

WHAT SMALL FIRMS WANT FROM BREXIT

A PREVIEW OF FSB'S BREXIT RESEARCH SERIES



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Experts in Business

METHODOLOGY

In order to represent the potential impact of the UK exiting the EU on small businesses, FSB has undertaken a comprehensive research programme of quantitative and qualitative research. FSB commissioned Verve, a leading independent research agency, to undertake a series of quantitative surveys of FSB members along four main themes to ensure that each is robust, representative and delivers statistically significant results. The survey 'future trade with EU and non-EU markets' was answered by 1,758 small business members during 27 October – 8 November 2016. The survey 'access to labour and skills after Brexit' was answered by 1,236 small business members during 17-29 November 2016. The survey 'EU funding and business support' was answered by 1,659 small business members during 14-25 November 2016. The regulation survey is currently in the field.

FSB also held focus groups with members in various parts of the UK, and conducted in-depth interviews. Additionally, FSB appointed a group of independent specialists (accountants, economists, international trade advisors and lawyers) to an external reference group, to road-test our plans and surveys, and sense-check our analysis. All content and conclusions of this preview and the four in-depth research reports that will be published in the coming months, remain entirely those of FSB.

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FOREWORD

The political agenda and focus of 2017 will be dominated by Brexit, as the Government prepares to trigger Article 50 by the end of March. Since the outcome of the referendum on the UK's membership of the European Union (EU), FSB has undertaken a comprehensive research programme to analyse the potential opportunities and risks of the UK leaving the EU for small businesses.

This initial preview provides a snapshot of our research and some key findings, with the full Brexit series of reports all coming in the next few weeks and months. Our research has been based directly on what the small business community and our members have told us is important to them.

All of these areas are like chapters in a book, their stories are interconnected and it's likely there could be competing priorities between them. The four areas are not in order of importance, but simply in order of when the research was undertaken and, in turn, the sequence of how the Brexit series will be published. The areas include:

1. Access to EU single market and non EU markets
2. Access to skills and labour from the EU and ease of 'doing business' within the EU
3. What's next for EU funding?
4. Regulatory framework post EU exit

Our Brexit research has included extensive engagement across every nation and region of the UK. It has also addressed specific issues for Scotland, Wales, Northern Ireland, the English regions and London. These issues, such as the future of the border between Northern Ireland and the Republic of Ireland, will be considered fully within the context of each report.

FSB's membership is personal, made up not of companies and corporations but of small business owners and the self-employed. Therefore, our research programme brings a unique insight into the opportunities and risks of Brexit. The programme follows on from our EU referendum research published in September 2015 and February 2016. FSB's research aims to inform Government and indeed all policymakers so that small firms will continue to be the powerhouse of the UK economy.



Martin McTague
FSB Policy Director

ACCESS TO THE EU SINGLE MARKET AND NON-EU MARKETS

How access to the single market might change when the UK leaves the EU is of particular importance to a significant proportion of small firms that already trade overseas, as well as those with the ambition to trade in the future. The EU single market is the largest¹ market that exporting UK small businesses currently trade with. Many small businesses are also involved in supply chains which extend into the EU single market, or where the end product is exported to the EU. When the UK leaves the EU single market² and the full customs union³ we believe there are potential new global trading opportunities that small businesses will be able to take advantage of. Already, the single largest country for exports is the US, and emerging markets appear to be increasingly attractive as an export destination for potential exporters.⁴ However, to take advantage of these new opportunities, small businesses will need tailored support.

Therefore, it's crucial for FSB to explore the impact that changes to the current trading arrangements with the EU will have on small businesses. Our analysis has focused on the ease, cost and importance of trading with both the single market and with countries outside of it. This is important as the UK's relationship with non-EU markets will be affected by our eventual EU trade agreement and the process by which this will be implemented. Our research differentiates between small businesses which are currently exporting and/or importing and those that are considering to do so in the future. Some key initial findings from our research include:

Destination

92 per cent of exporting small businesses trade within the EU single market.⁵ In comparison, 78 per cent of exporting small businesses trade outside the EU single market⁶ – these two figures are not mutually exclusive, with 72 per cent⁷ exporting both inside and outside of the EU single market.

