

BIS | Department for Business
Innovation & Skills

SMALL FIRMS IMPACT TEST

Guidance for Policy Makers

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**Small Firms Impact Test
Flowchart**

Policy Proposal

Does the proposal affect small business, their customers or competitors?

Yes

No

Contact a sample of small businesses/business representatives to explore issues. As part of this you should consider:

A) Whether a more flexible approach, or possibly exemptions, would be appropriate for firms with fewer than 20 employees; **AND**

B) Is there potential to fully or partially exempt small business (those with fewer than 50 employees)?

Does the impact fall more heavily on small businesses (those with up to 50 employees) than large businesses?

No

Yes

More detailed exploration of impact with representative bodies and small firms.

Update SFIT and note template

Proceed to public consultation

Finalise policy proposal

Small Firms Impact Test

Checklist

A. At an early stage in the Impact Assessment preparation make a preliminary assessment of businesses likely to be affected:

- Does the regulation apply to small businesses or affect the business environment in which they operate? If "yes" then the initial presumption should be that costs will fall disproportionately on small businesses and the process should move to step B.
- What are the characteristics of small businesses likely to be affected? – For example, number of businesses, size, ownership type (sole proprietor, partnership, limited company, etc), geographic distribution?

B. Consider alternative approaches for regulating smaller firms:

- Consider whether alternative approaches (including, but not limited to, exemptions, simplified inspections, less frequent reporting) might be appropriate for firms with fewer than 20 employees¹.
- Consider whether a complete or partial exemption would be appropriate for micro and small businesses (those with fewer than 50 employees).

C. Scope issues with a representative sample of small businesses:

- Contact a reasonable number (e.g. 10) of representative businesses.
- Obtain feedback about the likely effects of the proposal:
 - How serious is the problem the proposal seeks to address in relation to smaller firms?
 - What changes will smaller firms have to make to the way their business operates?
 - Is there likely to be a greater impact on the operations and performance of smaller business than others²?
 - What are the likely approximate costs and benefits of the proposal for small business?
 - Will exempting (either fully or partially) smaller firms from the policy materially affect the potential benefits from the policy?
 - Are there alternative approaches for smaller firms, which would not materially affect the potential benefits from the policy?

D. Determine if there is likely to be a greater impact on the operations and performance of small business than others:

- If yes, proceed with the next stage of the small businesses analysis, based on the information received from the sample of businesses and other research, where appropriate. (Note it is normal for the impact

¹ For all regulations that affect business, policy makers are now required to consider whether alternative approaches (e.g. flexibilities or exemptions) are appropriate for firms with fewer than 20 employees. This requirement was announced in the Government's 2008 Enterprise Strategy - see <http://www.berr.gov.uk/whatwedo/enterprise/enterprisesmes/enterprise-framework/index.html>

² It is normal for the impact of measures to bear more heavily on small businesses because they do not enjoy the economies of scale of larger firms.

of measures to bear more heavily on small businesses because they do not enjoy the economies of scale of larger firms).

- If no, prepare the draft impact assessment for public consultation, including details of preliminary soundings. Note that you will still need to consider:
 - Whether alternative approaches (including, but not limited to, exemptions, simplified inspections, less frequent reporting) are appropriate for firms with fewer than 20 employees; and
 - Whether exemptions are appropriate for small firms (those with up to 50 employees).

E. Gather detailed data about likely impacts on small businesses as part of the wider consultation including costings:

- Contact a wider sample of representative businesses.
- Obtain feedback about likely effects of the proposals, including estimates of costs and benefits that can withstand external scrutiny.
- Consider again if the proposal will have a greater effect on small business.
- Consider alternative approaches for smaller firms.

F. Ensure that the IA covers the impact on small businesses

- The Small Firms Impact Test (SFIT) should be viewed as an integral part of the IA process and will help policy leads assess the costs for self employed, micro, small, medium and large firms that can be fed back into the IA template. Policy leads should summarise details of feedback obtained from SFIT analysis in the Impact Assessment. Points to cover are:
 - Industry structure (e.g. number of businesses; business size)
 - Consultation to date
 - Estimates of costs and benefits of each option
 - Implementation issues

The SFIT will also help policy leads comply with the Government's new commitment to regulating small firms, which involves assessing whether alternative approaches (e.g. additional flexibilities or exemptions) are appropriate for firms with fewer than 20 employees. The analysis underpinning this decision should be included in the evidence base section of the IA – if an alternative approach appears possible this should be included as a separate option. A summary of the evidence on which the final decision on how to regulate smaller firms is based will also need to be included in the Explanatory Memorandum (EM). To view guidance visit: <http://www.opsi.gov.uk/si/statutory-instrument-practice.htm>. To see an example of a completed EM see Annex E

- Provide feedback to participants on:
 - How policy was influenced or, if no changes were made, why not
 - How they can have further input into the regulatory process.

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Introduction

Small Firms Impact Test – A Quick Guide

What types of intervention require a Small Firms Impact Test?

Any proposal that **imposes** or **reduces** the cost on business requires a Small Firms Impact Test.

What is the Small Firms Impact Test?

