



Federation of Small Businesses
The UK's Leading Business Organisation

Mr Sean Browne,
Department for Business, Innovation and Skills,
1 Victoria Street
London.
SW1 0ET

30 June 2015

Dear Mr Browne

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the BIS call for evidence on the protection of small businesses when purchasing goods and services.

The FSB is the UK's leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. The FSB is non-party political, and with around 200,000 members, it is also the largest organisation representing small and medium sized businesses in the UK.

Small businesses make up 99.3 per cent of all private sector businesses in the UK, 47.8 per cent of private sector employment and 33.2 per cent of private sector turnover.

We trust that you will find our comments helpful and that our comments will be taken into consideration.

Yours sincerely,

Ken Moon

Chairman,
FSB Regulation Committee



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PROTECTION OF SMALL BUSINESSES WHEN PURCHASING GOODS AND SERVICES: CALL FOR EVIDENCE

2015





FSB response to the BIS: 'Protection of small businesses when purchasing goods and services: call for evidence'

1. Introduction

The FSB welcomes this call for evidence by BIS regarding the principle and practicality of offering new protections to small businesses when purchasing goods and services for their business.

1.1 The importance of small businesses to the economy

Small businesses make a vital contribution to the UK economy. The latest BIS estimates suggest that:

- Small businesses make up 99.3% of the 5.2 million private sector businesses.¹
- Those 5.2 million businesses account for 48% (12.1million) of UK private sector employment.²
- The combined annual turnover of small businesses in the UK is £1.2 trillion or 33% of total private sector turnover.³

Small businesses have contributed significantly to net job growth in the economy over a long period of time. For example, between 1998 and 2010 existing small businesses created 34% of new jobs, while start-ups created a further 33%.⁴ In total 67% of new jobs were created by small businesses over this period.

The self-employed are a particularly vulnerable group of businesses. To understand why measures which protect them might be beneficial it is useful to have a picture of their significant contribution to the economy:

- Businesses with no employees make up 76% of all private sector businesses and make up 17% of private sector employment.⁵
- The self-employed have constituted the main source of business growth since 2000, accounting for 91% of business growth.⁶

1.2 The benefits of treating small businesses as consumers

The importance of small businesses to the UK means that measures which help nurture small businesses and enable their success can result in significant gains for the British economy. This submission will aim to show that:

- The smallest businesses i.e. the self-employed and micro-businesses in particular (from here-on referred to as 'micro-businesses' or 'vulnerable businesses') display behaviour and receive treatment from other businesses in

¹ Rhodes C (2015). 'Business statistics: Briefing Paper No 06152'.

² Rhodes C (2015). 'Business statistics: Briefing Paper No 06152'.

³ Rhodes C (2015). 'Business statistics: Briefing Paper No 06152'.

⁴ BIS (2013). 'SMEs: the Key Enablers of Business Success and the Economic Rationale for Government Intervention'.

⁵ Rhodes C (2015). 'Business statistics: Briefing Paper No 06152'.

⁶ Rhodes C (2015). 'Business statistics: Briefing Paper No 06152'.



the key infrastructure (regulated) industries that places them closer to consumers than to the typical-business, on the spectrum of market actors.⁷

- Micro-businesses in particular (but also slightly larger businesses in some cases) are vulnerable market actors. This is as a consequence of their inherent capability constraints related to time, size, behavioural biases and resource limitations.⁸ Policy should reflect this state of affairs.
- Micro-businesses suffer detriment particularly in key sectors such as energy, telecoms and financial services. This is in part due to the constraints within which they operate in combination with the market structures which prevail in those sectors. Consequently business-to-business (B2B) markets are not as efficient as they might be. The result is that many businesses are not getting the most value-for-money from the goods and services they are purchasing to enable them to run their businesses.
- Reflecting the unique position of micro-businesses as market actors in public policy could deliver efficiency benefits for B2B markets and the economy as well as individual businesses.

Commissioned by the FSB, a report by Amelia Fletcher et al in 2014 evaluated the strength of the evidence for looking at micro-businesses differently to larger businesses in the context of B2B markets for goods and services.⁹ The report found that there are a number of key behavioural characteristics displayed by micro-businesses in markets that are close to those which consumers display.¹⁰ It further found that businesses selling to micro-businesses often treat them in a way distinctly different from how they treat larger businesses.¹¹ In other words many micro-businesses suffer from a number of 'vulnerabilities' similar to those that consumers are widely understood to also suffer from.^{12 13} As a consequence markets often fail to deliver the best outcomes for micro-businesses.

This led Fletcher et al to convincingly conclude that policy should treat micro-businesses differently to other businesses for certain purposes.¹⁴ In-turn the nature of those differences between micro and other businesses suggest that the different treatment of the former by the policy framework should be based on lessons learnt from how the consumer policy framework operates.

The ultimate pay-off from policies which reflect the fact that micro-businesses can sometimes be vulnerable market actors could be significant medium and long-term gains for the economy. These would fall into two broad types of gains:

- Wider market efficiencies.
- Specific gains for individual small businesses.

⁷ The term micro-business will be used in this response to mean businesses with less than 10 employees, including the self-employed.

⁸ 'Andreasen, Menzel Baker et al...see [consumer vulnerability as being]...*'a state of powerlessness that arises from an imbalance in marketplace interactions or from the consumption of marketing messages and products'*" cited in Cartwright P (No date given). *'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'*. This description of 'vulnerability' could easily apply to the position of the micro-businesses vis-a-vis complicated products and services, non-transparent sales and pricing techniques and larger businesses.

⁹ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

¹⁰ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

¹¹ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

¹² Cartwright identifies a number of ways in which a consumer can be vulnerable and thus worthy of some protection. These are: Information vulnerability, Pressure vulnerability, Supply vulnerability, Redress vulnerability; and Impact vulnerability. Source: Cartwright P (No date given). *'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'*.

¹³ The principle of 'normative coherence' suggests that micro-businesses should be treated differently to other businesses and more similar to consumers by the regulatory framework. If smaller businesses and in particular the self-employed and micro-businesses are closer to consumers in their behaviour and in the way they are treated by other businesses then it is logical and consistent to acknowledge this in policy terms. Source: Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

¹⁴ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

Table 1 below outlines in more detail the two categories of 'gains' that would accrue from a more nuanced policy regime that recognised that vulnerable businesses required specific protection and support.

Table 1: two categories of gains from treating small businesses like consumers

Wider market efficiencies	Individual gains
<ul style="list-style-type: none"> • More efficient markets for the goods and services required by small businesses by facilitating better and more discriminating purchasing decisions and thus a more vigorous demand-side across many B2B markets. • More efficient micro-businesses with positive consequences for the wider economy e.g. more intense competition in many sectors due to a more sustained competitive challenge from more efficient small businesses. 	<ul style="list-style-type: none"> • Reduced risk of poor purchases by micro-businesses and over-time lower levels of detriment for individual micro-businesses. This means less wasted time and money. In turn this will result in lower costs of doing business and (over-time) higher profitability.

1.3 Existing recognition of the principle

The principle of treating smaller business similar to consumers is not new. Fletcher et al recognised in their report that the principle is already being applied. To varying degrees it happens in the key regulated sectors, such as telecoms, financial services and energy already. However, as the Annex to Fletcher et al illustrates the application of the principle is inconsistent across and within the regulated sectors.

In addition there is the equally important question of how effective the existing rules and current regulatory practices are in relation to vulnerable businesses. This question is particularly pertinent in those instances where some of the rules are in the form of voluntary codes rather than statutory or explicit licence requirements or where the rules are drawn up too broadly:¹⁵

1.3.1 Examples of current practice

Ofcom applies almost all of its current rules to micro-businesses. Although Fletcher et al found some ambiguity in relation to mobile services and the rules regarding the disclosure of information in contracts with public electronic communications services providers.¹⁶ In addition, it should be noted some of the provisions covering both consumers and micro-businesses are voluntary codes e.g. broadband speeds.¹⁷ To help ensure that the communications market delivers for smaller businesses Ofcom recently published an action plan focussed on the SME market for broadband.¹⁸ We welcome this. As Annex I highlights, the communications market in general and broadband in particular is a challenging market for micro-businesses. Therefore we support further action by Ofcom, which builds on their existing approach of regulating in the interests of business as well as consumers.

In contrast to Ofcom, the financial services picture is more mixed. In relation to credit, businesses can expect similar protections to consumers up to a certain value (£25,000) and while the Banking Conduct of Business Sourcebook

¹⁵ An example of this is the Ofgem revised Standards of Conduct for energy suppliers. Published in 2013 these required suppliers to treat small businesses fairly when they are billing, contracting, and switching. These are backed by Ofgem's powers to levy fines if necessary. However, these Standards of Conduct are very loosely defined and it is unclear under what circumstances they would or could be breached.