Our further research will show a detailed breakdown by country and global region, and will identify priority markets that small businesses are considering in the wake of the referendum decision.

Impact on future business trade

Our research explores how small businesses are likely to react to the UK leaving the EU in relation to their import and/or export decisions. It is worth noting that 69 per cent⁸ of small business exporters are also importers.

For current small business exporters, just under one third (29%)⁹ expect their level of exporting, regardless of destination, to decrease as a result of the UK leaving the EU. However, one in five (20%) small firms expect their level of exporting to increase, with 42 per cent¹⁰ of small exporters expecting very little or no change. The difference is starker for current importers. Around one third (31%)¹¹ of small businesses expect to import less overall, while only seven per cent expect to increase their level of imports when the UK leaves the EU. 55 per cent expect very little or no change.¹²

1 92 per cent of exporting small businesses export to the EU single market – FSB Research survey, November 2016

2 Leaving the EU single market is defined, for the purposes of this report, as losing the level of access to the EU single market allowed for through membership of the EU or the EEA. We understand it would also mean the UK is no longer party to the preferential free trade agreements between the EU and third countries.

3 When the UK leaves the full EU customs union, it will have the ability to agree FTAs with third countries. Currently as a member of the customs union it cannot do this. Full membership of the EU Customs Union requires members to comply with the common commercial policy and implement the common external tariff on all goods imported from outside of the EU. The common commercial policy is an area of exclusive EU competence. The EU therefore has exclusive competence of trade policy. The UK Government has expressed interest to seek a new customs arrangement with the EU, which allows goods to be traded freely with no tariffs.

4 FSB report 'Destination Export: the small business export landscape', July 2016

5 FSB survey on future trade with EU and non-EU markets 2016

6 FSB survey on future trade with EU and non-EU markets 2016

7 FSB survey on future trade with EU and non-EU markets 2016

8 FSB survey on future trade with EU and non-EU markets 2016

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11 FSB survey on future trade with EU and non-EU markets 2016

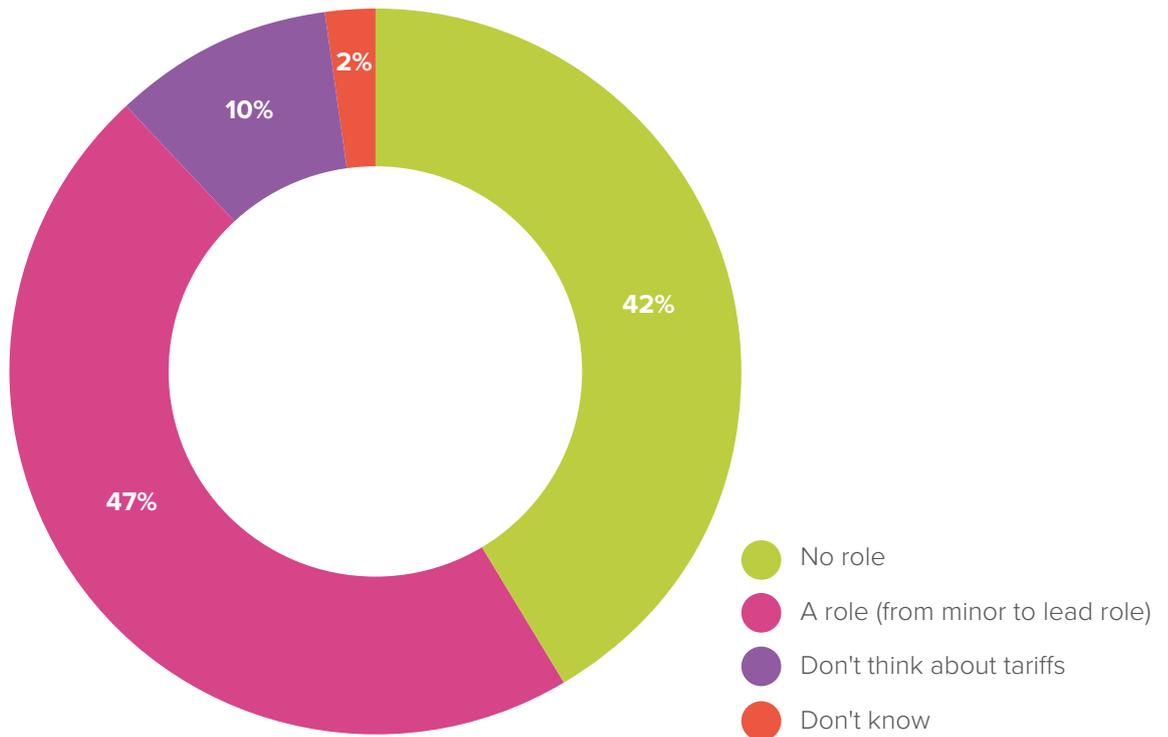
12 These figures do not add up to 100 per cent due to additional categories not counted in these figures, such as 'don't know' responses