The Small Firms Impact Test (SFIT) process³ seeks to help you assess the impact of new proposals, including those being negotiated internationally, on small business. The process should be viewed as an integral part of the Impact Assessment (IA) process; in particular the SFIT should help you complete the cost benefit analysis element of the IA that includes:

- Examining whether alternative approaches (including, but not limited to, exemptions, simplified inspections and less frequent reporting) are appropriate for firms with fewer than 20 employees, as part of the Government's new approach to smaller firms;
- Examining whether small businesses (those with fewer than 50 employees) can be given a complete or partial exemption from new rules, as part of the Government's commitment to target new regulation only where it is needed⁴; and
- Quantifying the annual costs your policy will place on micro, small and medium size businesses.

The SFIT seeks to help you design your policy proposals or response in a way that meets your objectives, without unduly limiting or damaging opportunities for small businesses. The process begins when ideas and options are first developed, well before the publication of any consultation document, and concludes when the "Final Proposal" is published alongside any legislation or other implementing measure.

The Government announced a new approach to regulating small firms in the 2008 Enterprise Strategy⁵. Under this approach, policy makers are required to consider whether alternative approaches (e.g. simplified inspection, less frequent reporting, exemptions) are appropriate for firms with fewer than 20 full time employees. Note that this is not a hard and fast limit - Departments are expected to look pragmatically at the sector(s) affected by their measure and make a judgment on a sensible threshold for potential alternative arrangements. Therefore alternative approaches may be considered for firms with, for example, fewer than 5 or 17 employees or more. A more flexible approach should help to deliver better policy outcomes and minimise costs for smaller businesses.

For legislation laid from the beginning of the Parliamentary session 2008/09, policy makers will have to fill in a new section in the Explanatory Memorandum which asks for the information below:

- If and why the legislation applies to small business with fewer than 20 employees.
- What consideration has been given to minimise the impact of the requirements on small firms with fewer than 20 employees.
- The basis for the final decision on what action to take to assist small businesses with fewer than 20 employees and how it was reached.

³ This process is illustrated in the flow diagram at page 2.

⁴ The Chancellor of the Exchequer announced in his March 2007 Budget that "fuller consideration [would be given] to exemptions, either complete or partial, for small firms where possible" [Budget 2007 Chapter 3 Para 3.62].

⁵ Please see the summary of the Enterprise Strategy: <http://www.berr.gov.uk/files/file44993.pdf> (p26)

What are the key stages?

The key stages are:

- **A. Development and Options stage:** An initial sounding of small businesses and their representative bodies to identify/verify the likely impact and solutions before formal public consultation. This is essential for European measures under negotiation as compliance issues for small businesses are often significantly under-estimated.
- **B. Consultation stage:** Where the impact appears to fall more heavily on small businesses – i.e. firms employing fewer than 20, a more detailed exploration of the issues and solutions with representative bodies and small businesses should be undertaken. In addition, separate consideration should be given to:
 - Whether alternative approaches (e.g. flexibilities or exemptions) are appropriate for firms with fewer than 20 employees; and
 - Whether small businesses (those with fewer than 50 employees) can be given a “complete or partial” exemption from the measure, as part of Government’s commitment to target regulation only where it is needed.

This step should take place ahead of the public consultation to ensure the issues are scoped and set out fully in the consultation documents (including the IA).

- **C. Final Proposal stage:** Assessing and reflecting the representations made by small businesses during the consultation in the Final Proposal, including making any necessary changes to ensure that the policy is properly targeted and adapted to the needs of small businesses.

How BIS’s Enterprise Directorate can help

Consulting small businesses is not an easy task and as a general rule, the smaller the business, the more difficult it is to consult them. A scattergun approach is unlikely to be successful. Running a small business is tough and few are likely to have the time to respond. Many rely on trade associations to represent their views but many more are unlikely to be members of any representative organisations. The SFIT helps you to deal with these issues head on.

The Guidance on the following pages should provide sufficient tools to successfully undertake the SFIT. If you are consulting a sector you already regulate or oversee, the likelihood is that you will have some idea of representative firms or bodies to contact. Enterprise Directorate can however provide further assistance and advice in this area and can help facilitate further consultation with small businesses.

The Government has committed to conduct a Small Firms Impact Test on all measures affecting business and any IA lacking a SFIT will be regarded as deficient. Enterprise Directorate (formerly the Small Business Service) will advise the Secretary of State for Business Enterprise and Regulatory Reform against giving policy clearance to any policy proposal where no adequate SFIT has been conducted. The Government has decided that Enterprise

Directorate (formerly the Small Business Service) is expressly entitled to have its assessment of the impact of a proposal on small businesses included in the final IA, before it goes to Ministers for consideration.⁶

The Small Firms Consultation Database

Enterprise Directorate maintains a database of owners and managers of small businesses who have expressed an interest in working with policy officials during the policy development stage. The database allows Enterprise Directorate to contact Micro, Small and Medium sized businesses on behalf of policy officials to gauge the potential impact of proposed regulations.

This free-to-use service can be useful as a point of contact for all stages of the Small Firms Impact Test, for example when recruiting participants for focus groups, test panels and workshops.

Consultations can be tailored in several ways, including targeting specific industrial sectors, geographic regions, and business sizes. You may therefore need to send a short questionnaire to a sample of businesses. If this is the case, the approach will need to be discussed and cleared with your departmental Survey Control Unit.

The normal arrangement is for respondents to send comments direct to the officials leading the work. For further information, contact Yeolanda Lopes, on 020 7215 5266 or email regulation@bis.gsi.gov.uk.

