

LIGHTENING THE LOAD

The Regulatory Impact on UK's Smallest Businesses

A REPORT TO GOVERNMENT BY THE BETTER REGULATION EXECUTIVE
NOVEMBER 2010

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Contents

| | |
|---|-----------|
| Executive Summary | 1 |
| Introduction..... | 3 |
| 1. The cumulative burden of regulation..... | 6 |
| <i>The overall burden.....</i> | 6 |
| <i>Timing of regulatory impact.....</i> | 7 |
| <i>Obligations falling on a single person can be substantial</i> | 7 |
| <i>Micro Businesses often under-comply or over-comply with regulations.....</i> | 8 |
| <i>New regulations and the pace of change increases burden</i> | 8 |
| <i>A multiplicity of licenses and fees add up</i> | 9 |
| 2. Policy makers are failing to think small first..... | 10 |
| <i>Policy design, evaluation and its impacts</i> | 10 |
| <i>The implementation of new regulations</i> | 11 |
| <i>Business feels Government is still not as joined-up as it needs to be.....</i> | 11 |
| <i>Guidance and information provision</i> | 11 |
| <i>Principles based regulation are not working for micro business</i> | 13 |
| <i>The smallest businesses obtain regulatory advice — not all of it accurate — from a range of sources.....</i> | 14 |
| <i>Local Authorities - Enforcement and inspections.....</i> | 14 |
| 3. Capacity and Capability is an underlying issue..... | 15 |
| 4. Key regulatory issues | 16 |
| <i>Employment.....</i> | 16 |
| <i>Environment, especially waste.....</i> | 18 |
| <i>Regulations relating to health and safety.....</i> | 18 |
| <i>Food safety.....</i> | 19 |
| <i>Procurement</i> | 19 |
| <i>Planning & Building Controls</i> | 19 |
| <i>Fire safety.....</i> | 20 |
| <i>Data Protection Act (DPA).....</i> | 20 |
| Annex A - Map showing potential obligations applying to a business..... | 21 |
| Annex B – RRAC Health and Safety Map | 22 |

Executive Summary

This report focuses on the experience of the UK's smallest businesses and summarises the experiences they reported in dealing with the overall regulatory burden.

What we found

We spoke to 500 micro businesses (those with fewer than 10 employees) and found that businesses are struggling to cope with existing regulations and that each new regulation or change simply adds to their problems. The sense of frustration felt by these businesses was evident, with some showing clear signs of distress.

Most frequently we were told that they try to do the right thing, but felt that they were not supported and were unreasonably expected to cope with the same levels of paperwork and regulatory obligations as larger companies.

Most owner-managers estimated that they spent between one and two days per fortnight on regulatory issues, but some claimed to be spending as much as two days per week.

Three key themes emerged from what business said:

1. *Frustration* - there are significant levels of frustration and a real sense of 'no one cares'. Businesses are frustrated with the extent of regulation, the pace of regulatory flow and the expectation by government that a single business owner can cope with the cumulative array of regulations. While the overall cumulative burden is an issue, the number of small fees that businesses have to pay for licensing or for other reasons also adds to their frustration and directly affects their profitability.
2. *Complexity & Misunderstanding* - a range of regulatory areas place a huge cumulative burden on micro businesses. For example, because of the complexity of employment law and the challenges of its implementation we found businesses that actively avoid recruiting and expanding. Health and safety regulations are still widely misunderstood with businesses using the term to cover a range of regulatory areas from environment to food safety which adds to the difficulty of understanding business' problems.
3. *Tax system* – Although tax and its administration are not regulation and are therefore outside the scope of this project, most businesses we spoke to raised them as issues. The micro businesses we spoke to do not generally differentiate between tax and regulation but rather see both as government intervention. The comments raised have been passed to HM Revenue and Customs and HM Treasury.

From our analysis, two underlying issues emerged, firstly about policy-makers understanding and treatment of micro businesses; and secondly on the capability of businesses themselves:

- Policy makers are still not 'thinking small first' when designing and implementing regulations. The move to principles-based regulation has allowed many businesses to take a proportionate and outcome focused approach to regulations to suit their business. However, for micro businesses, which are often owner-operated, their ability to understand and interpret regulations across the regulatory field is limited, leaving them feeling confused and 'on their own' when trying to cope with regulation.

As a result they often unknowingly either under or over comply with regulations. Many businesses simply do not understand why certain regulations are introduced or why they are asked to provide information to government e.g. data protection requirements; keeping written records of refused sales or statistics.

- The level of managerial capability in micro businesses is a key constraint. For experienced businesses, many regulations are easy to manage and have become part of general business processes (unless they change, which then does cause problems). However, for less experienced businesses, when new regulations are introduced, there is a general difficulty in interpreting, understanding and complying with regulation. It is probable that there is a wider issue around managerial training and support.

Key business views

- The cumulative burden on micro businesses of regulations, licenses and fees is considerable and hampers their ability to stay profitable, grow, invest, hire staff and even pay themselves a wage.
- Policy-makers are still not 'thinking small first' when designing and implementing regulations.
- Principles based regulations can be difficult to interpret for micro businesses. Future regulations & guidance should consider this.
- Simplification measures are not being felt by micro businesses.
- Micro businesses face issues of insufficient managerial training and expertise. For less experienced businesses, or when new regulations are introduced, the general ability to interpret, understand and comply with regulations leaves them feeling overwhelmed, leading to poor compliance or even prosecution.
- More sophisticated businesses can scrutinise regulation in order to get the best out of it for their business. Smaller businesses with fewer resources find it more difficult and may consequently be at a competitive disadvantage.

Next steps

The challenges highlighted in the report have been passed to Lord Young for consideration as part of his review of how government interacts with, and affects, small businesses.

Introduction

Why do micro businesses matter?