¹⁶ Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.
¹⁷ Ofcom (2010). '2010 Voluntary Code of Practice: Broadband Speeds', can be accessed at: <http://stakeholders.ofcom.org.uk/telecoms/codes-of-practice/broadband-speeds-cop-2010/>

¹⁸ Ofcom (2015). 'Broadband services for SMEs: assessment and action plan'.



rules cover micro-businesses there are carve-outs e.g. for distance marketing.¹⁹ In relation to insurance products commercial customers are less well protected around issues of disclosure.²⁰ While the Financial Ombudsman Service does cover micro-businesses there is a 'sophistication' criterion which has the potential to create some ambiguity and uncertainty for business.²¹

In energy the picture is less advanced than in the financial services sector. While there are protections for micro-business in relation to some issues the rules tend to be more permissive to suppliers than those which protect consumers. In other areas there appear to be no protections at all e.g. consumers have a good deal of freedom to switch even when they are on a fixed-term contract, while micro-businesses do not.

1.3.2 Building on current practice and filling in the gaps

We believe that the Government should build on the existing practice briefly described above and set out in more detail. The Government's aim should be to develop a more systematic and coherent approach by the regulators for protecting vulnerable businesses.²² This should include the development of a set of over-arching 'vulnerable business' principles to guide regulatory practice. Such principles would:

- Give extra impetus to the regulators to protect vulnerable businesses by embedding the principles in their strategic planning.
- Create some clarity and certainty for small businesses over where they can expect protection from regulators and where they cannot.
- Provide a comparator against which to measure how effectively vulnerable businesses were being protected. Regulators should be made publicly accountable for adhering to the principles.

At the same time the application of such principles in each sector will require nuance. Regulators will need flexibility to be in-built so they can apply rules in the most appropriate way to the relevant circumstances.

Wider application of the principles to other B2B markets should not be ruled out. Their extension should be actively explored by the Government. The experiences of other countries that have moved much further in this direction could offer some valuable insight in this regard. The Government should look in detail at the policy regimes prevailing in other countries. Where found to be beneficial for small businesses the Government should look to adapt such measures to the UK context.

1.3.3 Recognition of the principle in other countries and its application in practice

The principle that smaller businesses (and micro-businesses in particular) hold a distinct position in markets is more systematically recognised internationally. We believe that the Government should undertake a comparative review of practice in other countries as was carried out by the University of East Anglia with regards to consumer protection

¹⁹ Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.
²⁰ Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.
²¹ An example of the 'sophistication' criteria can be found in the area of misrepresentation and non-disclosure. The guidance on the FoS website describes: '...our approach to cases involving misrepresentation by small businesses is similar to our approach where the consumer is an individual...If we consider that the small business is financially 'unsophisticated' - for example, where it has a small turnover, a simple structure, and is not involved with financial and/or legal services - our approach to deciding whether it took reasonable care is much the same as our approach in cases involving individual consumers...where we think a small business may be more financially sophisticated - for example, if it offers financial and/or legal services - we will consider whether it is reasonable to expect it to have shown a higher standard of care'. Source: FoS (2015). 'Online Technical Resource: misrepresentation and non-disclosure', it can be accessed at: http://www.financial-ombudsman.org.uk/publications/technical_notes/misrepresentation-and-non-disclosure.htm

²² This was also the recommendation of Fletcher et al. Source: Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'



frameworks.²³ This would help reveal where effective practice has taken hold and whether there might be lessons for the UK.

Australia and South Africa are perhaps the most advanced in this area.²⁴ However, a number of EU countries have taken limited strides in this direction too. These include: Austria, Belgium, Czech Republic, Denmark, France, Greece, Portugal and Slovakia.²⁵ Some have taken advantage of the option available under some EU legislation to extend the provisions of certain Directives such as the Unfair Commercial Practices Directive and the Consumer Rights Directive to ‘...non-governmental organisations, start-ups or SMEs...’.^{26 27} In addition, the EU has passed legislation focussed specifically on creating bespoke protections for businesses in regards to misleading marketing to businesses through the Misleading and Comparative Advertising Directive 2006 (MCAD).²⁸

While these examples are informative, Australia is a country close to the UK in terms of legal and business culture and so perhaps offers the best laboratory for testing the policy of treating smaller businesses more like consumers. Australia has taken a fairly comprehensive approach, which should enable any potential downsides to pursuing a policy along these lines to be identified and learnt from. There are six main strands to the Australian policy in this area:

- Australia has extended their consumer protection framework to all transactions below AUS\$40,000.²⁹ They do not only apply specific protections in specifically identified sectors.
- Further, they are also planning on extending their protections against unfair contract terms protections to small businesses.³⁰
- Businesses are protected by the laws on misleading and aggressive practices.³¹
- Australia also offers additional contractual protection for parties to a transaction through more extensive use of the equitable principle of unconscionability. This has offered additional legal protection to some businesses that are engaging in deals where there are significant inequities in bargaining power.³²
- There is a strong emphasis on small businesses being able to access dispute resolution and redress. The various (Federal and State/ Territory) Small Business Commissioners provide advice and sign-posting to dispute resolution services as well as offering some themselves. In addition the Productivity Commission

²³ Centre for Competition Policy (2008). ‘Benchmarking the performance of the UK framework supporting consumer empowerment through comparison against relevant international comparator countries’, can be accessed at: <http://competitionpolicy.ac.uk/documents/107435/107584/file50027.pdf>

²⁴ The South African Consumer Protection Act 2012 extends consumer protections to the smallest businesses such as the self-employed. The main three elements of South African consumer law extends to businesses an asset value or annual turnover of less than R2 million, the equivalent of 150,000Euros. Source: Fletcher A et al (2014). ‘Small Businesses as Consumers: Are They Sufficiently Well Protected?’.

²⁵ University of Bielefeld (2007). ‘Consumer Law Compendium – Comparative Analysis’ cited in Fletcher A et al (2014). ‘Small Businesses as Consumers: Are They Sufficiently Well Protected?’ an can be accessed at: http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf

²⁶ Fletcher A et al (2014). ‘Small Businesses as Consumers: Are They Sufficiently Well Protected?’.

²⁷ As Fletcher et al outlines, Germany, Austria, France, Sweden and Italy have ‘...taken up this flexibility to extend the provisions, although in Germany the extension only covers Annex I of the Directive (‘the Black List’) while in France it only covers Article 6 and Annex I (that is, it is limited to the provisions on misleading practices)’. Source: Fletcher A et al (2014). ‘Small Businesses as Consumers: Are They Sufficiently Well Protected?’.

²⁸ This Directive was implemented in the UK as: *The Business Protection from Misleading Marketing Regulations 2008*. The regulations can be accessed here: http://www.legislation.gov.uk/uksi/2008/1276/pdfs/uksi_20081276_en.pdf

²⁹ ‘Under the Australian Consumer Law 2010 extends consumer guarantees to all consumer and business contracts for a product with a value below AUS\$40,000. The provisions ‘...do not apply, however, where the products are bought for resale or for transformation into a product for resale (that is, where it is related to the core trade of the business)’. In addition, the provisions ‘...of the ACL on misleading...[and]...deceptive...conduct...cover both individual and business customers (of any size)’. Source: Fletcher A et al (2014). ‘Small Businesses as Consumers: Are They Sufficiently Well Protected?’.

³⁰ Billson MP, B (2015). ‘Extending consumer-like protections to small businesses across Australia’, Australian Treasury Press Release, can be accessed at: <http://bfb.ministers.treasury.gov.au/media-release/056-2015/>

³¹ Fletcher A et al (2014). ‘Small Businesses as Consumers: Are They Sufficiently Well Protected?’.

³² S21 and 22 of the Competition and Consumer Act 2010 are the relevant section on unconscionable conduct. Small businesses are somewhat crudely protected through a limit on the ability to bring an action for unconscionability by excluding listed companies from the provisions of the law. Much of the scope of the unconscionability law was set out in recent Federal Court case: *ACCC v Lux Distributors Pty Ltd* [013] FCAFC 90.



recently undertook a comprehensive review into the Australian formal dispute resolution landscape with the intention of enabling small businesses to more easily access redress.^{33 34}

- Finally, the Australian competition enforcement framework appears to be more flexible than the UK regime because it appears to allow the competition authorities to investigate B2B activity as a matter of routine in addition to B2C markets. As a result where micro-businesses are suffering detriment for example the authorities are able to take the initiative and investigate failing market structures and the behaviour of particular businesses. Currently, in the UK this is generally not the case, albeit this is subject to some exceptions such as energy and business banking.

We would urge the Government to closely monitor the Australian example with the aim of identifying the effectiveness of their approach and the possible policy lessons for the UK.