⁶ Evaluation of Regulatory Impact Assessments Compendium Report 2004-05 Chapter F page 21
http://www.nao.org.uk/publications/0405/regulatory_impact_assessments.aspx

Detail

Why small businesses need particular consideration

Most businesses are small businesses. Small businesses make a major contribution to the health of the economy and to diversity of opportunity in our society. There are over 4.7 million enterprises in the UK. Small enterprises and self-employed sole traders represent well over half of private sector jobs and make up 52% of UK turnover. Whilst there are over 1.2 million businesses in the UK employing staff, there are only 6,000 firms employing 250 or more people. Small Businesses make an important contribution to improving the productivity of UK business. New entrants and growth businesses enhance competition by challenging incumbent businesses; and they are an important source of innovation and new ways of doing things. The vitality of the small business sector is therefore critical to the Government's objective to raise the rate of UK productivity growth and narrow the productivity gap between the UK and France and Germany.

Why do regulations cost small firms more than larger businesses?

New regulations will involve the use of owners' time in understanding the regulation; implementing and monitoring compliance with the regulation; purchasing new equipment or obtaining new supplies; and in dealing with the relevant Regulatory body or Inspectorate. Staff time is a critical cost driver because research shows that in very small firms with fewer than 5 or 10 staff, regulatory responsibilities are dealt with personally by the owners of businesses. Although business owners tend to value their time relatively cheaply, this is typically two to three times the cost if the tasks could have been delegated to employees, as would be the case in larger small firms and medium and large firms. In addition business owners are not regulatory specialists and they can, therefore be expected to take longer than average to digest and understand government documents about the impact of new regulations. Proportionally very few are members of trade associations or similar bodies.

Where a proposed regulation requires the purchase of equipment or supplies to comply, these are usually relatively more expensive for small firms because they lack the economies of scale that would enable them to use equipment intensively. In addition because the cost of capital of small firms is substantially greater (by a factor of two or three) than for larger firms, investment in assets is more expensive.

Similar comments apply to the fixed costs associated with sourcing new supplies (or suppliers) and the prices that small firms can negotiate will generally be higher than for businesses able to purchase larger volumes, that are probably also regarded as a better credit risk to their suppliers.

When a proposed regulation results in the utilisation of additional factory, office or car park space e.g. for new equipment or storage facilities, costs will also be relatively higher for smaller firms. This is because premises costs can be disproportionately higher for small firms (e.g. because the cost of business rents and rates is strongly regressive).

Where a regulation could increase small firms' overheads in any other way, their costs are likely to rise more than their prices, because the majority of small firms are "price takers" in the market. Thus, even where prices rise in response to a new regulation, if small firms are competing with larger businesses, the proportionate price increase will probably reflect the lower additional costs of regulation that large firms bear, thus squeezing small firm margins. Where international competitors are involved prices may not rise at all. The impact of regulations on suppliers and customers may also be borne by small firms because of their relative dependence on a limited customer and product base. Put simply, small firms have less freedom to negotiate hard with important customers and suppliers, the loss of any one of which could cause a small business to fail.

If there will be a period of uncertainty for small firms, e.g. during a period when understanding of the requirements and best ways of managing the new regulation are being developed and disseminated, then evidence shows that this will create psychological costs for business owners that may mean that they will assume the responsibilities of the regulation are more onerous than is actually the case, thus further increasing the costs of compliance.

Small firms are also more likely to have to compete with businesses in the informal sector, who are not compliant, once more squeezing the margins of compliant businesses.

Finally, high compliance levels with new or changed requirements are unlikely to be achieved unless full account is taken of the practicalities confronted by small business people. A “one-size fits all” approach to regulatory or policy problems is often unlikely to be appropriate.

Business with fewer than 20 employees

Many of the issues outlined above can affect very small firms to a much greater extent. For example, in relation to staff time, research shows that in firms with fewer than 5 or 10 staff, regulatory responsibilities are dealt with personally by the owners of the business. In addition, very small businesses may face additional issues such as shared premises or lack of specialised HR expertise for example. Business models do not suddenly change when people move from the definition of micro into being classified as small businesses. That is why the Government’s new approach to regulating small firms asks you to look at those who may struggle more to meet requirements than businesses which employ 50 people.

Although the new approach involves assessing alternative options for firms with fewer than 20 employees, it should be noted that this is not a hard and fast limit - Departments are expected to look pragmatically at the sector(s) affected by their measure and make a judgment on a sensible threshold for potential alternative arrangements.

A. Development and options stage – Starting the Small Firms Impact Test:

You should begin the assessment by considering whether the measure will affect small firms either directly or indirectly (e.g. by causing behavioural changes by competitors, suppliers or customers.) If there is likely to be an effect you should use the SFIT to help assess its scale and the extent of any differences in impact between large and small firms.

A proposal may have a significant or greater impact either directly, e.g. a flat fee will bear more heavily on small businesses than large, or indirectly e.g. small businesses will be unable to adapt processes or buy new equipment in the proposed timeframe, as equipment may be replaced less often. This initial stage of the SFIT involves sounding out a number of small businesses to obtain their comments on the proposal. You should explain your policy proposal and outline the possible options for implementation (which may reflect alternative approaches for firms with fewer than 20 employees or exemptions for firms with fewer than 50 employees – see below for more on this). If the measure is confined to a specific sector or industry, you may already be familiar with the representative bodies and trade associations and should consider contacting them too⁷.