The UK's Micro Businesses are a key economic force, with the potential to be a greater one, and they face particular challenges with regulation. Thus, the Better Regulation Executive and BIS's Enterprise Directorate, along with the Local Better Regulation Office have explored how regulation affects the UK's smallest businesses, particularly sole traders and businesses employing fewer than 10 employees, referred to in this report as 'micro businesses'.

Businesses with fewer than 10 employees account for 96 % of UK businesses and around 7 million jobs.

Micro businesses also play an important social role, providing work for many in the 'margins' of the labour force (the unskilled, formerly unemployed, part time workers, women returnees, young and old people). In rural and deprived areas, micro businesses are among the main employers and wealth generators, and in urban areas micro businesses are often the front-runners of urban regeneration. Many entrepreneurs started out as micro businesses, and by empowering individual businesses to grow, the enterprise-led recovery can be supported.

Our interviews with micro businesses considering closing or in the process of closing found that whilst regulation may not be the key driver of these closures, it did play a significant part in businesses' struggle with difficult trading conditions. The interviews also found that regulatory and other costs continued to rise for micro businesses during the recession, when profits were falling, adding to the pressure on their viability.

The aim of the study

This study sought to find out, through engaging business owners themselves, how regulation was affecting their ability to operate and grow their businesses. It also sought to find ideas for improving their situation. This report has been written to represent the views provided by those businesses and organisations we spoke to.

We interviewed businesses across all sectors, but focused on one sector, the high street. We looked at how regulation is impacting typical high street businesses — newsagents, convenience stores, drycleaners, hairdressers, pubs and restaurants.

By understanding how regulation affects owners and managers of these businesses, we hope to improve conditions and reduce costs for most UK businesses. Many regulations fall on all businesses, so benefits gained should apply to all. Also there should be benefits for the UK's alternative business models, as many of these face identical or similar regulatory burdens.

Do micro businesses face particular regulatory challenges?

Businesses in general struggle to comply with regulations. The National Audit Office's (NAO) survey of businesses in 2009 suggests that businesses continue to find regulation a burden. NAO found that only 1% said that complying with regulation had become easier or less time consuming – with 37% of businesses saying it had become more time consuming in the last year¹.

BRE studies and others have found that micro businesses (defined as those with fewer than 10 employees) can find the cost of regulatory compliance to be disproportionately high, placing additional calls on scarce resources. For example, our recent research into health and safety regulation found that, on a per employee basis, small and medium-sized enterprises (SMEs) may be spending almost six times more than larger ones on risk assessment.²

"There is always a difference between perception and reality but our testing shows that almost no businesses think that complying with regulation has become easier or less time consuming in the last year."

—National Audit Office

Engagement with businesses and associations

Our approach has been to work with business associations to gather insights from their micro members and we have also spoken to many individual micro businesses and business advisors across the country.

We spoke to over 500 small and independent businesses and their representatives, from newsagents in Leicester and pubs in London and the South East to bed and breakfast operators, independent media companies, training firms, hairdressers and other independent businesses in the North East, Yorkshire, North West, West Midlands and South West.

We met with groups of businesses via workshops we held in conjunction with the Federation of Small Business, the Association of Convenience Stores, the Federation of Retail Newsagents, the Rural Shops Alliance, the British Hardware Federation and British Shops and Stores Association. We also met with individual businesses who were referred to us by either the Trade associations or London Business Link and those identified ourselves.

We also consulted:

- LACORS (the Local Authorities Coordinators of Regulatory Services) who surveyed their members;
- Individual regulatory and enforcement staff in a number of Local Authorities, in particular Enfield Council staff, who helped us attend some very insightful local 'Pubwatch' meetings, and staff at Lewisham and Bexley who also generously gave us time and explained just how difficult it can be for micro businesses to get to grips with the range of regulations applying to their businesses; and
- Other business groups such as the Federation of Private Business, the British Innkeepers Institute (BII), Pet Care Trust who promoted our work to members, and many other associations who provided insights and support.

¹ Complying with regulation - business perceptions survey 2009, NAO.

² Improving Outcomes from Health and Safety 2008, Better Regulation Executive.

We were particularly grateful to the owners of the many pubs, hairdressers, newsagents, convenience stores, B&B operators, independent shops and other business people who spent time with us and who were able to tell us about their experience of regulation.

Summary of key views: what micro businesses think about regulation and Government

- They feel like they are not rewarded for the contribution they make and that ‘hurdles are put in their path at every step’.
- They believe that no one is looking after their interests but they are expected to do things on behalf of government (e.g. collect monies, control sales of certain goods) but get nothing back from the government.
- They recognise the value of some regulation but did not like the demand of regulation requiring them to keep written records (for example records of replacing number plates, refused sales of alcohol or tobacco).
- They feel like they have no one ‘on their side’ and have no negotiating power with suppliers or government (e.g. planning allowing large chains to open next door).
- They almost solely rely on accountants and associations for advice.
- They have the greatest interactions with inspectors and HMRC but have very little interaction with other parts of government.
- Views were mixed on inspections but many agreed that they can be useful, although they do feel at the mercy of an individual inspector’s opinion and did not believe that they had anyone they could turn to if they disagreed with the inspector.
- They would like more local support and somewhere they could go to get clarification about all regulations. A significant proportion of them do not use the internet as part of their business.
- They believe that they are seen less favourably in planning and by other enforcement agencies as the group most likely to be in breach of regulations.
- Employment regulations- pendulum has swung too far in favour of the employee.
- They find it hard to make a profit.

1. The cumulative burden of regulation

1.1 Micro business owners say that regulation not only inhibits growth but also their ability to pay themselves what they would regard as a decent wage. This has left them feeling frustrated and disenfranchised. Many stated that they structure themselves in such a way as to avoid employing staff because of the cost, regulatory burden and fear of the employment tribunal. Others will cease activities that attract various regulations. This has clear impacts on the growth of the businesses and ultimately on the dynamism and health of the economy, as well as the economic opportunities for many young people.