1.4 This response

This remainder of this submission is divided into four sections:

- The first outlines in more detail the fundamental proposition and the logic behind:
 - Why micro-businesses should be thought of differently to other businesses
 - Why this means they should benefit from specific policies which reflect the fact that they are different.
- The second briefly describes the more detailed evidence on how micro-businesses behave as market actors and micro-business detriment.
- The third, sets out some policy ideas which would help protect micro-businesses from some of the worst of the detrimental practices and market failures in the regulated sectors and more widely.
- The fourth is an Annex that offers a brief overview of some of the existing published evidence on:
 - How micro-businesses behave as market actors
 - How they are treated by other market actors (such as larger supplier companies)
 - Where markets are currently failing micro-businesses

2. The fundamental insight: micro businesses are different and businesses can be vulnerable

2.1 The differences between micro-businesses and larger businesses as market actors

The core insight behind the original FSB commissioned report by Fletcher et al is that there are clear, consistent and persistent differences in the behaviour and experiences of micro-businesses in markets, compared to larger businesses.^{35 36} These differences can make some businesses especially micro-businesses vulnerable as market actors.

Fletcher et al found that size and maturity of a business correlates strongly with better market experiences and outcomes. In the energy sector for example larger businesses were able to have positive and '*...business-like relationships...*' with suppliers, while medium-sized companies had '*...stable and functional...*' relationships with

³³ The Australian (Federal) Small Business Commissioner's website (including a list and description of services it offers) can be accessed here: <http://www.asbc.gov.au/>

³⁴ Productivity Commission (2014). 'Access to Justice Arrangements' can be accessed at: <http://www.pc.gov.au/inquiries/completed/access-justice>

³⁵ 'Larger businesses' for the purposes of this response describes larger smaller businesses e.g. those with more than 10 employees through to the very largest.

³⁶ The '*...evidence paints a broadly consistent picture of significant differences between smaller and larger customers in terms of their decision-making behaviour and also their treatment by suppliers*'. Source: Fletcher A et al (2014). '*Small Businesses as Consumers: Are They Sufficiently Well Protected?*'.



suppliers while small and especially micro-businesses had consistently poor experiences, felt unable to negotiate the market effectively and in some cases considered themselves to be exploited due to their vulnerability.³⁷

Further, these patterns of behaviour identified and market outcomes by Fletcher are repeated in other sectors. Micro-businesses have these negative experiences and suffer from these poor outcomes in-part because they *'...struggle to engage in the accessing, assessing and acting on information that is required for effective purchasing decisions'*.³⁸ In the consumer policy literature this bundle of information related failures and constraints are often referred to as 'information vulnerabilities'.³⁹ When these demand-side issues combine with an uncompetitive supply-side the results can be considerable detriment for smaller businesses.

There are four key underlying reasons why micro-businesses suffer from poor market experiences and outcomes. These underlying reasons are:

- Lack of expertise in purchasing a particular product or service. Outside a micro-business's core area of business it is unlikely they will have access to any more expertise than ordinary households.⁴⁰ Whereas as, even in larger small businesses, there may be staff whose role is (at least in part) dedicated to dealing with the procurement of goods and services for that particular business. This lack of expertise is a key element in the 'information vulnerability' suffered by micro-businesses.⁴¹
- The high 'opportunity cost' of using resources (such as time and money) for searching out and making purchasing decisions rather than concentrating on keeping cash-flowing into the business i.e. servicing existing customers and finding new ones. The opportunity costs of expending scarce resources on non-core activities is much higher for a micro-business than for households.⁴² The high 'opportunity cost' of engagement dis-incentivises engagement compounding the likely lack of expertise.
- Relatively marginal gains (actual or perceived) compared to the time spent making purchasing decisions on goods and services which might not contribute directly to the end-product of the business. This reason is closely aligned with the second reason. The prospect of only marginal gains constitutes part of the opportunity cost calculation. Perception can play a big role. In reality bigger gains in the long-run (e.g. the accumulation of small gains over time) may be achieved if micro-businesses had the resource to dedicate to navigating often complicated markets. Consequently the perception and the reality of short-term marginal gains in particular can be a barrier to switching.
- Asymmetries in bargaining power. Micro-businesses do not have the purchasing power to drive hard bargains especially with larger suppliers. Consequently, in markets with few suppliers, micro-businesses can be subject to what are often referred to as 'pressure vulnerability' and 'supply vulnerability'.⁴³ In a

³⁷ Fletcher et al describe how Ofgem commissioned research into the energy sector found that the experiences of larger businesses are significantly different to those of micro-businesses. As Fletcher et al set out: *'Size and maturity of business emerged as the crucial factor in dictating an organisation's ability to manage supplier relationships effectively.....Large and very large consumers had positive, business-like relationships with energy suppliers.....Medium-size consumers had generally developed a functional but stable relationship with suppliers, having often had bad experiences in the past from which they had learned.....Small consumers often had poor experiences with suppliers, and felt insufficiently protected in their dealings with them.....Micro consumers also had poor experiences on a regular basis, and sometimes felt exploited by suppliers or brokers. They were often very confused by their dealings with energy suppliers.'* Source: Insight Exchange (2012). *'Research into the Proposed Standards of Conduct: Non-Domestic Consumers'* cited in Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*. The original research can be accessed here: <https://www.ofgem.gov.uk/ofgem-publications/39447/non-domestic-soc-report.pdf>

³⁸ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

³⁹ Cartwright P (No date given). *'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'*.

⁴⁰ Fletcher et al acknowledge the point that: *'The only exception is where a firm is purchasing core inputs for its particular trade, where we might expect even a small firm to be reasonably expert'*. Source: Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

⁴¹ Cartwright describes 'vulnerabilities' deriving from 'information gaps' as 'information vulnerabilities'. He further points out that Burden, in a 1998 paper for the OFT called *'Vulnerable Consumer Groups: Quantification and Analysis'*, highlights one of the two key reasons that consumers are vulnerable is because they *'...may find it more difficult to obtain or to deal with information needed to make appropriate purchasing decisions...'*. Source: Cartwright P (No date given). *'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'*.

⁴² Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

⁴³ Cartwright P (No date given). *'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'*.



well functioning market transactions should be entered into freely and transparently after making a choice from a wide variety of options. However, in markets with limited choice and where the customer will not be making a sizeable purchase and consequently have little bargaining power, the opportunities for poor deals and high levels of detriment can be significant.

In addition, micro-businesses can also suffer from other vulnerabilities, which vulnerable consumers also suffer from. These are 'redress vulnerability' and 'impact vulnerability':

- Redress vulnerability refers to the situation where access to remedies is difficult for those who have suffered some sort of detriment.⁴⁴ Access to remedies can play an important part in creating efficient markets by ensuring that providers of goods and services are held accountable if they do not meet their customer's expectations. While all businesses have access to the civil courts if there is a breach of contract or a duty of care and there are also alternative dispute resolution options, '*...the availability of such remedies may be more apparent than real*'.⁴⁵ The opportunity costs of pursuing remedies can be high. This cost not only includes any direct fees for using the courts or an ADR scheme but the uncertainty and time and information costs associated with pursuing some sort of claim. Therefore much micro-business detriment goes un-remedied.
- Impact vulnerability describes how some market actors suffer greater (and very significant) losses due to '*...inappropriate purchasing decisions*'.⁴⁶ If losses '*...disproportionately impacts upon certain consumers it seems appropriate to describe them as vulnerable*'.⁴⁷ A bad purchasing decision can have significantly negative consequences for micro-businesses. A number of the small businesses caught up in the Swaps and Embedded Swaps mis-selling ended up going insolvent as a result of it. Micro-businesses cannot absorb the consequences of a loss as easily as larger businesses. Poor purchasing decisions especially of relatively complex and often expensive products or services such as financial services can have very large negative even ruinous consequences.

2.2. The way forward

The vulnerabilities that many micro-businesses experience lead to the conclusion that consumer policy could be used to help counter-balance some of their most egregious consequences of the vulnerabilities.⁴⁸ This would have the positive outcome of enhancing the potency of the demand-side in a range of B2B markets where micro-businesses buy goods and services.

The benefits which derive from a strong and discriminating demand-side are well known. Further, the role that legal protections and other regulations can play in helping secure a robust demand-side have been articulated by the Office of Fair Trading in the past. We believe that similar to consumer markets targeted measures to protect micro-businesses could have a similar effect to consumer protections on markets and the wider economy:

'When consumers trust firms and markets (because of consumer protection) and when consumers actively choose and buy what is best for them (with the aid of consumer protection), then firms will compete fairly to deliver what consumers want, in order to gain business from each other...Active consumers with the confidence to engage in markets will, in turn, act as a driver for economic growth. Firms can only gain from innovation if consumers are active and willing to adopt these new products. In this respect, consumer protection can ensure that competition

⁴⁴ Cartwright P (No date given). 'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'.

⁴⁵ Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.

⁴⁶ Cartwright P (No date given). 'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'.

⁴⁷ Cartwright P (No date given). 'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'.