Where the impact of the proposal appears to fall more heavily on small businesses, you should contact Enterprise Directorate at regulation@bis.gsi.gov.uk, who will try to provide policy advice and assistance. Enterprise Directorate can also provide assistance on consulting small businesses (including those with fewer

⁷ See Annex C for a list of the major small business representative bodies

than 20 employees). It maintains a database of small businesses willing to take part in policy development.⁸ If the proposal appears likely to fall more heavily on smaller businesses, you should identify and explore more fully the impact so that these issues can be fully identified in the consultation document. The SFIT aims to help clarify thinking about implementation and the reasons behind your proposed arrangements.

As well as the aspects of your specific measure you must also consider:

- i. Whether alternative approaches (e.g. flexibilities or exemptions) are appropriate for firms with fewer than 20 employees⁹; and
- ii. Whether small businesses (those with fewer than 50 employees) can be given a “complete or partial” exemption from measure, as part of Government’s commitment to target regulation only where it is needed.

The Regulator’s Compliance Code, which came into force on 6 April 2008, provides practical examples of a risk-based, proportionate, targeted and flexible approach to regulatory inspection. For further details visit - <http://www.berr.gov.uk/files/file45019.pdf>

Exemptions from regulation are another tool for improving the quality and effectiveness of regulation by helping tailor provisions to meet the circumstances of small businesses, for example relieving them of the most complex obligations which may only be appropriate for much larger operations.

In some circumstances policy outcomes can still be achieved even when small firm exemptions are established. For example consider the opportunities for “voluntary compliance” where firms might be accredited as meeting particular standards which might be evidenced by certification or kite marks. Consider too that customer and supplier markets and the labour market may all exert positive influences on businesses.

Exemptions are already encountered in the UK in a number of regulated areas. Firms with fewer than five employees, for instance, are exempt from some health and safety requirements. Other exemptions apply to such areas as union recognition, company abbreviated accounts, and publication requirements in directors’ reports.

There are a number of issues that will need to be explored in assessing whether alternative approaches may be appropriate for smaller firms, including what the appropriate size threshold should be. Although the relevant issues will differ according to the policy in question, some of the more generic issues that need exploring include:

- How serious is the problem the proposal seeks to address in relation to smaller firms?
- Is there likely to be a greater impact on the operations and performance of small business than others?
- Are there alternative approaches for smaller firms (including, but not limited to, exemptions, simplified inspections, less frequent reporting), which would not materially affect the potential benefits from the policy?
- Are there any potential unintended effects associated with alternative approaches for smaller firms?

⁸ For further information on accessing the database see page 7

⁹ Note that this is not intended to be a hard and fast limit - Departments are expected to look pragmatically at the sector(s) affected by their measure and make a judgment on a sensible threshold for possible tailored/alternative arrangements.

Exemptions and additional flexibilities can have unintended effects and these will need to be explored in detail when considering alternative approaches, in conjunction with your departmental economists. For example, a full exemption for firms below a certain threshold (above which firms need to fully comply with the measure) can create barriers to expansion for firms operating just below the threshold. Such firms may decide not to expand their operations if the increase in compliance costs, as a result of crossing the compliance threshold, results in a significant increase in costs¹⁰. A phased approach (where the degree of compliance increases incrementally with the size of the firm) could result in lower barriers to expansion compared to a full exemption.

- iii. The potential Annual Costs per organisation minus benefits;
- iv. Possible non-regulatory alternatives such as industry codes of conduct; and
- v. Any unintentional effects of the measure.

When a proposal's impact on small businesses is more complex you should complete this stage of the Small Firms Impact Test using face-to-face methods. Where possible, meet those whose views you seek at their business places, and consider focus groups or impact test panels¹¹. The IA should cover the points above and detail the following:

- The size, sector and location of the companies consulted;
- The small firms representative organisations who were consulted;
- How your discussions influenced your policy options.

How do I work out the annual cost per organisation?

The Impact Assessment template calls for officials to assess the annual costs of a new or amended regulation for micro, small, and medium businesses. Undertaking the SFIT can help you complete this task. When quantifying the costs and benefits to small firms a proper distinction should be made between the self-employed/single company directors without employees and those that employ.

By working with businesses through focus groups or other consultative methods, officials should explore quantify and highlight the impact of the proposal on small firms specifically.

This involves:

- quantifying the costs and benefits for self-employed/single company directors without employees, micro, small, and medium businesses, including more extensive consultation with a sample of representative firms, and data analysis on the number of affected firms and;
- listing any possible unintentional or offsetting effects that exist – for example, tighter controls could result in SMEs facing greater competition from illegal traders or businesses from overseas. It may also result in greater risk of non-compliance due to increased regulatory complexity or regulatory overload.

¹⁰ For example, consider a regulation that imposes costs on firms in proportion to the number of workers employed. Assume compliance costs are approximately £10 per worker employed and firms with less than 10 employees enjoy a full exemption. If a firm with 9 employees wants to expand operations and employ an additional worker, the increase in compliance costs faced by that firm as a result of employing one additional worker will amount to £100.

¹¹ See Annex D for details of running focus groups

Ideally, analysis should be quantitative because this provides the most objective basis for making a decision. Qualitative information, such as quotes and anecdotes, can be used when quantitative information is not available and recorded in the SFIT section of the IA.