“Regulations are a distraction. I should be out there looking for new orders and growing my business, instead I have to fill in endless forms.”

– Business owner, Gloucester

1.2 Businesses accept that regulation is required, to regulate markets and provide protections to customers and staff, and that regulations can create new markets and opportunities. However, micro businesses reported to us that regulation is a costly distraction, with some business owners reporting that this burden contributed to them not being able to pay themselves a minimum wage and working long hours for little gain.

1.3 Businesses are extremely frustrated by regulation and feel that ‘no one is looking after our interests’. It is also apparent that for some business owners the combined costs imposed on them, make running a profitable business impossible. We met at least five that were preparing to cease trading. Many say costs had increased during the recession whilst profits fell, making it impossible for them to carry on.

1.4 Also, some of the costs of compliance seem unnecessary and/or duplicative and distract owner/managers from more economically productive pursuits.

The overall burden

1.5 We found that for micro businesses, it is the cumulative burden of regulations that impacts the most;

- One small B&B owner said that she averaged 45 minutes per day on paperwork
- The owner of an electrical services company spends about 10-15% of his time on paperwork. He has therefore opted to use contractors rather than permanent staff to keep the administrative burden down.
- The owner of a family run business selling cakes to small cafés and small stores said that 25% of his week is spent on paperwork.
- A businessman who has worked in the retail industry for 38 years said that he spends 10 times more on regulation now than he did 20 years ago.
- A restaurateur claimed he spends 1-2 hours of his time each week trying to comply with government regulations. He said it is practically impossible for him or any business owner to know the whole breadth of regulations.

- The owner of a business that specialises in pond construction and maintenance said that it takes him 3 days to complete his Health and Safety accreditation forms which come in two packs.
- An entrepreneur in the asbestos business said he pays £1,000 for a 2 ½ day risk assessment inspection. He employs 6 staff.
- A struggling restaurant owner who has been hit by the recession and is already working excessive hours to make ends meet said it takes her 3 days to prepare payslips at the end of each year as required by employment law.

1.6 Annex A shows a map of the overarching obligations a business can face.

Timing of regulatory impact

- 1.7 Timing of regulatory impacts can also be an issue — many regulations hit business when they start up:
- Employing staff requires an understanding of the paperwork an employee needs to provide.
 - Conduct health and safety risk assessments.
 - The need to conduct fire risk assessments (micro businesses complained that they were forced to gold-plate compliance by insurance companies when applying for public and employee liability insurance).
 - To understand and comply with food safety, alcohol licensing laws or sale of tobacco laws.
- 1.8 Our analysis of the ‘learning burden’ at start up does show that businesses face a very steep learning curve. We also found that there is no single place where a business can obtain a clear explanation of what they need to take action to comply in each area. BusinessLink – www.businesslink.gov.uk offers some very useful tailored regulatory checklists but timings are not provided in many cases and a single list of timelines is not available across government.
- 1.9 In most cases businesses are provided with reasonable time to ‘get up to speed’ but this is not made clear to them.

Obligations falling on a single person can be substantial

- 1.10 Micro businesses say that managing the array of regulations is an almost impossible task. A single person is required to understand and comply with a large number of regulations — which places direct and indirect cost pressures on them. Government would not expect an inspector to have this level of cross-sector expertise.
- 1.11 We found that micro pubs have a particularly high regulatory burden – they have to be registered with around 5 agencies, have around eight licences of various kinds and have to keep written records for National Minimum Wage, PAYE, food safety and refusals of underage sales. They also have to pay for staff training, waste collection and recycling.

"I think we business owners need to see the government walking the walk and not just talking the talk I was very disillusioned by the paternity leave announcement, and I think it undermines any credibility for cutting red tape that the government had."

– Business owner, Bristol

- 1.12 A number of pub operators said that they were either struggling from month to month or said that they were unable to make a profit but ‘couldn’t afford to close’.

Micro Businesses often under-comply or over-comply with regulations

- 1.13 As a result of the cumulative burden of regulations falling on a single person with limited time and resources in a micro business, this person often unintentionally either under-complies or over-complies with regulation. This is particularly the case with principle based regulation that requires a degree of interpretation. In most cases a business will turn to their accountant, who some rely on to advise them on all regulations. They also report using specialist consultants for areas such as health and safety, fire and environment.
- 1.14 The consultant may take the safest, risk averse option, or be tempted to overstate the regulatory burden to either justify or extend their costs. We were consistently told by micro business that they were doing something ‘because it’s the Law’ – when in fact, it was a third party’s misinterpretation of the regulations
- 1.15 These factors lead to significant costs being paid by micro businesses under the mistaken belief that they had to. One micro business was unnecessarily paying £200 a year for fire extinguisher contracts, and a hairdresser was unnecessarily paying £1,000 a year for portable appliance testing. Another micro business paid £3,800 for a consultant to do their risk assessment and an electrical contractor was paying £1,000 a month to a health and safety advisor. In almost all cases the micro business could have avoided these charges by using free guidance and advice already available.
- 1.16 A second aspect of over-compliance is micro businesses being dictated to by third parties to go above and beyond the regulations. This could be the local authority (in terms of licensing), their insurance company (when setting premiums) or accreditation schemes (when bidding for work). For example a garage owner was paying £600 a year for testing workshop equipment in order to comply with an employee liability insurance certificate.
- 1.17 Many micro businesses are also unaware of whole areas of regulation, or think that it doesn’t apply to them. One micro business said that health and safety regulations didn’t apply to businesses with less than five employees; another that their accountant was in charge of their environmental regulations and another, a hairdresser, had no knowledge of legislation around chemicals, and was putting them in the bin. They would be likely to comply if they were aware of their obligations, as they complied with regulations they were aware of.

***“Insurers are driving over-compliance”
- micro business***

New regulations and the pace of change increases burden

- 1.18 The frequency with which new regulation is introduced is a major source of complaint from micro businesses. Businesses have clearly said that regulation, particularly regulatory change, adds costs to their business and many are simply struggling to survive.