Tariffs

As the UK will be leaving the EU single market and will not retain full membership of the EU customs union, tariffs¹³ may be introduced on trade between the UK and the EU. The UK Government has made it clear that they will aim to negotiate a comprehensive Free Trade Agreement (FTA) with the EU which has no, or as few possible, trade barriers (in respect of both tariffs and non-tariff barriers). However, we understand that if the UK leaves the EU without an FTA then the default position may be to trade with the EU under World Trade Organisation (WTO) rules and tariffs.

We have therefore explored the possible implications of introducing tariffs on the export destinations of small businesses. Small business exporters are split, with just under half (47%)¹⁴ stating, to varying degrees, that tariffs play a role on where they decide to export. A similar proportion (42%)¹⁵ state that tariffs play no role on where they decide to export.

Figure one: The role of tariffs on export destinations
 Source: FSB survey on future trade with EU and non-EU markets 2016



¹³ A tariff is a tax imposed on imported products. Tariff rates may vary from country to country and differ according to type of product.

¹⁴ FSB survey on future trade with EU and non-EU markets 2016

¹⁵ FSB survey on future trade with EU and non-EU markets 2016

Non-tariff barriers

A non-tariff barrier is any trade restriction to exporting or importing that is not a tariff. Non-tariff barriers may vary from country to country and differ according to the type of product. For example, non-tariff barriers can range from licensing requirements to complying with product labelling and packaging standards. Non-tariff barriers can be particularly challenging for small businesses seeking to trade services, though they also apply to goods.

More than half of exporting small firms (53%)¹⁶ state that non-tariff barriers play a role, to some degree, on where they decide to export. Around one third (34%)¹⁷ state that non-tariff barriers play no role in where they decide to export. When the UK leaves the single market and the full EU customs union, it is possible that businesses will face new or additional non-tariff barriers when trading with the EU. Small firms are particularly concerned about any measures which increase the administrative or cost burden of exporting or importing, including dealing with rules of origin.¹⁸ In this respect, the UK decision to end full membership of the customs union (unless mitigated through a new customs agreement between the UK and the EU), is likely to add another layer of cost for many small firms trading with the EU in the future.

“As a dairy farming family we supply milk processors on both sides of the border. With Brexit and talk of a return to a hard border and customs checks between Northern Ireland and the Republic, we are concerned by what this means for our business and those we supply. Milk is a perishable product so, in addition to the challenges from tariffs and currencies, we also need to know that any new regime won’t cause delays in getting our product to market nor shrink our available customer base.”

FSB member, Agri-food sector, Northern Ireland

¹⁶ FSB survey on future trade with EU and non-EU markets, 2016

¹⁷ FSB survey on future trade with EU and non-EU markets, 2016

¹⁸ Rules of origin are the criteria needed to determine the national source of a product. Goods traded between countries within the EU customs union do not need to comply with rules of origin.

ACCESS TO SKILLS AND LABOUR FROM THE EU AND EASE OF 'DOING BUSINESS' WITHIN THE EU

FSB members need simple, straightforward access to people and skills, in order to grow in the future. The Office of National Statistics (ONS) data shows that since 1997, the non-UK EU workforce total has more than tripled from two per cent to seven per cent of the total UK workforce.¹⁹

FSB has already been a prominent voice for small business in early discussions on this policy agenda. On behalf of members and all small firms that employ non-UK EU citizens, FSB has called for the status of these staff to be clarified as soon as possible and for them to be granted the right to remain and work within the UK. FSB has also been clear in opposition to firms collecting and publishing nationality data on employees or, becoming immigration enforcers. While debate continues on this point, our survey work assesses the current situation and then looks at the future approach that may be required.