⁴⁸ Cartwright P (No date given). 'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'.



results in the 'right' kind of innovation, aimed at addressing consumer demand and improving processes, not at obfuscating consumers'.⁴⁹

This is not to say that micro-businesses can or should be treated identically to consumers. There are differences between consumers and even the smallest businesses.⁵⁰ However, the evidence suggests there are sufficient similarities for some of the key principles which inform consumer policy-making to be adapted to apply to micro-businesses. We consider that the fundamental insight outlined above could be reflected in policy in two ways:

- An extension of existing consumer principles to micro-business policy along with some of the existing consumer protections in law.
- The bespoke adaptation of a selected number of the key consumer principles and policy measures. This approach would recognise that although micro-businesses do suffer from similar problems in markets and often for many of the same reasons as consumers there are still some differences between consumers and micro-businesses. Therefore, a tailored approach to policy is needed to ensure appropriate measures are implemented.

We support the latter approach. We believe it provides the right balance between acknowledging the problems (and their causes) that need to be tackled by policy but taking sufficient account of the complex reality of the business environment. That reality includes those differences between the smallest businesses and individual consumers.

In addition to measures which strengthen the demand-side and ameliorate vulnerabilities, the experience of consumer markets is that a robust supply-side is also needed.⁵¹ This requires a rigorous competition policy regime which will ensure that practices by businesses which inhibit the interplay of market forces are minimised. When they are identified action against barriers to competition can deliver significant gains. Measures therefore, which can deliver such supply-side gains in B2B markets need to be part of the policy mix too.

3. Market failures: examples of where micro-businesses lose out

3.1 A growing body of evidence

There is a good deal of evidence suggesting that micro-businesses as market actors have much in common with consumers especially in the regulated sectors. We explore some of this evidence in more detail in the Annex to this response. Primarily the Annex outlines the evidence in three of the key regulated sectors: energy, telecoms and financial services.

The evidence for these three sectors highlights a number of common themes:

- Micro-businesses in particular suffer from information asymmetries and knowledge gaps about the products and services on offer.
- Micro-businesses do not have the internal resources or time to devote to being 'active consumers'.

⁴⁹ Office of Fair Trading (2011). 'Competition and Growth'.

⁵⁰ There are differences between businesses and consumers. Those differences include:

- Business activity and business models are more diverse than households
- B2B markets tend to be more highly segmented;
- B2B markets usually contain fewer buyers and sellers than consumer markets;
- Businesses often use goods and services more intensely, in much greater quantities and in different ways than consumers;
- Businesses can require goods and services specifically designed for a unique purpose;
- Businesses operate under a range of rules and obligations imposed them by Government, which consumers do not;
- Business activity is associated with more risk than consumer activity and might require bespoke methods/ tools to ameliorate risk.

⁵¹ Office of Fair Trading (2011). 'Competition and Growth' and Armstrong M (2008). 'Interactions between Competition and Consumer Policy' in Competition Policy International, Volume 8, No 1.



- They are often unable to make reasonable comparisons between different product options available.
- Prices and other contractual terms and conditions for goods and services are often opaque.
- They do not have the purchasing power to be considered important customers by many large suppliers.
- There is a feeling of powerlessness and consequently apathetic behaviour among micro-businesses:
 - The ability to get redress when problems emerge is seen as remote at best; while
 - There is a strong perception about a lack of interest in their custom (from suppliers).

In combination with the 'supply vulnerability' (i.e. the concentration among suppliers) that exists in many of these markets the result is less efficient B2B markets than might otherwise be the case.

In addition, the Annex also describes evidence of detriment in other markets, which the FSB collected through a recent call for evidence to our members in one of our southern regions. The evidence collected through our call for evidence is qualitative. As such it does not provide a comprehensive picture of the extent and depth of detriment suffered by small businesses. Rather, it is intended to indicate that there are problems for micro-businesses beyond the main regulated sectors and encourage further research into the extent of the detriment experienced by small businesses.

Some of the most salient examples collected are set out in Table 2 in the Annex. The table splits the types of problems into three categories:

- Unfair contract terms.
- Misleading and aggressive sales and marketing.
- Supply of services.

We consider that the cases presented in the table offer something of an insight into what other areas small businesses are subject to market failures. It seems likely that this small sample reflects greater levels of detriment suffered by small businesses in many sectors of the economy. We urge the Government to undertake a bigger and more systematic study of B2B markets and the position of micro-businesses within them.

4. What Government can do

4.1 Thinking Small First

We would like to see Government internalise the idea that micro-businesses are in many ways a unique category quite different from larger businesses. As part of that process we would like to see a more coherent approach across Government in the development of policies that impact on micro-businesses. We have already seen something of this in the Small and Micro Business Assessments (SaMBA) which are now a routine part of departmental Regulatory Impact Assessments (RIA) of new policy proposals. However, we believe the Government can take the Think Small First principle a step further by:

- Continuing to think and develop micro-business focussed policies where appropriate.
- Applying the principle to all measures which could impact on micro-businesses e.g. where measures are proposed that would support business the first concern should be the extent to which any measure supports micro-businesses, how any proposal might be better adapted to support micro-businesses and finally, how the measure can be tailored to enable micro-businesses to fully utilise its benefits.



4.2 Begin with the regulated sectors

We consider there to be sufficient evidence in the energy, financial services and telecoms sectors to warrant policy measures that build on current practice in those sectors but which will take it a step further. There is good practice being undertaken by the sectoral regulators but it is not systematic and is not based on any coherent framework.⁵² A more systematic and coherent approach would help create more regulatory certainty for both micro-businesses and those being regulated.

We believe the regulators in these sectors need to be more pro-active in their regulatory focus in relation to micro-businesses. We acknowledge that all, to varying degrees, already regulate in the interests of micro-businesses but we believe it needs to become as routine as regulating in the interest of consumers.

Achieving that regulatory end will mean:


- Regulators should - by default - include micro-businesses as a category in regulatory investigations and activity unless there is a compelling reason not to. More generally regulators should develop a more consistent, coherent and systematic approach to regulating in the interests of vulnerable businesses. The Financial Ombudsman criteria of whether the purchaser can be considered 'sophisticated or not' may offer one option on which a flexible system can be based. We would like to see the Government explore whether it would be feasible to recognise the length of time a business has been trading, given that this has been identified as a key vulnerability.
- As part of encouraging a coherent and systematic approach each regulator should be required to embed a series of micro-business principles which will form the basis of an approach to regulating in the interest of micro-businesses. The set of principles should be consulted upon. However, we believe they should include most of the core principles that have become established and inform consumer protection in the UK, such as: access, transparency, information, enforcement, education, redress and representation. A principles-based approach that is relatively consistent across regulators will enable micro-businesses to have a greater degree of confidence in markets as they will be more aware of where they might be protected from certain practices and where they might not.
- Consistent principles should not however undermine the discretion of the regulators to implement them as they see fit, subject to a rigorous transparency and accountability criteria. In addition, we believe that regulators should take a particular interest in B2B markets where transactions are between parties where there is a significant imbalance of bargaining power and where the consequences of a particular transaction could be 'ruinous' to a small business. The evidence from the energy sector in particular highlights how micro-businesses suffer from having little bargaining power at their disposal while the evidence from the financial services sector illustrates how some products are potentially 'ruinous' for some businesses. Where the latter is a risk the vendor needs to be under clear obligations to fully disclose – in an understandable manner - the full set of risks which a 'vulnerable' business customer may be taking on by purchasing a particular product.
- Finally, where it is not already the case, all the appropriate regulators should be given the power to enforce the Business Protection from Misleading Marketing Regulations 2008.

4.3 Making other markets work better for micro-businesses

In addition to the primary focus on the regulated sectors we believe that in light of the consistent findings about the behaviour and market outcomes for micro-businesses (including the evidence in the Annex from FSB members) there is scope for some refinement of the wider general regulatory frameworks which underpin markets.

⁵² Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.



Alongside the sectoral regulators routinely regulating in the interest of micro-businesses we believe that there is a case for extending a similar principle to general market regulators such as the Competition and Markets Authority and Trading Standards Services 

4.3.1. The CMA

The remit of the Competition and Markets Authority (CMA) should be extended to formally cover micro-businesses. The benefits which competitive markets can deliver for consumers are well known.⁵³ Competition policy which helps deliver competitive markets interacts positively with the consumer protection framework.⁵⁴ The benefits and synergies that are present in consumer markets from such a framework could also be guaranteed in B2B markets given the right policy regime. Given the numerous 'vulnerabilities' faced by micro-businesses and the established behavioural and treatment similarities with consumers, there is a strong case for more formally extending to micro-businesses the reach of some of the policy measures which ensure that consumers are able to benefit from robust market competition.

Currently, the CMA can look at B2B markets in the context of the CMA's ultimate goal of ensuring consumers are benefiting from competitive markets. As a consequence the CMA only look at B2B markets on an ad-hoc basis e.g. the current investigation into the energy market, where they have included micro-businesses within the scope of their investigation. The CMA should have the authority to investigate B2B markets where micro-businesses are the 'end consumers/ users' without having to link the reasoning for the investigation ultimately to consumer markets. We believe that over-time (and if the CMA has the requisite resource) such a change could result in more frequent investigations into B2B markets and any anti-competitive behaviour by businesses supplying other businesses. In-turn this could lead to more competitive markets servicing micro-businesses with goods and services. More competitive B2B markets would have both market wide and individual benefits for micro-businesses.