***“I struggle to keep up with the changes in regulation just in my area. It must be nigh on impossible for a small business to keep up across all areas”
– Local Authority Inspector***

- 1.19 Businesses agreed that each new regulation

costs them many days to try and interpret it. Often the guidance is not provided or is provided late (i.e. after it has come into force) or is not provided in a way that makes sense for their business.

A multiplicity of licenses and fees add up

1.20 Hidden within the range of regulations are a number of licence fees and charges a micro business is required to comply with. Micro businesses have said that although individual charges can be small, they can add up over a year and create real cash-flow problems.

“It took me half a day to register for data protection and I was also told that by law I have to have a ‘privacy policy’ written up on my website — what is the point of that? To get the policy up on the site, it cost me £100 to pay the website company”.

1.21 Micro businesses said that the cost of licenses was not linked to the cost burden to the local authority, but rather was a revenue raiser. Our interviews showed that there seemed to be a wide disparity of costs and time taken between local authorities in the issuing of licenses.

1.22 Businesses report a licence to open for street trading costs £87 in Carlisle, and £2892 in East Staffordshire. An application to put tables & chairs on the pavement costs £150 and takes up to 56 days in Oldham, and costs £487 and takes up to 126 days in York. A licence to host marriages & civil ceremonies cost £418 in Hammersmith and £1750.50 in Thurrock. There is also a contrast in ‘tacit consent’ – with some councils agreeing that a licence becomes granted by default if they do not respond with a certain time and others not permitting this. These disparities create cost burdens, delays and uncertainty for micro businesses.

1.23 Examples of costs reported are:

- Data protection registration: £35 per annum.
- Employers liability insurance: circa £1,000- £1,500 per annum.
- Rates: £4,000 - £28,000 per annum.
- Alcohol fees, as well as fees for minor and major changes to the licence, including fees for each event held, granted annually or over a 3 year period, depending on the local authority.
- Street trade licence fees, granted annually or over a longer period, depending on authority.
- Waste, Electric and Electronic Equipment (WEEE) exemption certificate.
- Performing Rights Society licence: £130 - £450 per annum.
- Public Performance licence: £50 - £130 per annum.
- Television licence: £142.50 per annum.
- Waste collection: £250 - £2700 per annum.

How much?

A garage owner that sells alcohol had to attend a one-day course along with his employees at a total cost of £240. He also had to pay for an individual license.

Another store owner said, “My off- licence fee is now £300 per annum, geared to rateable value, and this is added to rates. It doesn’t relate to how much I actually sell or the amount of space I allocate to alcohol in my shop! When it was dealt with by the magistrate’s court I paid £30.

2. Policy makers are failing to think small first

- 2.1 The UK has a policy of ‘think small first’ when designing and introducing regulations. However a review of regulatory impact assessments shows that policy makers do not fully consider the impacts on micro businesses and do not invest sufficient resources into helping small firms cope with new regulations. Policy appears to have been designed around ideal situations, not what is practical or proportionate for businesses to cope with. This needs further work as micro businesses dominate the UK business base and any regulation impacting on them, needs to consider and accommodate their needs.
- 2.2 Based on our consultations with around 500 micro businesses, it is clear that policy design and regulatory communication is still not meeting the needs of this business segment.

***“The government must think we are out to exploit our staff. This is not true; I know all my staff and am on friendly terms with most of them. The Government does not understand the reality of small business”
— micro business store.***

Policy design, evaluation and its impacts

- 2.3 Our research shows that too many costs are being transferred to business in a haphazard and piecemeal fashion. Even small costs can have a significant impact on micro business and a baseline needs to be created so that the cumulative impact can be factored in to the cost-benefit analysis of policies.
- 2.4 As stated earlier, much good regulation is simply good business practice, for example, in areas such as health and safety and workplace disputes. However, Government has legislated certain behaviours that are beyond the ability of micro businesses to manage or pay for, whilst large businesses tend to go beyond these legal requirements.
- 2.5 Many businesses have said to us that the balance is wrong and that there is too much emphasis on an over-protective version of safety or consumer or worker rights and too little emphasis on individual responsibility. One business said that costs have been transferred wholesale to business, at the cost of individual responsibility. They say that this has left them exposed to ‘jobs-worth’ inspectors and litigious employees who expect the employer to be liable for mistakes that the employee makes, even if the employee is in the wrong.
- 2.6 Some objectives of regulations are already being met by micro businesses, for example, giving staff the right to be consulted on health and safety or ask for flexible working. Most micro business owners work with their staff every day, and have good working relationships with them. Due to this relatively informal working environment, their staff are more likely to be consulted or to request something directly than in a large corporate organisation, with or without regulations.
- 2.7 Furthermore, policy owners need to consider the end users of their regulations and develop guidance that makes sense for them. A substantial proportion of businesses we consulted with, were either not aware of environmental regulations applying to them or could not understand the guidance that they had been given. In some cases businesses are told that they have a duty to act in an environmentally responsible way, but what does this actually mean, how can a business do so, and what is a reasonable cost?

- 2.8 Businesses complained that it is unrealistic to expect a single businessperson to understand all regulations applying to them, particularly when Government itself is unable to clearly and simply communicate regulations and work in a cross-departmental or cross government way.

The implementation of new regulations

- 2.9 Our interviews with businesses revealed that when new regulations are implemented or are designed, too little thinking goes into the consideration of enforcement and implementation implications. Enforcers and Local Authorities do not feel adequately consulted when policy is designed.
- 2.10 Local Authorities have reported that support and guidance in relation to new regulations is patchy, with some initiatives being well supported and others without appropriate support and enough lead-time to ensure that end users and enforcement teams are well placed to implement new measures. They report that they feel that they have to re-write guidance so that it is comprehensible to businesses in their area.

