to see how focused they were on the practicalities of marketing a product. I must say that they had really done some good work and had some brilliant ideas, but they were very short on real knowledge about things like VAT, profit ratios, etc.

“I then had to choose one group’s product that I thought was the best thought-through and most likely to succeed. If I remember rightly it was a pillowcase that helped you to learn while you were sleeping – good idea!”

Annex A

What is self-employment?

Self-employment means taking a leap of faith and working for oneself. This can be either as a sole trader, a partner, a franchisee, or part of a small limited company.

Being a sole trader does not involve paying any registration fees; the keeping of accounts and records is straightforward, and the sole trader keeps all profits made. However, they are personally liable for any business debts.

In a partnership, two or more people share the costs, responsibilities and risks of being in business. Each partner is self-employed and takes a share of the profits. Generally, each partner shares in the running of the business and is personally responsible for any business debts. Partners do not have any protection if the business does not succeed. Examples of business partnerships include KPMG and John Lewis.

Buying a franchise takes advantage of the success of an established

business. As a 'franchisee', one buys a licence to use the name, products, services and management support systems of the 'franchisor' company. This licence normally covers a particular area and is time-limited, after which it can be renewed. Liability depends on the business structure that the franchisee chooses for their business.

A limited liability partnership (LLP) is similar to an ordinary partnership in that a number of individuals or limited companies share the costs, responsibilities, profits and risks of the business. However, liability is limited to the amount of money invested in the business and to any personal guarantees given to raise finance. Thus members have some protection if the business runs into trouble.

Limited liability companies exist in their own right. In this case the company's finances are separate from the personal finances of their owners.²²

²² The detail in this page is taken from Legal structures: the basics. Self-employment, Business Link <http://www.businesslink.gov.uk/bdotg/action/detail?itemId=1073789618&type=RESOURCES>



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