4.3.2 Trading Standards

As a companion measure we believe that Local Trading Standards Services (LTSS) should be more explicitly tasked with looking after micro-businesses alongside their work protecting consumers. Although they can already enforce the law where it applies in B2B contexts e.g. the Business Protection from Misleading Marketing Regulations 2008, consumers inevitably get priority. The FSB's call for evidence uncovered numerous examples of micro-businesses suffering at the hands of misleading marketing and sales practices (See Table 2). As this response has described, this is in part because micro-businesses suffer from a number of vulnerabilities that, like consumers, make them susceptible to unfair and unlawful practices. We would like to see clearer recognition of LTSS's role in protecting micro-businesses. To complement this, we would like to see where LTSS can be given additional powers to help protect micro-businesses e.g. the Government should consult on whether, for the purposes of public enforcement, some elements of the Consumer Protection from Unfair Commercial Practices Regulations 2008 (CPRs) and the Unfair Terms in Consumer Contracts Regulations 1999 could be extended to cover micro-businesses.⁵⁵

⁵³ Armstrong M (2008). 'Interactions between Competition and Consumer Policy' in Competition Policy International, Volume 8, No 1.

⁵⁴ OFT (2011). 'Competition and growth'.

⁵⁵ We do not propose extending private rights to micro-businesses. There may be a case for this if and when further evidence emerges. The result of following this policy would be that a LTSS could bring an enforcement action against a business that, in their dealings with another business, had breached those aspects of the CPRs or the Unfair Contract Terms rules, which has been extended to cover micro-businesses. As described earlier, some EU Member States have only extended parts of the former to smaller businesses. This 'selective' may be the most appropriate way forward in the UK too. We believe the Government should consult on this.

4.3.3. Future EU legislation

Finally, when future relevant EU rules are proposed e.g. consumer protections, the UK should argue that the option for the inclusion of an Article which would allow Member States to extend the provisions in the Directive to micro-businesses.⁵⁶ This should only be an option. The decision to extend rules beyond individual consumers should be at the discretion of the Member States. This will allow the Government of the day to make a judgment, based on domestic circumstances, over the appropriateness of any new protections being extended to micro-businesses. Not all consumer rules are suitable for applying across to micro-businesses.

4.4 Clarifying the existing framework of rules

The Consumer Rights Act 2015 separated out consumer protection law and left a set of residual rules relating to B2B contracts for the sale of goods, supply services and unfair contract terms. Consequently provisions in the Sale of Goods Act 1979 and the Unfair Contract Terms Act 1977 for example, remain on the statute book and still apply to B2B transactions – where they are not excluded by the terms of individual contracts. We believe that these residual rules should be consolidated into a single statute focussed on B2B transactions. This would be a helpful consolidation of the law. Business owners would be able to more easily see what protections they might be entitled to and also what obligations they have to abide by or (where appropriate) what implied contractual terms they can or might want to exclude or limit their liability for in any commercial transaction. A single statute with a clear set of rights and obligations would:

- Enable micro-businesses in particular but potentially all businesses to better understand their rights and responsibilities and thus reduce the opportunities for disputes.
- If a dispute arose, each party would be able to better identify their position and reach a resolution.
- At the margins perhaps it may make it simpler and quicker to draft contracts.

In addition, one of the underlying concerns in a number of the sectors touched on in this response is the asymmetry in bargaining power between larger businesses and micro-businesses. Evidence from the energy and financial services sectors in particular has shown that the lack of bargaining power can lead to some fairly poor outcomes for micro-businesses and complete dis-engagement from the market. In Australia the equitable principle of unconscionability plays a role in helping ameliorate the worst excesses of asymmetrical bargaining power as will, no doubt, the extension of their rules on unfair contract terms to cover small businesses. We believe that the Government should look at whether there is merit in re-visiting the principle of 'inequality of bargaining power' as set out by Denning MR in *Lloyds Bank Ltd v Bundy* [1974].⁵⁷ We urge the Government to look into whether re-invigorating this legal principle may be one way forward for public policy to help mitigate the most egregious consequences that sometimes result from a gross inequality in the bargaining positions of the contracting parties.

4.5 The 'redress vulnerability' and access to remedies

Redress or more accurately the inability to access redress is one of the key vulnerabilities that micro-businesses face. Trying to obtain redress after suffering a wrong is fraught with difficulty and uncertainty for a micro-business, especially if the other party is considerably larger/ has more resource. As they have recognised in Australia, a vital element of any policy which looks to support micro-businesses has to take seriously the issue of redress.

⁵⁶ This measure was recommended by Fletcher et al. Source: Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.
⁵⁷ *Lloyds Bank Ltd v Bundy* [1974] EWCA Civ 8. In this case Lord Denning MR held that a contract was voidable owing to the 'unequal bargaining position' in which Mr Bundy had found himself vis-a-vis the bank. Lord Denning in the judgment outlined the principle of 'inequality of bargaining power'.



Further, markets cannot function efficiently without the ability for parties to enforce their rights against other parties who fail to fulfil their promises. Access to redress:

- Ensures accountability for poor business practices.
- Drives improvements in those practices.
- Generates trust in markets and among market actors i.e. suppliers and purchasers.
- Helps contribute to making markets are more efficient.

However, access to redress is not just the ability to access a court or an alternative dispute resolution scheme. It also includes businesses offering rigorous complaints procedures to customers when things go wrong and being willing to put problems right.

To help increase the opportunities for accessing redress by micro-businesses the Government should review the B2B dispute resolution landscape. The aim of the review should be three-fold:

- To assess the effectiveness of the current arrangements in the regulated sectors. This should include access to the relevant ombudsman and the requirements and rules of the various regulators regarding the complaints procedures of the businesses operating in these sectors. If gaps are uncovered the Government should look to give the regulators any additional powers needed.
- To discover and remove any unnecessary barriers which hinder the ability of micro-businesses to access methods of redress not just in the regulated sectors but across the economy more generally.
- Examine whether there might be a case for the Government to have a role in helping (micro) businesses access and use redress mechanisms.

4.6 More insight

The Fletcher et al paper was a comprehensive review of the available evidence regarding the characteristics and behaviour of micro-businesses as market actors and the market outcomes they often result in. It found evidence of detriment being suffered by micro-businesses in a number of vitally important markets which provide the key infrastructure on which the small business community relies.

In addition, this submission has tried to complement the Fletcher et al paper, including the carrying out of our own (albeit limited) call for evidence. We believe that our evidence indicates that FSB members and by extension the wider small business community do experience problems similar to consumers in a range of markets, not just the major regulated sectors. Our call for evidence only offered an indication however. It seems clear that what is needed are significant pieces of quantitative and qualitative research in order to establish the full extent, depth and nature of the detriment experienced by micro-businesses across a wide range of sectors. We urge the Government to undertake such work. One model to follow could be the BIS Consumer Engagement and Detriment Survey.⁵⁸ The prize of obtaining a comprehensive picture and developing subsequent policies based on the collected evidence is likely to be significant: lower business costs for small businesses and more efficient B2B markets and in turn a more competitive economy.

⁵⁸ TNS/ BIS (2014). 'Consumer Engagement and Detriment Survey', can be accessed at:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/319043/bis-14-881-bis-consumer-detriment-survey.pdf



Annex: evidence of micro and small business detriment in B2B markets

The energy market

The market for energy does not work effectively for micro-businesses. The FSB's own research found that only a quarter of small firms believe there is enough competition in the energy market.⁵⁹ A significant 65% of small businesses surveyed by the FSB thought that it was difficult to switch energy supplier.⁶⁰ While, according to Ofgem commissioned research micro-businesses in particular are:⁶¹

- Less likely than businesses in other size categories to switch.
- Less likely to have switched during the preceding 5 years.
- Substantially less likely to have switched more than once or to have contacted 4 or more suppliers when doing so.

This is not surprising given the litany of issues uncovered by qualitative research conducted by Opinion Leader and commissioned by Ofgem:

*'Smaller businesses in particular showed lower levels of understanding of the energy market and similarly lacked understanding of the role of third party intermediaries. Many within this group harboured mistrust of brokers and tended not to use them to procure their energy supply. Given the difficulties smaller businesses also expressed with regard to shopping around and switching supplier, this meant there was a lower propensity to switch overall within this group.'*⁶²

This complicated picture is supported by FSB research which found that *'...many businesses simply find the switching process too difficult, time consuming or misleading to engage with...'*⁶³ Particular barriers to switching included unclear notice periods, complicated contract terms and the speed of the switching process.⁶⁴

Unsurprisingly given the findings outlined above, micro-businesses were the least likely to be satisfied with the value for money offered by their existing energy supplier. This low level of satisfaction is consistent with the high proportion of micro-businesses that feel alienated from their energy supplier: 81% of FSB members believe that their energy suppliers do not care about their needs. The absence of the feeling of being a valued customer was complemented by significant levels of dissatisfaction with the energy company's complaints processes, which regularly failed to successfully resolve complaints.⁶⁵

⁵⁹ FSB (2015). 'Letter to the CMA Market Enquiry'.