Business feels Government is still not as joined-up as it needs to be

- 2.11 Businesses are still expected to 'join the dots' between departments and regulators as well as to interpret what it all means for their particular circumstance. If government is unable to make sense of regulations from an end-user point of view, it is unacceptable to expect a business owner to do so. Many publicans that we spoke to were confused about the interplay between planning restrictions on them and restrictions relating to their premises licence.
- 2.12 Many central policy owning agencies and departments have little real interaction with the businesses they regulate or provide services for. However, local inspectors are out each day seeing small firms and we should seek to help local authorities and inspectors to maximise the value of these interactions. This could be a two way process – with local inspectors feeding into policy formation, especially around enforcement issues, and also by local inspectors having better cross regulatory guidance to give to micro businesses. Inspectors believe that it would be a way of showing that businesses do 'get something back' and that there is support available out there for them.

Guidance and information provision

- 2.13 Micro businesses find it hard to find out about, understand and then comply with regulations. Lack of clarity leaves micro businesses exposed to over compliance, unnecessary consultant fees and overly high insurance premiums.
- 2.14 Poor guidance which is not adapted to micro businesses needs leaves business owners worrying that they are doing something wrong and feel that when they try to do the right thing, they can be penalised for not getting it absolutely right.

- 2.15 We were repeatedly told that micro businesses want and need prescriptive guidance that directly relates to their type and size of businesses. Local authorities echoed this and said that policy departments need to be able to make clear the intention of the regulation and to interpret this for businesses.

What guidance do they want?

As other studies have found (Anderson Review etc), the smallest businesses want regulatory certainty. They want prescriptive, not principles-based guidance. This is in contrast to many large businesses. Businesses asked for 'quick start guides' or 'dummies guides' to regulations. In particular they want guidance that tells them how to comply the first time.

They have said that they want guidance based on their actual type and size of business and that this needs to include a clear definition of what minimum legal compliance looks like and what would be illegal. All guidance should provide a level of legal certainty to the business owner.

They are happy to be provided with examples and case studies of best practice but this should be clearly state that they are best practice only and are not a legal requirement.

Worked examples of any paperwork and processes is desired, similar to the sector examples of risk assessments that HSE has on its website (www.hse.gov.uk/risk/casestudies).

- 2.16 Current provision of regulatory guidance and support is not adequate for micro businesses for three reasons:
- I. There is a strong demand for a single source of information and recognising this need has led to the government investing heavily in www.businesslink.gov.uk. It is a convenient, cheap and easy way of keeping up to date for many businesses. Awareness of BusinessLink was poor.

A large proportion of the businesses we met are not online and are from minority or immigrant backgrounds both making it more difficult for them to access government advice. Interpretation of text-heavy guidance can be difficult and it can be difficult for micro businesses to explain problems over telephone helplines, especially where English is not their first language. Businesses we spoke to expressed a preference for face-to-face advice.

Some food safety inspectors in London boroughs reported that even the Food Standard's Agency's Safer Food, Better Business packs (which are probably some of the best government guidance) are still too complex and that the reading ages should be revised down.

Many business associations recognise this and have been able to create one-page guidance sheets for their members. The British Hardware Federation- British Shops and Stores Association (BHF-BSSA) for example has single page employment guidance.
 - II. Individual departments seem to have no sense of the cumulative burden that regulation places on individual owners and managers — a typical high street business has to cope with over 30 pieces of legislation, regulations or guidance. Similarly, government is still not working cross-departmentally to interpret legal requirements and to provide guidance for different sectors. Businesses believed if departments cannot determine how environmental regulations should be interpreted for example by a small convenience store or drycleaner, they should not expect businesses to comply.

- III. Finally, the move towards more targeted inspection and enforcement means that fewer businesses are inspected and they have limited if any contact with other local and central government officials. They lack a face-to-face connection to an official source. Our consultations found that in a majority of cases this contact is desired and that many businesses see (the good) inspectors as a valuable source of advice and guidance. This is a connection that we could do more with.

2.17 The effect of this is fivefold:

- I. The typical micro business owner said they were spending around one day per week complying with government regulation, rather than bringing in new business or investing time in improvements or customer service.
- II. High rates of under-compliance, which are associated with poor perception of regulations fuelled by regulatory myths in the media, which are often believed by micro business owners. This has the effect of reinforcing the business-owners sense that compliance is too hard, has nothing to do with common sense and that the government does not look out for their interests.
- III. Perception issues, particularly around employment mean that businesses are afraid to take the risk of employing people or from offering new services for 'health and safety' or other reasons.
- IV. Micro businesses resort to paying for regulatory guidance or insurance, particularly in the areas of employment, health and safety, food safety. Many micro businesses use commercial companies for guidance and regulatory insurance, usually via subscription to schemes organised by their associations.
- V. Lack of clarity around regulatory obligations leaves businesses exposed to those who may promote over-compliance. We have uncovered instances where businesses have told us that lack of certainty exposed them to fraudsters or unnecessary expenses such as being told (by 'consultants') to buy more fire extinguishers than is needed, take out more insurance than they need or to buy chemicals or other products that turned out to be unnecessary.

How do micro businesses want to access guidance?

They told us that they prefer regulatory information to be provided in person or that they should be able to go and speak to someone if they have problems.

They also want to go to a single place for regulatory guidance and not have to 'make sense of guidance coming from different areas of government'.

Principles based regulation are not working for micro business

- 2.18 The move towards principles-based regulation is helping many UK businesses interpret and apply regulation to their business in a flexible and appropriate manner. For the micro businesses this can present a problem because they do not have the capacity to interpret and develop the expertise and systems in keeping with the principles of the regulation. This is especially true in regulatory areas where a high degree of knowledge is required to understand and manage the risk – such as fire safety.
- 2.19 Micro businesses crave certainty and it is this lack of certainty that currently causes them problems and exposes them to uncertainty and additional costs. In our consultations, business owners repeatedly said that they want clear, prescriptive guidance highlighting minimum requirements that they can follow to gain certainty that they are 'doing it right'.