Estimating impacts¹²

According to the Small Business Research Trust survey (2001), a small business with 10-14 employees spends 31 hours a month complying with government regulation and paperwork, while an owner of a business with 50 or more workers needs 43.4 hours a month to comply.

An important step in estimating the impacts of a proposal involves estimating the number of affected firms by firm type or regulatory event. This is then multiplied by the estimated impact per firm to estimate the aggregate impacts of the proposal for small business.

An important addition to the new impact assessment is the separate calculation of admin burdens. It must be borne in mind that admin burdens are only one aspect of the total costs that should be reflected in an impact assessment. **In addition to the admin burden the IA needs to include estimates of any one-off costs (minus benefits) from the implementation of the policy, as well as policy or financial costs.** The cost of adopting systems may also be significant. The distribution of all of these costs needs to be examined over the range of firm sizes (See Annex A and Annex B).

¹² See Annex B on breakdown of businesses, sectors and hourly rates

Issues to consider in estimating impacts

The assessment of the impact on small business should include consideration of the following issues:

- the variation in the regulatory burden between a self-employed/single company directors without employees, micro, small, medium and a large business;
- whether compliance flexibility options could assist a micro, small, medium business to meet the requirements of the proposal;
- the distribution of benefits of the proposal between a self-employed/single company directors without employees, micro, small, medium business;
- the extent of compliance by a self-employed/single company directors without employees, micro, small, or medium business versus large business; and
- the relative impact on a self-employed/single company directors without employees, micro, small, or medium business of penalties for non-compliance – for example, by expressing costs as a percentage of turnover.

You do not need to consult with a large number of businesses to obtain this information. A small sample that is representative of the industry should be sufficient.

B. Consultation stage

BIS's Better Regulation Executive provides guidance on consultation that is, available from <http://www.berr.gov.uk/bre/consultation%20guidance/page44459.html> and a Code of Practice on consultation, available from <http://www.berr.gov.uk/files/file47158.pdf>

Consultation approaches

The detailed consultations in this step should generally take place during the development process or before the public consultation phase of the IA process.

Preparing for full public consultation

There are a range of consultative approaches that can be used to elicit information on the impacts of a proposal on small business, including one-to-one interviews, telephone interviews, focus groups, postal or online questionnaires and written submissions. The most appropriate approach will depend on the issues under consideration, the nature of the group being consulted, and the resources and time available for undertaking the consultation. The information obtained during the development stage should provide a good basis for articulating the questions you would like businesses to consider during formal consultation.

Consultation documents

When Government consults on policy, it needs to properly explore different approaches to regulating small firms, and give an explanation of the intended approach to small firms. From October 2008 future consultation documents should contain an assessment of the scope to minimise the impact of the requirements on small firms, showing what simplified inspection, less frequent reporting, exemptions etc for businesses with fewer than 20¹³ employees have been considered. There will remain instances where policy and legal reasons necessitate that

¹³ Note that this is not intended to be a hard and fast limit - Departments are expected to look pragmatically at the sector(s) affected by their measure and make a judgment on a sensible threshold for possible tailored/alternative arrangements.

small firms are encompassed by measures but the presumption will be against their inclusion. The IA published alongside the consultation should reflect the findings of the work undertaken in the development stage.

C. Final Proposal stage

When the consultation is concluded you will need to obtain final policy clearance and produce a final IA. The final IA should include full details of the reactions and issues that have arisen during the consultation, an update of the assessment of the impact on small firms, together with your analysis and an explanation of your policy response.

If your policy proposal has changed substantially because of the consultation leading to either a widening of scope or increased burden, you should reconvene focus groups. Ideally, this should include small businesses who have already taken part in the earlier discussions since they will be familiar with the policy goal and options for implementation.

Enterprise Directorate will advise the Secretary of State for Business Enterprise and Regulatory Reform against agreeing any policy proposal where no adequate SFIT has been conducted. The Government has decided that Enterprise Directorate is expressly entitled to have its assessment of the impact of a proposal on small businesses included in the final proposal stage before it is sent to Ministers for sign off.

Small firms and the Explanatory Memorandum

Going forward, as part of the Government's commitment to changing the way it regulates small businesses with fewer than 20 employees, policy makers will need to fill in a new section in the Explanatory Memorandum (EM) which asks for the following information:

- The legislation [applies to or does not apply to] small business.
- To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is [free text].
- The basis for the final decision on what action to take to assist small business [free text].

To view guidance visit: <http://www.opsi.gov.uk/si/statutory-instrument-practice.htm>. To see an example of a completed EM see Annex E.

- This applies to **Secondary legislation** laid from the beginning of the next Parliamentary session 2008/09 that impacts on business.
- This applies to **Primary legislation** coming into effect from the Parliamentary session starting in 2009/10.

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What is a small business?

There is no single definition of what constitutes a small business or “SME”. The simplest approach, and that adopted in the Small Firms Impact Test, is to regard all businesses having fewer than 250 full-time (FTE) employees as being SMEs. Except for the technical description given in the paragraph below the term “small business” is used in this document generically to mean micro, small or medium enterprises or SMEs with fewer than 250 full-time equivalent employees.

The vast majority of SMEs (over 95%) have fewer than 10 employees and you should make a concerted effort to consult them. It is often appropriate to distinguish between the categories of micro, small and medium-sized businesses.