In addition to access to labour and skills, our research also considers the ability for UK small businesses themselves and the self-employed to easily undertake short-term contracts within the EU. Projects for many types of services are key for a thriving British industry.

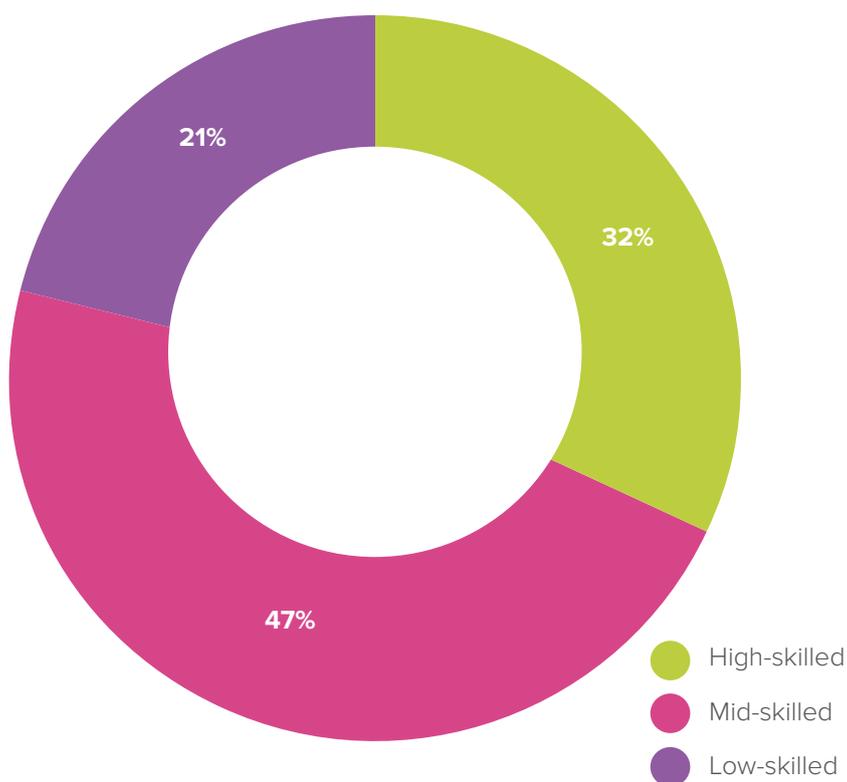
In our analysis, we have distinguished between skills and labour. We have defined skills as the knowledge and ability to undertake a particular task and labour as the quantity of people needed by a business. We have also disaggregated skills into the categories of high-skilled, mid-skilled and low-skilled. Examples of high-skilled occupations include: chief executives, engineers, IT and telecommunications professionals and professional services providers, such as accountants and architects. Mid-skilled jobs include: mechanics, construction workers and care workers. Low-skilled occupations include: farm workers, packers, cleaners and hospitality staff.

¹⁹ Source: Labour Force Survey: Office for National Statistics

How small businesses employing non-UK EU workers are using skills

A fifth (21%)²⁰ of our members (who have employees)²¹ currently employ EU citizens.²² Furthermore, almost half of these (47%)²³ predominantly employ highly sought, mid-skilled workers to address acute existing skills shortages. 21 per cent²⁴ of small firms with EU citizens mainly employ low-skilled employees and 32 per cent²⁵ mostly employ high skilled employees.

Figure two: The skills that small businesses with EU employees predominantly use
Source: FSB survey on access to labour and skills after Brexit 2016



We are exploring the level of concern amongst our members about any additional administrative burdens that may be placed on small businesses in the event of moving away from the current status quo of freedom of movement for EU nationals to, for example, a work permit based system. Our detailed report will aim to look at the potential implications of worker restrictions for small businesses.