2.20 Micro businesses would prefer a twin-track regulatory solution, namely that businesses can choose to adopt the principles based approach, interpreting and embed regulatory principles in their business practice or, simple prescriptive rules about what is legal and illegal tailored to a micro business.

The smallest businesses obtain regulatory advice — not all of it accurate — from a range of sources

2.21 Consistent with previous studies, we found that businesses get advice from a range of sources:

- From accountants, banks or HMRC for tax-related matters;
- From trade associations (if they are a member of one) for other issues and for regulatory changes;
- From other business owners and networks;
- From Business Link advisors and websites, along with other websites.
- From companies such as RBS Mentor or C&G Safety and Environmental Ltd
- From local authorities, regulators and central Government

2.22 Importantly, some of the smallest micro businesses get much of their advice through informal or non-authoritative sources, such as newspapers and personal networks. Sources such as these are thought to have driven the culture of misinformation and over-compliance, particularly in relation to health and safety.

2.23 To combat this type of rumour and poor information, one example of good practice is the Health and Safety Executive's 'myth of the month' column on its website (www.hse.gov.uk/myth/index.htm), an example that could be adopted by other regulators.

2.24 We found that many businesses are paying for advice where they don't need to — one business owner was paying a bank £180 per year for regulatory updates they could have got from www.businesslink.gov.uk for free.

2.25 Through our consultations with many associations, we have noticed that associations themselves offer some guidance that is more concise and reader-friendly than official government advice.

Local Authorities - Enforcement and inspections

2.26 Businesses say that regulatory enforcement can be inconsistent but connections with inspectors can prove valuable. Comments about inspections varied, with some seeing inspectors as a valuable source of advice, while pockets of poor practice remain. Many regulations and the way they are applied by enforcers are not proportionate to the business size or the ability of an individual business owner to cope.

2.27 Micro businesses feel very vulnerable to the particular interpretation of regulations by individual inspectors and when they disagree, they do not know who they can seek advice from or complain to.

2.28 While some local inspectors have been a source of complaint by local businesses, overall our consultations found that they are often a source of good advice and support.

3. Capacity and Capability is an underlying issue

- 3.1 Our study has predominantly focused on a group of businesses that could be categorised as being relatively low entry threshold businesses, requiring modest to moderate start up investment. Although we did meet many business owners with substantial and profitable businesses, and some high-growth, ambitious firms, the core of the market we were looking at was struggling with growth for a variety of reasons.
- 3.2 After speaking to many of the businesses, the reasons why they were not growing were broadly three-fold:
 - I. They lacked the capital to expand or take advantage of new opportunities but were stuck in sub optimal retail premises, with success in retail having a lot to do with location, because they are trapped by a vicious cycle of low turnover, low margins and thus limited access to growth capital.
 - II. The owners themselves didn't seem to have had the knowledge or training, or access to situation-specific quality advice,
 - III. There was also a significant subset that didn't appear to be seeking growth. Businesses of this type could be seen to be running 'lifestyle businesses' in the sense that they may have had a small B&B or shop that was enough for their personal income needs and that they were not wanting to jeopardise this by taking a risk to expand.
- 3.3 Although regulation is an issue, much regulation could be considered good business practice and much regulation (as long as it does not change from year to year) is not a daily burden to business owners.
 - What our conversations with associations and micro businesses has revealed is that many business owners lack training in business management and therefore struggle, not just to comply with regulation, but to develop and grow their businesses.

4. Key regulatory issues

4.1 Specific problem areas identified by businesses are:

- Employment
- Environment, especially waste
- Health and safety
- Food safety
- Planning & Building Controls
- Fire safety
- Procurement
- Data Protection Act

Employment

4.2 Our study found that, according to micro businesses, employment law does have a negative effect on business growth, and that the concern about employment law is less about paperwork but probably more about cost, complexity and the perceived cost of 'getting it wrong'.

"I purposely avoid employment law and only work with other self-employed persons."

— Media company, Bristol

4.3 In terms of specific regulations, employment law was the greatest barrier to growth. Businesses felt that it is too complicated, expensive and that employers lack protections 'if things go wrong' or 'if we simply cannot afford to keep people on'.

4.4 Employing staff is a critical milestone for a growing business, but unfortunately it is a step many businesses do not dare to take. For this reason, many businesses told us that they intentionally avoid employing staff but will use contractors or other self-employed persons. One business thought that this is so prevalent that it is changing the shape and dynamics of the entire labour market.

4.5 Employers felt that 'the pendulum has shifted', meaning that the balance of rights between employers and employees has moved too far away from employers resulting in them not prepared to take the risk of employing anyone.

4.6 5 issues are:

- Employment related costs including Employers Liability Insurance and the cost and administration of statutory payments.
- Fear of litigation and dismissal processes;
- Administrative difficulties with employing young people;
- Costs involved with maternity/paternity obligations
- The right to request flexible working arrangements was said to be an administrative headache with little benefit because they would generally consider people's requests but were constrained in their ability to juggle hours within a small team.

National Minimum Wage

4.7 While many micro businesses will pay in excess of the National Minimal Wage, not all are in a position to, due to their individual circumstances or the nature of their industry— or their location.

Employers Liability Insurance

- 4.8 As soon as an employer takes on a member of staff they are required to take out Employers Liability Insurance. At a minimum this appears to cost small shops and pubs around £1500 per year and this is the case regardless of whether they employ 1 or 4 staff. Although the legal requirement is that employers have to be covered for £5 million, insurers are reported as providing quotes on the basis of £10 million.