UK SME statistics are split into the following categories:

- Sole Trader
- 1-9 (micro)
- 10-49 (small)
- 50-250 (medium)

The majority of sole traders are self-employed but they also encompass companies with 1 employee and partnerships. You should therefore consider how the proposed legislation impacts on different legal structures.

The European Commission¹⁴ follow the categorisations below:

- Micro-businesses – those with fewer than 10 FTE employees
- Small businesses – those with fewer than 50 FTE employees
- Medium-sized businesses – those with fewer than 250 FTE employees
- Large businesses – 250 employees or more

Social Enterprise

When defining and targeting small businesses it is also important to include non profit distributing businesses such as social enterprises, which are frequently SMEs. These organisations may face different impacts from regulatory reform due to their social mission, legal structure and governance.

Social enterprises are defined as businesses with primarily social or environmental objectives, principally reinvesting surpluses in the business or community.

¹⁴ OJ L 124, 20 May 2003, p36-41 accessible via

http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/index_en.htm
or http://europa.eu.int/comm/enterprise/enterprise_policy/sme_definition/index_en.htm

Breakdown of businesses and sectors

The following information and tables can help when estimating impacts¹⁵:

- There are 4.7 million businesses in the UK;
- Almost all of these enterprises (99.3 per cent) are small. Only 27,000 (0.6 per cent) are medium-sized and 6,000 (0.1 per cent) are large.

Table 1: **Breakdown by business size**

| Micro, small and medium size businesses (2007) | |
|---|--|
| Business size (number of employees) | Total number of businesses¹⁶ |
| Zero | 3,460,360 |
| 1-9 (micro) | 1,019,295 |
| 10-19 | 111,165 |
| Zero to 19 employees | 4,590,820 |
| 10-49 (small) | 166,820 |
| 50-249 (medium) | 26,690 |
| 250+ | 5,920 |

UK private sector enterprises employed an estimated 22.7 million people at the start of 2007, an increase of 332 thousand (1.5 per cent) since the start of 2006.

Estimated employment in SMEs has risen from 13.2 million at the start of 2006 to 13.5 million people at the start of 2007, or from 58.9 to 59.2 per cent of all private sector employment.

At the start of 2007, UK enterprises had an estimated combined annual turnover of £2,800 billion, an increase of £181 billion (6.9 per cent) since the start of 2006.

Turnover in SMEs is estimated at £1,440 billion, £83 billion (6.1 per cent) higher than 2006. As a proportion of all private sector turnover, this has decreased slightly from 51.9 per cent to 51.5 per cent.

¹⁵ These figures relate to the start of 2007. Source <http://stats.berr.gov.uk/ed/sme/>

¹⁶ Source: [BIS](http://stats.berr.gov.uk/ed/sme/) Small and Medium Enterprise Statistics 2006, available at <http://stats.berr.gov.uk/ed/sme/>

In terms of the sectors small businesses are active in, the breakdown is as follows:

Table 2: **Small Businesses in the Economy**

| Small Businesses in the Economy | Number of Businesses¹⁷ | Number of businesses with fewer than 20 employees (inc. zeros) | Percentage |
|--|--|---|-------------------|
| Agriculture; Fishing | 168,000 | 168,000 | 4% |
| Mining, Utilities | 13,000 | 13,000 | 0% |
| Construction | 978,000 | 970,000 | 21% |
| Wholesale, Retail, Repairs | 562,000 | 546,000 | 12% |
| Hotels and Restaurants | 150,000 | 142,000 | 3% |
| Transport, Communication | 298,000 | 293,000 | 6% |
| Financial Intermediation | 67,000 | 65,000 | 1% |
| Business Services | 1,131,000 | 1,115,000 | 24% |
| Education | 163,000 | 161,000 | 3% |
| Health and Social | 274,000 | 263,000 | 6% |
| Other services | 528,000 | 524,000 | 11% |
| Manufacturing | 348,000 | 329,000 | 7% |

Table 3: **Hourly rates**

| Hourly rates | |
|---------------------|--------|
| Director | £78.84 |
| Senior Manager | £61.32 |
| Middle Manager | £42.33 |
| Junior Manager | £32.12 |
| Clerical | £20.41 |
| | |

¹⁷ Source: [BIS](http://stats.berr.gov.uk/ed/sme/) Small and Medium Enterprise Statistics 2007, available at <http://stats.berr.gov.uk/ed/sme/>

Small Business Representative Organisations

Federation of Small Businesses

2 Catherine Place
Westminster
London
SW1E 6HF
Tel: 020 7592 8100
Fax: 020 7233 7899
Email: <mailto:london.policy@fsb.org.uk>
Website: www.fsb.org.uk

Confederation of British Industry

Centre Point
103 New Oxford Street
London
WC1A 1DU
Tel: 0207 395 8125
Fax: 0207 379 0945
Website: <http://www.cbi.org.uk/>

Institute of Directors

116 Pall Mall
London
SW2Y 5ED
Tel: 0207 451 3103
Fax: 0207 839 2337
Website: www.iod.com

British Chambers of Commerce

65 Petty France
St James Park
London
SW1H 9EU
Tel: 020 7654 5800
Fax: 020 654 5819
Email: info@britishchambers.org.uk
Website: www.britishchambers.org.uk

The Forum for Private Business

Ruskin Chambers
Dury Lane, Knutsford
Cheshire
WA16 6HA.
Tel: 01565 634467
Fax: 0870 241 9570
Email: info@fpb.org
Website: <http://www.fpb.co.uk/>