20 FSB survey on access to labour and skills after Brexit, 2016

21 93 per cent of FSB members who responded to the 2016 FSB survey on access to skills and labour are employers

22 This also included EEA country citizens

23 FSB survey on access to labour and skills after Brexit, 2016

24 FSB survey on access to labour and skills after Brexit, 2016

25 FSB survey on access to labour and skills after Brexit, 2016

“The Polish employees I work with now are very skilled, well-educated and very reliable. They do beautiful, traditional stonework and cement-based trades. I only build one-off architectural specials and unusual jobs. We recently finished converting a lighthouse, so I tend to require specific expertise. If I didn’t have access to my non-UK workforce I would close down. It wouldn’t be possible to operate without my European staff. I would have real reservations about my ability to get the skills I need from the domestic labour force. Not just reservations – I know it wouldn’t happen. Anything that affected my Polish workers’ employment here would be a disaster. If skills like these were acknowledged as more specialised – which they can be – perhaps they would be training people who were more interested in it.”

FSB member, Construction sector, Scotland

The extent to which small businesses do business in other parts of the EU

Almost a third (30%) of small business owners have benefited from free movement rights in the last 12 months.²⁶ This has included business visits and carrying out projects in the EU, working with individuals and companies from other parts of the EU, and contracting out services.

²⁶ FSB survey on access to labour and skills after Brexit, 2016

WHAT'S NEXT FOR EU FUNDING?

EU funding currently aids a range of activities which support growth and regional economic development. Brexit provides an opportunity to substantially improve the delivery of business support, and access to finance schemes.

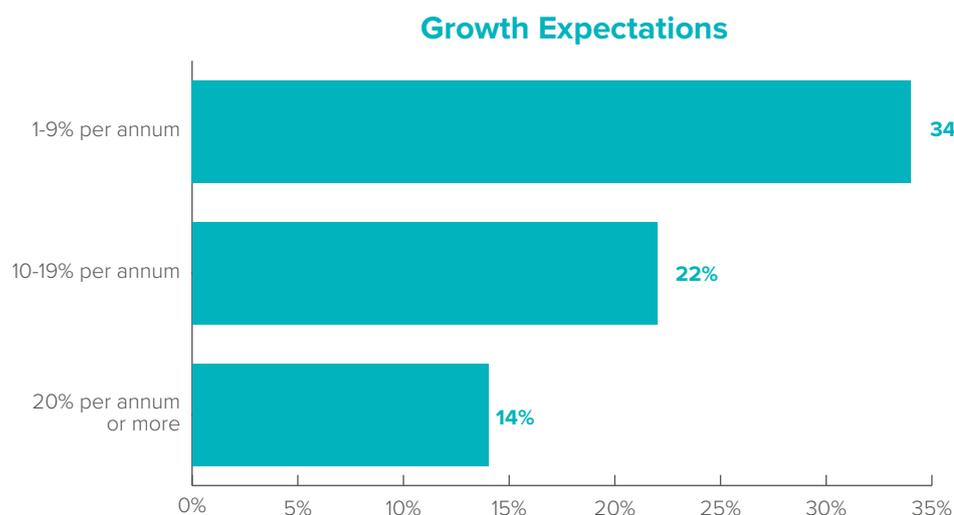
The ambition by policymakers for economic growth and prosperity in every area of the UK will be affected by the extent and manner in which current EU funded schemes are replaced following Brexit. Significant investment is currently allocated to nations and regions which have historically experienced economic challenges, such as Scotland, Wales, Northern Ireland and the North East and South West of England.

Business support as a whole, which remains complex for small businesses to secure, is in need of streamlining. Business support and access to finance remain two aspects of EU funding that businesses across the UK consistently say are key in order for them to grow.

Growth expectations

Figure three: Small businesses growth expectations over the next 12 months

Source: FSB survey on EU funding and business support 2016



The debate on business support has polarised how best to identify and back scale-ups and start-ups.²⁷ However, our evidence suggests this is not a useful way to segment our community, as it assumes all others have no perceived aspiration of growth. In fact, our evidence suggests a far more complicated picture. Our research shows that 22 per cent²⁸ of small businesses are targeting growth of between 10-19 per cent²⁹. Although these businesses may not meet the OECD's definition of high growth firms that are scaling up, they still have a distinct set of support needs to enhance their productivity and their ability to grow. An exclusive focus on scale-up risks ignoring the significant growth and productivity potential of many small businesses. Ultimately, we believe that raising the productivity of all small businesses across all the regions and nations of the UK, to deliver an economy that works for everyone, requires a more nuanced and better-segmented approach to the UK economy, with a business support system that matches.