Fear of litigation and dismissals

- 4.9 Micro businesses stated that one of the reasons why they actively avoid employing staff is, in part, due to the processes they have to follow in order to dismiss staff. It is believed that it is becoming increasingly hard to dismiss people and that employers have to go through an onerous process.
- 4.10 It was said that current processes unduly favour employees (who may be underperforming etc) and that they have to follow around three series of meetings and written warnings. Our own review of guidance around dismissals does seem to indicate that it could be clearer and more certainty could be given to employers about what the minimum steps they need to take and also what appropriate intervening period between disciplinary measures should be.
- 4.11 They also say that the requirement to give an employee time to amend behaviour or improve performance is unclear and unfair. They are also unclear about which acts would justify immediate dismissals with no fear of it resulting in legal action.
- 4.12 Employees have the right to be accompanied at disciplinary meetings, however for micro businesses there may be no one available to accompany them and micro businesses say it is heavy-handed to insist upon this. They state that although a third-party presence in some cases can be helpful, in a worst case scenario the person could wrongly support staff in a tribunal, making it a 'two against one' scenario.

Employing young people or apprentices

- 4.13 Employing newspaper boys is a real hassle- they have to get forms signed and circulated to everyone from parents, the Local Authority through to the child's school and by the time this is completed, the child no longer wants the job. Similarly the obligation on newsagents to make sure that bike safety is maintained, that the child gets home OK etc, works against making it a worthwhile proposition.
- 4.14 The obligations to check anyone in contact with children has created an environment where businesses are unclear what this regulation extends to.

Maternity/Paternity Obligations

- 4.15 Although businesses complained about maternity and paternity payments, many recognised that maternity leave is a legitimate right but most were less happy about paternity leave. The key issue many businesses had was that they were required to hold positions open for women, who often didn't return, keep them informed, or returned late. They said that for a very small employer having to keep positions open created real pressures. It made it difficult to recruit someone for a short period and that they couldn't afford the time it takes to get a new staff member up to speed, especially because they find that if someone comes in to cover a maternity position, the person will naturally be looking for a permanent full time job, so frequently left within a short period of time.

Environment, especially waste

- 4.16 Micro businesses have particular issues around their disposal of waste. Although many produce waste comparable to that of a domestic residence, they are not allowed to dispose of it in the domestic collections or recycling, instead have to pay either the council or a private waste collector to take it. This can be a significant cost for a micro business, especially if they have 'hazardous waste' – such as cleaning chemicals or meat. One business pays a company £250 plus VAT per collection.
- 4.17 Perhaps because of this, there are often low levels of compliance in this area. Micro businesses admitted to us that they took their waste home to throw away, or that they put hazardous waste in with general waste. Some were simply unaware of what their obligations were. Many struggled to find and understand guidance, and found it difficult to get clarity as to what is exempt.
- 4.18 Micro businesses also were confused by certain regulations, such as the Waste Framework Directive (when waste stops being classed as waste and becomes a resource and WEEE exemption certificates) and the WEEE directive (customers return batteries to newsagents, who are not sure how to dispose of them). Some micro businesses are required under Environmental Permitting Regulations to purchase very expensive equipment - one micro garage was required to pay £5000 for a petrol vapour recovery system, and one local authority inspector reported that two drycleaners had stopped operating because they could not afford to purchase new equipment.

“We have to pay to get waste removed although almost all my waste is cardboard and plastic. 98% is recyclable but the council won't take it. I have to pay a contractor £114 per fortnight, in addition to business rates” – micro newsagent

Regulations relating to health and safety

- 4.19 These remain a concern for a number of businesses, largely because they either misunderstand the regulations or have been given poor advice by consultants or insurers. The Health and Safety Executive produces some of the best guidance for micro businesses – templates, the 'myth of the month' webpage, tailored guidance, sample risk assessments, and the free risk assessment toolkit CD we gave to micro businesses were very popular.
- 4.20 The use and understanding of the term health and safety can often include, for example, fire safety and food safety and so can make comments difficult to tie down to particular regulatory areas.
- 4.21 However, health and safety regulations more than any other area suffer from misinformation and over-complication in the media and elsewhere. This means that many micro businesses still feel that they need a consultant to do their 'health and safety', and/or are paying for things they believe are necessary to comply with regulations but which are not – for example paying for annual portable appliance testing.

***“I paid a consultant £800 to do a risk assessment for me”
- micro business***

- 4.22 Annex B shows a range of pressures on a micro business when trying to comply with the totality of regulations related to health and safety (from the Risk and Regulation Advisory Council Health and Safety Risk Forum³).

Food safety

- 4.23 Micro business have stated that some of the obligations on them involves too much paperwork, for example there is a belief that they need to keep temperature records several times a day, even though some fridges are alarmed to alert changes in temperature. Micro businesses often only have one chef, and they spend a significant amount of their time doing paperwork, rather than preparing food as was intended when they were hired.

“From the food point of view health and safety is important and is good but has a lot of paperwork. For 1 person it takes 2 – 3 hours. This could make you want to give up business”.

- Catering Company - London

- 4.24 The Safer Food, Better Business packs given to micro businesses make it easier than before for micro businesses to comply, but many believe there is still too much paperwork, and some admitted they were just filling in paperwork at the end of the day or week.

Procurement

- 4.25 In order to tender for work from other companies, or particularly local authorities, there are a range of pre-qualification questionnaires a micro business needs to fill in. As they are generic, they are often lengthy and filled with what business will consider irrelevant questions, such as around gender/equality policies, or employee consultation. Many micro businesses feel that the process favours larger companies who have the time and resource to fill these out. They were also frustrated that there is no standardisation of forms, when surely they all have the same objectives.
- 4.26 Over time accreditation schemes have been established to streamline the process – promising that by joining the scheme (for a fee) a micro business can avoid form filling when tendering for work however, in reality, a number of competing schemes have been established and a micro business needs to join a number of them in order to secure work.
- 4.27 Micro businesses state that both accreditation schemes and pre-qualification schemes set standards higher than those required by Government regulations. They ask for insurance limits in excess of what a particular contract or activity would really warrant.