⁶⁰ FSB (2015). 'Letter to the CMA Market Enquiry'.

⁶¹ Opinion Leader (2012). 'Research Findings on the Experiences of Non-Domestic Customers' cited in Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.

⁶² Opinion Leader (2012). 'Research Findings on the Experiences of Non-Domestic Customers' cited in Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.

⁶³ FSB (2015). 'Letter to the CMA Market Enquiry'.

⁶⁴ FSB (2015). 'Letter to the CMA Market Enquiry'.

⁶⁵ The closest we have found is a 2012 report commissioned by Ofgem, examining complaints to the Ombudsmen Services: Energy, by both domestic (individual) consumers and micro businesses. This survey reveals substantial similarity between the two groups of customers, at least in respect of their views of the complaints process. Both groups exhibit substantial dissatisfaction with the overall complaints process, with micro businesses marginally less likely to be satisfied (40% of Domestic customers and 34% of micro business customers claimed to be satisfied). There was also a significant disconnect in perceptions



The poorly functioning energy market is at least in part a result of the fact that it displays many of the underlying vulnerabilities from which small businesses suffer. There is the:

- Imbalance in bargaining power.
- Lack of expertise among micro-businesses and the consequent information vulnerability.
- High opportunity costs of engaging with the switching process as a result of the high information, search and selection costs. The relatively marginal gains to be made from changing supplier or tariff mean that on balance resource are better deployed concentrating on the business.⁶⁶ Therefore it is not surprising that micro businesses are less likely than other business sizes to have switched during the preceding 5 years and substantially less likely to have switched more than once or to have contacted 4 or more suppliers when doing so.⁶⁷
- Redress vulnerability as the complaints processes of the energy companies fail to resolve problems.
- Supply vulnerability where a small number of large providers dominate the market.

There is an additional complication in energy markets as a considerable proportion of the smallest businesses, because they are home-based, rely on domestic contracts for their energy supply.⁶⁸ A recent FSB survey found that 25% of FSB members are in such a situation. This blurs considerably the consumer-business dividing line.

The problems experienced by micro-businesses in the energy market are similar to those experienced by consumers, yet consumers benefit from a comprehensive set of protections which are constantly monitored and improved by Ofgem in order to make help consumers and thus the demand-side of the market work better. Given that the evidence marshalled above shows micro-businesses encounter many of the same issues we believe there are strong reasons for the regulator to more systematically and coherently regulate on behalf of vulnerable businesses, like they do consumers.

One place to start might be for Ofgem to revise the Standards of Conduct for energy suppliers. Revised standards were published in 2013. These required suppliers to treat small businesses fairly when they are billing, contracting, and switching. These are backed by Ofgem's powers to levy fines if necessary. However, these Standards of Conduct are too loosely defined and it is unclear under what circumstance they would be breached.

The communications sector

Research into the telecoms sector has revealed similar patterns among small business customers as those that exist in the energy sector. In a recent publication The Communications Consumer Panel (CCP) highlighted how the smallest businesses lack the time and resource to engage with the details of an often complicated market.⁶⁹ The research also found that micro-businesses found it difficult to make decisions about both providers and the range of

between the supplier and both types of customer, with over two in five of all complaints classified as resolved by the supplier being considered by the individual customer to be unresolved (41% for domestic and 44% for micro business customers. See GfK NOP (2013). 'Complaints to the Ombudsmen Services: Energy - Report for Ofgem exploring why few consumers refer their complaint to Ombudsman Services: Energy', <https://www.ofgem.gov.uk/ofgem-publications/85086/ofgemgfkcomplaintstoombudsmanservicesenergyreport2013.pdf> Source: Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.
⁶⁶ Four in five (81%) firms agree that published tariffs would benefit their business, encourage competition and make it easier to switch accounts. Source: FSB (2015). 'Letter to the CMA Market Enquiry'.
⁶⁷ Opinion Leader (2012). 'Research Findings on the Experiences of Non-Domestic Customers' cited in Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.
⁶⁸ BMG/ Citizens Advice (2014). 'The experiences of small businesses as consumers in regulated markets: A report for Citizens Advice by BMG Research'.
⁶⁹ Communications Consumer Panel (2014). 'Realising the potential: Micro businesses' experiences of communications services', it can be accessed at: <http://www.communicationsconsumerpanel.org.uk/downloads/panel-micro-business-report-final.pdf>



services on offer indicating a lack of expertise among most micro-businesses.⁷⁰ Bundling and complex pricing made it difficult to make proper comparisons revealing considerable concerns about transparency and information vulnerability.⁷¹

In the meantime, a recent and much more limited call for evidence to FSB members in one of our regions uncovered clear examples of some of the difficulties small businesses have in interacting with the telecoms market.

An FSB member running a tow-bar company switched their businesses telecoms provider from BT to another provider which offered a more sophisticated phone system and which they paid for on credit. The new system turned out to be way beyond what the business needed. They also had to pay a number of hidden charges e.g. for connection, on top of the basic line rental. Further, they were locked into a three year contract for the telephone system. These costs came on top of the substantial early termination charge (ETC) of £600, which the business was told the company they were switching to would pay for. The 'gaining provider' failed to do so. The costs were too much for the business and they eventually had to refuse to pay their bills in order to stay afloat. Finally they switched back to BT but had to pay several hundred pounds to get out of the contract. This example illustrates how smaller businesses can struggle to negotiate complex pricing and bundling of services in technologies they have little expertise in. The severity of the impact is a good example of how smaller businesses can suffer from 'loss vulnerability' as the complexity of the contract led directly to a poor purchasing decision which significantly negatively impacted the bottom-line of the business for a considerable period of time.

Another member who responded to our call for evidence described how he was hindered from switching his business phone number from one provider to another by an obscure clause in this contract that switching number is at the discretion of the new provider. For many businesses, number porting is critical.

There was also a reluctance to switch as there was a degree of suspicion about claims over speed and reliability in both internet and mobile services confirming the perception of marginal gains from trying to be an active market actor.^{72 73} Many small businesses disengage from the market as they are wary of making any change which could lead to a gap in service.

When things do go wrong for businesses they can find it difficult to get problems put right or obtain redress. One member who bought a bundled package of broadband and telephone for their beauty salon was mis-sold a domestic package despite them using their business address with the provider. When problems occurred including complete losses of service the provider refused to take responsibility saying they had a domestic package and not a business package. This impacted significantly the ability of the salon to make appointments with customers, existing and new. The member also highlighted the fact that the price kept changing which had not been explained when they bought the package in the first place. The owner felt powerless to argue with the provider over exactly what was said and not said at the time of the contracting. The salon was trapped in a two year contract for the service. This example further illustrates the contractual complexity that some telecoms services involve and the lack of expertise and bargaining power to force the provider to improve their service. The example also exposes the redress vulnerability

⁷⁰ Communications Consumer Panel (2014). 'Realising the potential: Micro businesses' experiences of communications services', it can be accessed at: <http://www.communicationsconsumerpanel.org.uk/downloads/panel-micro-business-report-final.pdf>

⁷¹ Communications Consumer Panel (2014). 'Realising the potential: Micro businesses' experiences of communications services', it can be accessed at: <http://www.communicationsconsumerpanel.org.uk/downloads/panel-micro-business-report-final.pdf>

⁷² Communications Consumer Panel (2014). 'Realising the potential: Micro businesses' experiences of communications services', it can be accessed at: <http://www.communicationsconsumerpanel.org.uk/downloads/panel-micro-business-report-final.pdf>

⁷³ Micro-businesses cannot afford for members of staff to dedicate some of their time to these sorts of business procurement issues. In some areas, in order to make up for this lack of in-house capacity, a micro-business may (at great expense) buy-in the services for a period of an expert. This is done fairly frequently in areas such as health and safety. However, as the CCP found, this is unlikely to happen in relation to communications issues, despite the potential complexity of some of the purchasing decisions to be made. Source: Communications Consumer Panel (2014). 'Realising the potential: Micro businesses' experiences of communications services'.



of small businesses who in this case felt they had nowhere to go to resolve their case once the provider had failed to properly deal with the issue.

The telecoms market is fast moving, with considerably higher levels of product innovation compared to other sectors. This innovation allows small business consumers to take advantage of disruptive technologies and to integrate new products and services into their business. Less positively, these high levels of innovation can make the market hard to understand, especially for older or lower information consumers.