The Social Enterprise Coalition

Southbank House
Black Price Road
London
SE1 7SJ
Tel: 020 7793 2323
Fax: 020 7793 2326
Email: info@socialenterprise.org.uk
Website: <http://www.socialenterprise.org.uk>

Tips and Suggestions on Running Focus Groups and Test Panels

1. What is a focus group?

A focus group or “test panel” is a group of individuals having a common interest, brought together to gain information about a specific issue. In the case of the Small Firms Impact Test, this will be made up of either owner/managers of small businesses, representatives of business representative organisations or relevant Trade Associations. The information gathered is qualitative (opinions, insights and personal responses) rather than quantitative. Focus groups provide an opportunity to identify respondents’ true feelings about the issue and options under discussion. They are an excellent way of getting interactive feedback from small businesses and often generate thoughts and responses that might not have come from simple interviews, in the same way that brainstorming can lead to many ideas on a particular issue. The results can help inform the development of policy options and also the best way of implementing them e.g. drafting a new regulation is not the only or perhaps the ideal way of achieving a policy objective.

Participants are selected because they have certain characteristics in common that relate to the topic of the focus group.

2. When to use focus groups

Focus Groups Should be used at the development stage where the intention is to “sound out” a policy proposal and also again where, as a result of initial “soundings”, it is decided that the impact on small firms may be disproportionate.

The results of both these approaches should be recorded in the IA and used to inform the options/questions contained in the published in the IA constituting part of the formal public consultation document.

Focus groups can also help policy makers to: assess whether alternative approaches (including, but not limited to, exemptions, simplified inspections, less frequent reporting) may be appropriate for smaller firms; and help identify possible unintended consequences of a policy proposal, both of which should also be recorded in the IA.

It is important to recognise that consulting small businesses is not always easy and unless you conduct such meetings frequently, consideration should be given to buying in professional expertise in organising, running and chairing your focus group. A degree of commitment is definitely required. Nevertheless, it is very important that policy makers do so as 95% of all businesses have 10 or fewer employees. And most recent business growth has been in this “micro” sector; one-person companies or businesses that employ fewer than 10 people. Legislation has a greater effect on these small businesses, as they have few internal resources to deal with complicated compliance issues. Whilst there is no hard and fast rule about when to hold a focus group, it is essential that, focus groups should be held early in the policy formation process i.e. at the development IA stage. The greater the impact of a policy proposal on small businesses – then a correspondingly greater effort should be made to consult them. Focus groups should normally be used as an integral part of the consultation process and their use and findings should be recorded in the IA. Policy makers should be prepared to defend their decision not to use a focus group.

3. How to set up a focus group

- Decide what you want to consult about and/or what information is needed.

- Select participants who can provide relevant feedback or information. Characteristics such as location, firm size, sectors etc are important. The participants should be as representative of those potentially affected as possible.
- Consult small firms' representative bodies (such as FSB, BCC, Forum of Private Business etc – see list at Annex C) and also talk to relevant sector specific trade associations.
- Many small businesses are not part of any representative organisation and it is also very important to seek their views.

BIS Enterprise Directorate recognises that this is not always easy to engage small businesses and in order to assist policy makers, we have set up a SME database which holds the details of nearly 4,000 firms with the majority having less than 10 employees, who have volunteered to take part in focus groups, test panels, steering groups, questionnaires or telephone interviews. The database represents most sectors, sizes and types of businesses, in all regions. Further information on the Small Firms Consultation Database can be obtained from:

Enterprise Directorate
 Department for Business, Innovation and Skills
 1 Victoria Street
 London
 SW1H 0ET
 T: 020 7215 5266
 F: 020 7215 6768
 E: regulation@bis.gsi.gov.uk

Focus group size should ideally be around 7-15. Groups of over 15 are generally too big to allow everyone to participate effectively whilst groups with fewer than 4 generally do not have wide enough experience.

More than one focus group may be needed e.g. if more than one sector is likely to be affected by a proposal: it is important to ensure that all key views and information is gathered. It is also important to ensure that geographical differences are taken into consideration e.g. it would not be best practice to hold focus groups comprising of businesses solely based in London or the South East. Ideally participants should not be familiar with each other (those who know each other tend to form a small inner discussion group).

- Contact potential participants to invite them to the meeting, include an agenda, session time, background paper explaining the issues and a list of questions the group will be asked to discuss.
- **Important** – When conducting a focus group before any potential policy proposal has been made public it is important to seek a commitment of confidentiality from those invited to participate. This should be sought before hand in writing (a standard form of words for a return/confirmation slip to be enclosed with the letter of invitation is at Annex B) and before the agenda with the list of specific questions is sent out.
- Provide a copy of the report from the session to participants and let them know beforehand that you will do this.
- About three days before the session, call participants to remind them to attend.

Questions should be carefully planned but appear spontaneous during the session. The amount of questions asked will depend on circumstances, however, for best results, a focus group session should include around five or six key questions and preferably not more than ten. They should follow the rules of a natural conversation, ranging from broad to narrow subject matter, and in logical sequence. Use open-ended questions (who, what, when, how and why) and avoid “yes” or “no” questions.