Planning & Building Controls

- 4.28 Micro businesses were deterred from undertaking major works because of the cost, complexity and uncertainty of obtaining planning permission. Micro businesses thought that larger businesses had an advantage because they were better able to work

“Planning is a postcode lottery. There is a lack of consistency, especially with listed buildings, and people just give up.”

— B&B, Southwest

³ <http://www.bis.gov.uk/files/file52340.pdf>

the system and they received better treatment from local authorities.

- 4.29 Micro businesses also reported problems with building controls, and how they worked in practice. One shop was forced by a council to put in a ramp to accommodate the one disabled person who required help before the ramp was fitted. The installation of the ramp has led to problems for many old people who cannot cope with a slope but who could manage before with a step and a rail. Other micro businesses reported problems when trying to comply with the new no smoking laws – but they could not obtain planning permission for smoking shelters.

Fire safety

- 4.30 Micro businesses reported significant problems in complying with fire regulations. In the past a fire inspector would visit the premises and issue a fire safety certificate. Now, since the Fire Safety Order of 2005, businesses need to conduct a fire risk assessment themselves and this, they feel, requires expertise and knowledge - such as how a fire spreads - which is beyond the ability of many micro businesses. For this reason many micro businesses that are aware of the new regulations have had to pay for one or more external experts to come in.

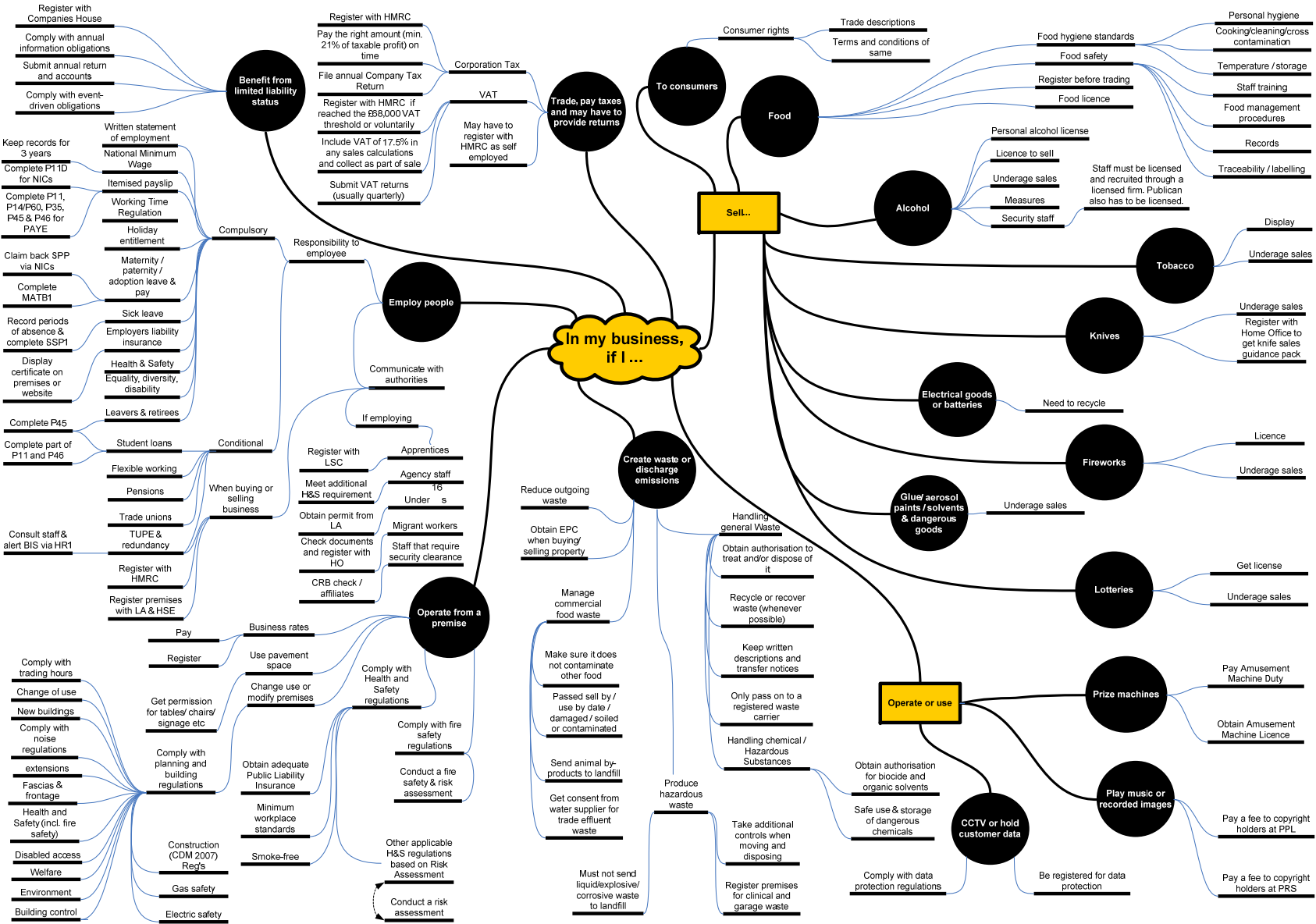
“There are so many special rules that I have to get a consultant in but because the requirements are so strict, I ultimately had to pay an advisor around £2000 to do it for me.”

- 4.31 Because fire safety is a complex area, business lack of knowledge also exposes them to less reputable ‘consultants’ who we were told, try to get them to buy too much equipment that they do not need.

Data Protection Act (DPA)

- 4.32 Many micro businesses need to be registered under the DPA, even if they just keep customer’s emails or have CCTV. They see no point to the registration – they are never contacted and find the guidance unclear and impractical.
- 4.33 As part of the DPA, one micro business had to get a new privacy policy for its website, which cost him £100 and half a day of administration.

Annex A - Map showing potential obligations applying to a business





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1 Victoria Street
London SW1H 0ET
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