The pace of technological change was a factor in the information and knowledge deficit which micro-businesses experience as customers in the communications sector. The CCP found that *'...the majority of the micro businesses...were just keeping pace with changes in communications technology, only developing their communications services if customer needs or expectations changed'*.⁷⁴ Micro-businesses are not able to fully exploit the advantages that come from high degrees of knowledge and engagement about products and services. In turn this means that micro-businesses are unlikely to be fully exploiting the full benefits of communications technologies.⁷⁵ In contrast those micro-businesses who are more sophisticated consumers with the requisite knowledge and access to information described how *'...communications services enabled them to enhance their competitiveness and expand their markets – essentially allowing them to 'punch above their weight'*.⁷⁶

The FSB is planning to publish a major report on demand side issues influencing how small businesses interact with the telecoms market later in the year. We would welcome the opportunity to share some of the evidence we have gathered with you ahead of the report launch

Cumulatively this evidence suggests there are a range of different issues affecting small businesses in the telecoms market. As a consequence, the market is not functioning as efficiently as it could be, with negative consequences for individual businesses and for the wider economy as so much of the modern economy relies on telecommunications infrastructure e.g. to communicate with and sell to customers. Some small businesses are not utilising the benefits of digital technology due to these market failures. This has serious implications for the wider economy as micro-businesses fail to derive the many efficiency and market reach benefits that can be obtained from full use of modern communications services while also failing to be the discriminating demanders that will help drive the telecoms sector to be more innovative and more efficient.

The financial services sector

Many aspects of the financial services sector works particularly poorly for micro-businesses. Problems in the small business banking sector have been well documented over many years. More recently there have been mis-selling scandals most notably in relation to Swaps and Embedded Swaps. Badly functioning markets are particularly damaging when the products and services are inherently complicated like many financial services. There are hard to judge trade-offs between present and future returns.⁷⁷ They can also involve delicate judgments about risk, with bad judgments resulting in potentially significant losses.⁷⁸ Finally the infrequency of purchase makes learning from past mistakes difficult.⁷⁹

⁷⁴ Communications Consumer Panel (2014). *'Realising the potential: Micro businesses' experiences of communications services'*, it can be accessed at: <http://www.communicationsconsumerpanel.org.uk/downloads/panel-micro-business-report-final.pdf>

⁷⁵ Particularly telling was the finding that *'Many of these businesses were conscious that they could be making greater use of communications technology'*. Source: Communications Consumer Panel (2014). *'Realising the potential: Micro businesses' experiences of communications services'*, it can be accessed at: <http://www.communicationsconsumerpanel.org.uk/downloads/panel-micro-business-report-final.pdf>

⁷⁶ Communications Consumer Panel (2014). *'Realising the potential: Micro businesses' experiences of communications services'*, it can be accessed at: <http://www.communicationsconsumerpanel.org.uk/downloads/panel-micro-business-report-final.pdf>

⁷⁷ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

⁷⁸ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.

⁷⁹ Fletcher A et al (2014). *'Small Businesses as Consumers: Are They Sufficiently Well Protected?'*.



It is unsurprising therefore that in a recent paper the FCA itself has found that: '*...SMEs are less likely to be sophisticated customers and many exhibit similar knowledge and experience to that of retail consumers when buying general insurance products*'.⁸⁰ This example of the businesses displaying similar characteristics as consumers stretches wider than insurance though to a considerable number of financial products and services. It is found in the more general business banking market too. The OFT point out that micro-businesses display high levels of dissatisfaction with products and services which often failed to meet their needs. However, at the same time businesses felt unable to do much about their dissatisfaction due to the significant asymmetries in information, knowledge and bargaining power they face *vis-a-vis* their respective bank.⁸¹ Small business customers are less likely to be assertive and tell their bank they were thinking of switching and even if they do, it was rare that the bank took any action to change their offering and improve the position of the small business customer.⁸² The lack of interest in keeping dissatisfied customers suggests a poorly functioning market with little competitive impetus. The OFT's last report into the business banking sector described why:

- Small businesses are hindered in their ability to shop around because of the difficulty in comparing prices and service quality.⁸³
- There is a high degree of inertia among small business customers and low levels of engagement with banking services. Shopping around for business bank accounts and loans is limited as the perceived benefits to switching are low.⁸⁴

Business banking lacks transparency in pricing and terms and conditions. This compounds the inherent asymmetry in bargaining power between the micro-business and the sophisticated financial services provider. The inertia in the business banking market also suggests that perceptions of only marginal gains at best (compared to the costs of switching) play a significant role as part of a wider calculation that the opportunity cost of changing banking providers is not worth the hassle when the focus should be on meeting existing orders and finding new customers. There is a good deal of 'choice vulnerability' in this market as potential alternative providers are small in number. Consequently micro-businesses are limited in whom they can go to for the services they need.

One of the most egregious examples of a failing market for business banking and vulnerable micro-businesses is the mis-selling of Swaps and Embedded Swaps to small businesses by the high-street banks.⁸⁵ 40,000 of the former and 60,000 of the latter were sold by high street banking institutions to businesses.

In the case of Swaps the FSA found that 90% were mis-sold to small businesses i.e. were not provided with the right information in order to make an informed choice.

In relation to Embedded Swaps many FSB members caught by the mis-selling were not aware they had tailored business loans until they tried to exit or move the loan and were told about the 'break costs' by their bank. At the point of sale most were not made aware of the expensive costs that would be incurred in such circumstances.

⁸⁰ FCA (2015). '*Handling of insurance claims for Small and Medium-sized Enterprises (SMEs): Thematic Review*', can be accessed at: <http://www.fca.org.uk/static/documents/thematic-reviews/tr15-06.pdf>

⁸¹ IFF Research Ltd (2006). '*Survey of SME Banking: Research Report prepared for Office of Fair Trading*', http://oft.gov.uk/shared_oft/reports/financial_products/oft937b.pdf cited in Fletcher A et al (2014). '*Small Businesses as Consumers: Are They Sufficiently Well Protected?*'.

⁸² IFF Research Ltd (2006). '*Survey of SME Banking: Research Report prepared for Office of Fair Trading*', http://oft.gov.uk/shared_oft/reports/financial_products/oft937b.pdf cited in Fletcher A et al (2014). '*Small Businesses as Consumers: Are They Sufficiently Well Protected?*'.

⁸³ OFT (2014). '*Review of banking for small and medium-sized businesses (SMEs) in the UK: Update on work to date*'.

⁸⁴ OFT (2014). '*Review of banking for small and medium-sized businesses (SMEs) in the UK: Update on work to date*'.

⁸⁵ Swaps are a financial product taken out against a loan or mortgage to help protect against rises in interest rates. The products were sold to all types of small firms, with the majority sold between 2006 and 2009. An 'embedded swap' or 'tailored business loan' is different from an ordinary swap as it looks like a normal fixed rate loan to the borrower but incurs disproportionately high break fees if interest rates fall.



The Swaps and Embedded Swaps examples highlight the considerable risks that customers of financial services can face if they lack relevant knowledge and suffer from an 'information vulnerability' when faced with complicated products without adequate regulatory protections in place to help compensate for that 'information vulnerability'.⁸⁶ The mis-selling caused significant amounts of detriment and highlighted clearly the 'impact vulnerability' of many micro-businesses in complex markets requiring high degrees of sophistication to understand the products and which consequently are not functioning effectively. In the most egregious cases the mis-selling resulted in ruin for the victims.

The FSB welcomed the action by the FCA in response to the mis-selling of Interest Rate Hedging Products. However, it was difficult at the time to know to what extent this represented action as part of a systematic policy of protecting smaller businesses. If small business customers fell more comprehensively within the FCA's regulatory remit, the problem may have been prevented or its extent more limited than was the case. Having smaller businesses routinely within the FCA's jurisdiction would also mean that micro-business owners could rely on the FCA's Treating Customers Fairly principles. Currently, many small businesses feel that they're not treated fairly e.g. by insurance companies especially when trying to claim on the insurance policy that they have paid into.⁸⁷ This is compounded by a lack of transparency over who has what role in the claims process.⁸⁸

We support the recommendation of Fletcher et al that micro-businesses should be comprehensively brought within scope of the regulatory powers of the FCA with scope for flexible qualifying thresholds for regulatory action and access to redress, probably depending on the issue, product or service. The FCA should more rigorously monitor the advice banks are giving to micro-business customers on the full range of products and services. This should involve requirements on vendors to make sure they disclose all the relevant information about the risks associated with a product along with evidence to prove they have made such disclosures in a meaningful way to the intended small business customer.⁸⁹ It should also include routine access to the redress mechanisms open to individual consumers by businesses.

