Research report

HMRC Segment Migration

Understanding the potential for SMEs to move segments.

Business Customer & Strategy

24 April 2012

Behavioural Evidence & Insight Team

About Business Customer and Strategy (BC&S)

Business Customer and Strategy is part of Business Tax.

The goal of BC&S is to maximise Business Customer compliance for HMRC at best cost for both HMRC and the customer. This us done by developing business tax strategies through customer understanding, working with teams in HMRC and across government departments.

Contents

Research requirement (background to the project)

The SME Compliance Segmentation was developed in 2009 to create an attitudinally-based compliance segmentation of SME businesses, and to provide a market representative view of SMEs' interactions with HMRC and their attitudes towards fulfilling their tax obligations. The resulting seven segments were built on the following six core dimensions:

1. Awareness
2. Acceptability of evasion
3. Perception of risk
4. Ability
5. Prioritisation of payments to HMRC
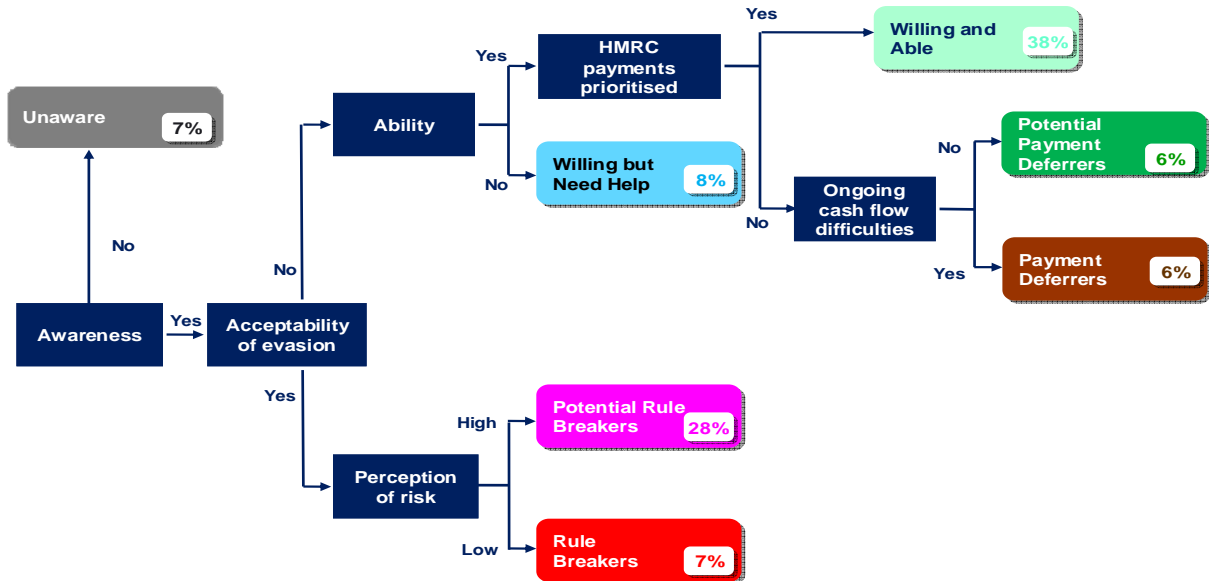6. Ongoing cash flow difficulties

Fig. 1

The SME Compliance Segmentation has provided HMRC with the basis from which to understand *why* businesses behave as they do and, to date, has been used primarily to underpin HMRC'S SME strategy.

The overall aim of this work was to move from theory to practice - to realise the potential of the SME Compliance Segmentation as a means to **direct behavioural change**, by understanding the potential for SMEs to move segments through analysis of:
*   The most likely paths for segment movement
*   The most likely triggers for movement

While the SME Compliance Segmentation provides the *basis* for the different strands of work in this project, and the end goal is to better understand the segments, only by focusing on generating knowledge and insight on the *dimensions* on which the segmentation is based can the potential for segment movement be inferred. Given that this analysis is based upon observing the allocation of SMEs to segments and their similarity to other segments, measures are of *potential* migration, not actual migration.

Who did the work (research agency)

The research was conducted by Quadrangle.

When the research took place

The research programme took place in January – March 2011.

Method, Data and Tools used, Sample

Sample was drawn from the HMRC database, and a specifically designed survey was conducted amongst 3,500 sole traders. The analysis also drew on an earlier piece of work (SME U&A 2009) which comprised a sample of n=1468 UK SMEs (0-249 employees) which was originally used to define the SME segments referred to in this work. The sample was skewed to reduce the size of the Willing & Able segment, therefore biasing it towards the attitudinally non-compliant. This enabled greater understanding of the more 'negative' segment shifts that can occur within a subset of the SME universe.