²⁷ Scale-up companies, also known as high-growth enterprises, are enterprises measured by employment or by turnover with average annualised growth in employees or in turnover greater than 20% a year, over a three-year period, and with ten or more employees at the beginning of the observation period, OECD, Enterprise at a Glance, 2011, OECD Structural and Demographic Business Statistics (SDBS) Database

²⁸ FSB survey on EU funding and business support, 2016

²⁹ FSB survey on EU funding and business support, 2016

Role of Local Enterprise Partnerships and Growth Hubs

Local Enterprise Partnerships (LEPs) and Growth Hubs play an important role in the delivery and promotion of business support in England. However, we believe that LEPs have further to go to understand the specific business support needs of small businesses. FSB has been pushing hard to ensure all LEPs deliver on the requirement to have a small business champion. The Government should also provide LEPs with better small business data, broken down by the number and business size in each LEP area.

A rethinking of funding

EU funding is also important for infrastructure at local, regional and national level. This is something our detailed report will be covering further. And it is not just the replacement for EU funding that needs to be considered. There remains a lack of clarity on reinvestment and legacy funds, such as the Northern Power House Investment Fund and Midlands Engine funds which appear not to be guaranteed beyond 2020.

Already it is clear from our focus group discussions that many small businesses are unaware of the current opportunities to access EU funding, let alone what might replace them.

In addition, many businesses have raised concerns about the administrative burden of applying for funds, and about the effectiveness of the evaluation of EU-funded schemes. Small businesses would like to see a renewed focus on what works rather than simply collecting data from each scheme, which does little to effectively measure the success of a project. There are important lessons to draw from this to inform the development of future funding schemes once we have exited the EU, and as policymakers design the new business support architecture for the economy of the UK and its nations and regions.

“As a private training provider offering skills support training, European funding has been vitally important to my business. Over the last two years, we have received £850k from the European Social Fund, which has enabled us to significantly expand our area of operations and reach many more businesses who are in need of support. It has also allowed us to provide some fully and part subsidised courses, opening up our services to clients who may not otherwise have been able to benefit.

To date, this funding has helped us provide tailored business support for over 500 employers and more than 1,100 learners. This has included training in apprenticeships, accredited training, and short courses.

The European Social Fund has been vital to help businesses like ours grow, create jobs as well as provide the skills needed where there is an increasing demand for provision, and tailor this offer to meet local needs.

However, accessing this funding hasn't been without its problems. The application process is lengthy, complicated and the funding often takes a long while to arrive, especially as we are in a supply chain. We were often also stopped from bidding directly for contracts as the value threshold was too high for small businesses.

We believe leaving the EU could provide an opportunity for a new streamlined and small business friendly replacement to be introduced, which avoids many of the pitfalls associated with the current system.”

FSB member, Business Support Company, Greater Manchester, England

REGULATORY FRAMEWORK POST EU EXIT

FSB research in 2015 showed that 53 per cent³⁰ of members believed that reducing the regulatory burden should be the top policy priority for Parliament. This statistic is not specifically related to EU-derived regulation, as small business owners often struggle to identify the original source of rules and regulations that they face. This question on regulatory burden was not asked within the context of likely competing priorities required as a result of Brexit. However it is still an indicator of the importance small businesses attach to regulatory change.

Regulation that small businesses find burdensome³¹



The UK's exit from the EU could be accompanied by an eventual divergence in legislation and regulation covering small businesses. The process, speed and direction of any such divergence from the EU has the potential to create both opportunities and threats for the UK's smaller businesses and the wider economy in general. It must be noted that some aspects of the regulatory areas that small businesses find burdensome are a devolved responsibility, such as regulations dealing with procurement, the environment, some aspects of consumer regulation and increasingly tax administration. This needs to be taken into consideration as there could be added scope for further divergence across the UK nations.

30 FSB post General Election small business survey, May 2015
31 FSB/RBD (2013). 'FSB 'Voice of Small Business' Survey Panel'

What's next for regulation?

FSB welcomes the certainty that the Great Repeal Bill should bring by providing regulatory continuity for businesses. Maintaining the broad regulatory framework provides small business owners with confidence regarding the rules within which their businesses will operate in the short to medium-term.