Flexibility for the FCA is particularly important because of the complexity of the products and potentially devastating impact an inappropriate product or service can have on a small business. Options for striking the balance between clear rules on protection and flexibility for regulators could include:

- Aligning the FCA's with those used by the Financial Services Compensation Scheme. Compensation for investment products is offered to businesses with 50 employees or less and a turnover of no more than £6.5m.⁹⁰
- Improve the current definition of 'sophistication' to something better than the current rules. During the Swaps episodes farmers were being excluded from accessing redress as they were deemed to be sophisticated. While there are advantages of having a flexible definition such as 'sophistication' which the FCA can use as a basis for its regulatory activity we believe the current rules are not sustainable. Some broad and clear rules would help create some more certainty for micro and small businesses about what they could expect from the FCA when they are engaging with the financial services sector.

⁸⁶ Davies has argued that two forms of information asymmetry are particularly apparent in financial services: complexity of contracts and difficulties in judging the soundness of firms. Davies H (1998). 'Why Regulate?', Henry Thornton Lecture, City University Business School cited in Cartwright P (No date given) 'The Vulnerable Consumer of Financial Services: Law, Policy and Regulation'.

⁸⁷ FCA (2015). 'Handling of insurance claims for Small and Medium-sized Enterprises (SMEs): Thematic Review' can be accessed at: <http://www.fca.org.uk/static/documents/thematic-reviews/tr15-06.pdf>

⁸⁸ FCA (2015). 'Handling of insurance claims for Small and Medium-sized Enterprises (SMEs): Thematic Review' can be accessed at: <http://www.fca.org.uk/static/documents/thematic-reviews/tr15-06.pdf>

⁸⁹ FSB (2014). 'CMA submission on Business Banking'.

⁹⁰ This is the definition of a small business in the Companies Act 2006. Source: Fletcher A et al (2014). 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'.



Other business-to-business markets

In addition to the key infrastructure sectors a limited call for evidence conducted by the FSB in one of our regions found clear indications of a range of problems being experienced by small businesses in a number of B2B markets.

The aim of the consultation was to help get an indication of the kinds of problems FSB members experience in B2B markets other than the main regulated sectors. There is a reasonably sized body of evidence about the latter but considerable gaps in the available evidence on the extent of problems and behaviour in the former.

In an open online consultation with FSB members in one of our southern regions we received over eighty submissions in only a few weeks. These outlined a wide range of problems experienced by our members in B2B markets. Overwhelmingly the problems were in service sectors, although some were in relation to goods, particularly sophisticated goods. This is perhaps unsurprising as they are harder to describe and make objective decisions about regarding key aspects such as quality and also tend to be purchased less frequently than goods. The responses covered a number of markets, from waste disposal to photocopiers, advertising to the purchase of computers. They revealed a number of recurring issues such as;

- The use by suppliers of unfair contract terms
- Misleading and aggressive marketing and sales of services.
- Breaches of contracts for the supply services with limited ability for the affected businesses to get redress due to contractual terms.

In Table 2 below we set out examples from the call for evidence and organise them into three broad categories: unfair contract terms, misleading and aggressive marketing and sales practices and the supply of services.



Table 2: examples gathered from the FSB's call for evidence

Unfair contract terms	Aggressive selling and misleading marketing	Supply of services
<ul style="list-style-type: none"> • A water treatment company member got locked-into a card payment machine contract through cancellation terms which required a year's notice which meant that if the right amount of notice was not given the provider could add a further year to the contract term. The only way they could get out of this was if they committed to signing another contract for another card machine. The company could not be without a card machine and so had to 'wait out' the contract with a machine that was not considered suitable for their needs. • A retailer member reported to us how they had got locked into a rolling contract on a card processing. Rollover terms and cancellation terms were buried in lengthy terms and conditions and were not made clear at the time the contract was made. • A member running a restaurant purchased some advertising for a period of time in order to help increase the customer-reach of the restaurant. The contract contained a hidden-rollover clause which meant that after the first period of advertising had expired the member was bound into a subsequent period. Despite the fact that they had realised the advertising was not doing what they had hoped it would do for the business. • A healthcare company suffered considerable financial detriment from a penalty clause for cancelling a contract for the provision of workplace hygiene services, protective clothing and washroom and toilet equipment. The penalty clause was not made clear and prominent at the time the contract was entered into. • A manufacturing company responded to the call for evidence in order to tell us about a lease for an office photocopier that they entered into. It was for five years but it contained a number of hidden unfair clauses. The 	<ul style="list-style-type: none"> • An engineering design and manufacturing member company fell victim to the aggressive and misleading selling of CAD software. They found that - having purchased the system - unless upgrades were subsequently purchased the licence on the current software expired. The member suggested that technical language and sophisticated marketing helped persuade them to buy software that was considerably below what they needed. • A training and planning business bought a new computer for their business. However, it transpired that it was barely adequate for basic business purposes. They bought it though because they had been led to believe by the salesperson that it would be suitable for business purposes. Consequently, they are now stuck with having paid out for a computer not up to the job. • A fine art printing company responded to the call for evidence to explain how they paid to participate in an event that had been marketed to them as being for artists – their target market – yet in reality it was an event for the general public to buy art. Having paid out considerable sums to attend the event was a completely useless event for them as it offered no business opportunities whatsoever. • A picture framing company used a third party intermediary service to obtain the best value-for-money contracts for a range of merchant services vital for their business. However, subsequent evidence emerged that a considerable number of better deals were available e.g. for card payment machines. The member found themselves trapped in a four-year deal for their card payment machine provider, which wasn't made clear at the time. They were therefore stuck with an overpriced service for a considerable period of time. Further, it also 	<ul style="list-style-type: none"> • A FSB member company primarily distance selling veterinary medicines were unable to get redress from delivery services providers because of contractual clauses that narrowly limited liability in their contracts. A delivery failed to arrive at the intended recipients business but the narrow-liability clauses meant that the FSB member made a considerable loss on the sale because while they got a small amount of compensation for the cost of producing the product they were unable to get it for handling costs, the cost of placating the disappointed customer and any profit that would have been made. • One member running a telecoms business was unable to get obtain redress against an accountancy business that had not delivered a satisfactory service. Clauses in their contract of service that excluded liability when things went wrong were not made clear at the time and only came to light when the problems arose. The situation caused considerable disruption and ended up having to resolve the situation directly with HMRC. • A member running a guest house suffered lost business because of the failure of a building firm to complete the repairs they were carrying out to the guest property. Due to the minimum safety requirements which guest houses are required to meet the repairs had to be done. • A member with a timber workshop entered into a contract with a builder to build a new workshop. The final construction was not big enough for the purposes agreed and specified at the start of the contract. The contractor would not accept the fact that he had not built it to adequate specifications and refused to make any alterations or reduce the price. The member felt unable to take it to court due to the costs he would



<p>photocopier quickly reached a point where it could no longer good enough for what it was needed for but the lease could only be terminated by providing full payment in one go. If they had been able to do that they would have no doubt purchased it in full, in the first place.</p> <ul style="list-style-type: none"> • A retailer member entered into a contract to ensure its business waste was properly dealt with and recycled where possible. However, the lengthy and complex terms and conditions required that the contract could only be terminated at a single point in the year but which also required considerable notice. Otherwise a large early termination fee would be required to be paid. The existence of this term only emerged during one attempt to terminate the contract. It was not prominent in the original contract discussions. The business felt trapped into another year of the contract despite a desire to terminate it. 	<p>was not clear at the point of sale that they were required it insure the machine with the card machine providers own insurance product. This was in addition to a number of contractual penalty charges. The member was quite clear that had they been made aware of these clauses at the time of the contract they would not have gone for the deal.</p> <ul style="list-style-type: none"> • An IT sector member business highlighted in a submission how they had been misled by marketers into paying for advertising in an attempt to reach new customers. The seller had offered a misleading impression of the level of exposure and amount of potential new business that might accrue from the advertising. The situation was then complicated by the difficulty the IT company had trying to get out of the contract that was useless to them. The marketing company insisted on the company seeing out the full contract for the advertising services despite it not meeting the claims made for it. • A member running a hairdresser found themselves in a similar situation. They were sold advertising for a fixed twelve month period on the basis of promises that it could help drive up footfall which didn't materialise. These claims were not true but they were unable to get out of the contract. • A member business operating in the medical science sector submitted a short response to the call for evidence to explain how they had entered into a contract for a managed business unit. However, a number of costs that were later incurred by the member were not made clear up front when the decision to rent the unit was made. For example, the contract did not make clear that there would be utility costs on top of 	<p>likely incur from going to court and the uncertainty over the outcome.</p> <ul style="list-style-type: none"> • A project management training business purchased rooms and other services from a hotel for their course attendees. The hotel was a four star hotel. However, service standards were poor. These had a considerable impact on the overall experience of the course attendees and their perception of the quality of the course being provided. However, contractual exclusions in the terms and condition of the hotel, which only emerged when the problem arose ensured that the FSB member could not obtain redress for the negative impact on their business of the inadequate hotel.
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	<p>the monthly rent, which in many cases are often included in such rental arrangements. Consequently the member company had to pay much more in outgoings than had originally been planned for. It impacted their bottom-line quite considerably for the remainder of the time they stayed at the property.</p>	
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