Possible areas for discussion

- What is your view of the overall concept of the Government's proposals for...?
- What do you perceive to be the costs and benefits?
- Are there other approaches Government could use as an alternative to regulation?
- Are there alternative (regulatory) approaches Government could adopt in relation to smaller firms e.g. less frequent reporting, simplified inspection, shorter forms, longer implementation periods etc?
- What are your views if Government exempted micro and small businesses? You will need to explore: 1) The extent to which this could affect the potential benefits associated with the proposal; 2) Whether exemptions could create unintended consequences (such as barriers to expansion); and 3) what the most appropriate threshold for any exemption might be. Note that exemptions can be full or partial and phased approaches (where compliance increases incrementally with firm size) are also possible.
- How does the proposed approach differ from what you already do?
- What plans would your business have to make before and after implementation to comply with the proposed measure?
- Would it change how your business operates generally, and how it relates to other businesses and consumers?
- Do you consider the proposals to be an opportunity or a challenge/threat to your business/the industry as a whole? Explore what the opportunities, challenges/threats are, and reasons for this.
- Who will be in a better position to exploit opportunities and respond to threats – small businesses or larger organisations?

4. Running the focus group

It is helpful to have a few short ground rules

- Keep focused!
- Maintain momentum
- Get closure on questions

Consider the following;

- Welcome,
- Review of agenda,
- Explanation of goal,
- Ground rules,
- Questions and answers,
- Wrap up.

Plan meetings to last between one and a half and two hours. People who run small businesses are often very busy, so timing of the focus group is important. Consider holding an early morning breakfast meeting or an evening meeting. Lunchtime may also be an option. Food and refreshment should be provided. Hold meetings in a conference room, or other setting with adequate airflow and lighting. Configure chairs so that all members can see each other. Provide name cards or badges.

The main role of the "moderator" or "chair" is to maintain the focus of the group. Although the session should appear to be unstructured to participants the chair needs to direct the discussion in order to gather the information required. They will be expected to introduce and explain the purpose of the group without influencing

the results. It is also important for them to be unbiased and open to information, allowing participants to express their views freely.

At the outset, the chair will need to reassure participants of the confidentiality of responses and make them feel comfortable enough to converse with each other. The conversation must be kept flowing, ensuring that everyone has their say and single speakers must not be allowed to dominate.

The chair can be a policy official. If the impact of the proposal is likely to be highly significant, an external/professional moderator could be brought in. If so, they will need to be appropriately briefed. Chairs need good interpersonal, communication and listening skills. Should be energetic, organised, sympathetic, and capable of enthusing the discussion, whilst at the same time maintaining control of the session. They should also be a clear and concise speaker.

The chair should keep the discussion on track without inhibiting the flow of ideas and comments and ensure that all group members contribute to the discussion and must avoid letting one participant's opinions dominate.

The chair should conclude the session by thanking everyone for participating. They may choose to summarise what was said and ask if anything was missed.

The meeting should be taped and transcribed (with the permission of participants). Responses provided should not be attributed to specific individuals/companies.

5. After the session

A summary of the discussion should be written up. Points to consider are:

- Participant characteristics;
- Descriptive phrases or words used by participants as they discussed the key questions;
- Themes emerging in response to the key questions;
- Views held by participants with common characteristics;
- Any changes in the list of questions;
- New avenues of questioning that should be considered in future – should questions be revised, eliminated etc.

When conducting an analysis consideration should be given to four factors:

- Words used and in what context;
- Responses and their degree of specificity. Responses that are specific and based on experiences should be given more weight than responses that are vague and impersonal; and
- Cross cutting trends and ideas, which emerge through out the session.

The results of the focus group will usually be qualitative in nature and not quantitative. Thus the information gathered will be descriptive. Statements by participants can be categorised by themes or summarised with illustrative examples. When undertaking an analysis of the discussion it is important to draw out and highlight the implications of the policy proposal in respect of the various options detailed in the Small Firms Impact Test and fed into the choice of options of the IA. The summary paragraphs for inclusion in the IA should reflect the discussion and conclusions reached. Any unresolved issues can be explored by adding questions to the consultation document as part of the formal consultation phase.

Care should be taken to ensure confidentiality of focus group members.

Enterprise Directorate
January 2009

Draft

HM GOVERNMENT CONSULTEES PANEL

Confidentiality undertaking

Undertaking

I, the undersigned, understand that in agreeing to join the panel of consultees/workshop/test panel, I will have access to confidential information that cannot be disclosed to any other party.

Signed.....

Name in Capitals.....

Position.....

Date.....

EXPLANATORY MEMORANDUM – An Example

Companies Act

11. Regulating Small Business

11.1 This legislation does apply to small businesses.

11.2 To minimise the impact of the requirements on firms employing fewer than 20 employees the approach taken by us will set:

- New thresholds and exemptions in accounting and reporting requirements for very small businesses;
- Private companies will not be required to have a company secretary;
- Private companies will not need to hold an annual general meeting unless they positively opt to do so;
- It will be easier for companies to take decisions by written resolutions and;
- There will be simpler rules on share capital, removing provisions that are largely irrelevant to the vast majority of private companies and their creditors.

11.3 The basis for the final decision on what action to take to assist small businesses was based on talking to representative organisations for small businesses to ask them for their views and a series of workshops with small businesses to identify areas where they faced challenging issues as a result of proposed regulation. As a result of this consultation it was possible to identify areas where taking a different approach to small business would be appropriate.

NOTES