Looking further ahead, the UK's exit from the EU will provide an opportunity to re-examine and tailor the UK's regulatory regime. FSB's survey for this area is in the field at the moment of publication. This will provide insight into exactly how small firms want to change the current approach. Much of the present framework has been heavily influenced by EU and wider international commitments, not least in areas such as employment law, health and safety and most recently in data protection.

We recognise that the future aspects of the EU-UK FTA aimed at reducing non-tariff barriers could impact on the UK's domestic regulatory regime (particularly with regard to harmonisation).³² The reduction of non-tariff barriers are key to supporting the trade of services across borders. We recognise there are mechanisms such as mutual recognition agreements (MRA), that accept goods/services suitable for sale in one country, are likely to be acceptable for sale in the other country. Another option is that of regulatory equivalence. Where regulatory equivalence is in place, parties agree to recognise that certain regulatory outcomes are mutually desirable. In addition, they recognise that the method employed to deliver these outcomes in each individual country may be different. Nonetheless, there are some FTAs which may mean aspects of domestic regulations are harmonised to reduce the extent of non-tariff barriers.

The Government now has a real opportunity to optimise the regulatory environment for business, to improve the productivity and competitiveness of the economy throughout the UK.

The UK has struggled with the productivity puzzle. In 2015, output per hour worked was below the average for the remaining six members of the G7 group of industrial nations.³³ Given the strong positive association between innovation, exporting and productivity,³⁴ we are particularly keen to explore any regulatory inhibitors of innovation.

Domestically derived regulation

Until the point at which the Great Repeal Bill is enacted, domestic legislation which is not derived through our membership of the EU or wider international commitments and which does not impact on the cost or ease of trade, should remain under close scrutiny. And where there are opportunities to deregulate or amend regulatory burdens to improve small business productivity, they should be taken. In terms of regulatory burden FSB is keen to retain the focus on the here and now. Our detailed report will also include information regarding domestic legislation not derived from the EU, and which does not impact on cost or ease of trade directly, but which is currently considered to be inhibiting small business productivity. In many cases, this is related to the cumulative burden, both in terms of cost and time, of meeting existing regulatory requirements and standards.

Tax regulation is largely derived from domestic legislation

'As a small business owner the constant change in the UK's tax structure, as a result of regulatory changes, continues to be hugely disruptive towards long-term planning. It has also mitigated against me expanding my business – both in terms of investing in capital or taking on more staff. In fact, it has actually resulted in me reducing the number of employees I am able to take on. More broadly, a very large proportion of the time I spend is taken up dealing with tax administration and talking to tax advisers and accountants.'

FSB member, property services, Wales

³² A third country is a country that is not a member of the European Union

³³ ONS – International comparisons of UK productivity (ICP), first estimates: 2015, released 6 October 2016, <https://www.ons.gov.uk/economy/economicoutputandproductivity/productivitymeasures/bulletins/internationalcomparisonsofproductivityfirstestimates/2015>

³⁴ ERC – SME Innovation, Exporting and Growth, released April 2013 - http://www.enterpriseresearch.ac.uk/wp-content/uploads/2013/12/ERC-White-Paper-No_5-Innovation-final.pdf

FSB'S BREXIT RESEARCH SERIES - THE UPCOMING RESEARCH

In the coming months, FSB will publish the four reports that will make up our Brexit series. These reports will include detailed findings, and recommendations for policymakers, to make sure the small business voice is heard during the Brexit negotiations.

Access to the EU single market and non-EU markets

This report will explore the potential impact of Brexit on small businesses trading overseas. It will also set out recommendations on how small firms can be supported to benefit from the potential opportunities created by Brexit and what risks need to be mitigated.

Access to skills and labour from the EU and ease of 'doing business' within the EU

This report will explore the potential impact on small businesses of restricting the freedom of movement of low and mid-skilled, as well as high-skilled, people from the EU. It will also set out recommendations on particular areas of concern for Northern Ireland and potential reform of the education and skills system.

What next for EU funding?

This report will explore the potential impact of Brexit on potential improvements to business support and access to finance schemes. It will also set out recommendations to target future funds more effectively in a place-based industrial strategy that redresses regional imbalances in the economy.

Regulatory framework post EU exit

This report will explore the potential impact of Brexit on the regulatory burden for small businesses, such as volume, implementation and compliance.

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