The methodology was designed to consider the impact of small and medium sized movements on each segment dimension, and the resulting impact on segment allocation, as follows:

Understanding the spread of SMEs within each segment:
- Identification of each SME's score on each of the key segmentation dimensions;
- Each factor to be broken down into its constituent parts, to understand each SME's corresponding location on the dimension;
- Profile those SMEs on the margins against key demographic information and calculate the approximate proportion of SMEs likely to move;
- Use the profile and location data to suggest approaches to move SMEs over time towards, and into, the 'Willing & Able' segment.

Second choice segment allocation:
- Use discriminant analysis on the basis of key segmentation dimensions to assign each SME their 'second choice' segment, i.e. if they were not where they are currently, which segment would they most likely move to?;

HM Revenue & Customs

- For SMEs which fall into the 'Rule Breakers' segment, test their score on the 'ability' dimension to see if they would move into 'Willing & Able' or the 'Willing but Need Help' segment, should their motivation to comply be improved;
- Subsequently profile/ quantify the proportions and types of SME that fall into each of 'second segments' and use this to inform conclusions on segment drift.

Calculating how to move SMEs to the 'Willing & Able' segment, and how this might be achieved:
- In determining 'Willing & Able' as the ideal segment destination, calculate the number of steps each SME is likely to need to move them to this destination.

Main Findings

- *Understanding segment antecedents is critical in the understanding of some potential migration paths.* For instance, if HMRC were to change what many SMEs needed to do to complete their tax obligations, lower educated groups show a higher likelihood to move segment. They are most prone to move into the 'Willing but Needs Help' segment. Its is important to note that attitudinal shifts are not simply a factor of demographic or firmographic factors, they are driven by many other things. For example, 'Potential Rule Breakers' with a propensity to migrate to either 'Rule Breakers', 'Payment Deferrers' or 'Willing but Needs Help' all report similar financial difficulties and education levels, but 'Rule Breakers' differ fundamentally in their attitudes towards the acceptability of tax evasion.
- *Changes in personal circumstances appear to be linked to potential changes in segment, or at least they could initiate behavioural shifts which would lead to changes.* This appears to be particularly the case where a change in circumstances has a financial impact for the sole trader (e.g. divorce), where a move to more evasive attitudes (and by association, behaviours) can be triggered by financial pressures on the individual. This suggests that trends in the wider economy are likely to put pressure on compliance attitudes and potentially make a proportion of the population more susceptible to taking risks they may previously not have taken.
- *Business life-stage is a significant potential lever for HMRC to use to influence Sole Traders.* The analysis confirms the trends identified in the original segmentation which suggest that initial business set-up is a key time to influence 'compliant' behaviours. Troublesome periods can signal a potential to 'move' towards payment deferral or attitudinal non-compliance.Taking on new tax requirements introduces complexity to their tax affairs, which some businesses find difficult to negotiate.
- *Migration to non-compliance is most likely to be experience-driven.* The 'Willing and Able' who might migrate to 'Potential Rule Breakers' as a second segment are more likely to have professional qualifications, report strong business growth and complete a tax return themselves. This indicates that their potential move to

3/E04, 100 Parliament St. London, SW1A 2BQ

attitudes more accepting of tax evasion could be experience-driven and potentially tied into an increased familiarity with how the system works. It is possible that learned behaviours over time can be directed in different directions, but HMRC's active presence as a deterrent will be critical in ensuring that these behaviours do not encourage large shifts towards non-compliance.

- *Business education is vital as information and knowledge are critical fundamentals for all the compliant segments.* Where there is a trend towards 'negative' shifts, there is strong evidence to suggest that this could be addressed through various business education programmes, for instance up-skilling on specific tax issues or understanding risk and the personal liabilities that Sole Traders take on in evading tax. Work to make clear the potential down-side of tax evasion as well as to demonstrate HMRC's role in 'clawing back' unpaid tax could well prove fruitful areas for further development.

- *The 'reluctant conformists' that the 'Potential Rule Breakers' represent are often the vocal minority who can influence attitudes.* Countering the effects of this and ultimately shifting people out of this segment will be important in ensuring 'positive' segment shift.

There follows detail on the ways in which potential migration was measured as part of this work for two of the seven segments.

Measuring Potential Migration

Discriminate analysis was used to enable an understanding of indicative migration and where it would be most likely to occur. The following shows for two segments (the 'Unaware' and 'Potential Payment Deferrers') where migration is most likely to occur, with behaviours from this study compared against the initial segmentation work in 2009.

'Unaware' (All SMEs 2009)

- Unsurprisingly, there was a highly-diffuse range of different attitudes within 'Unaware'.
- 'Unawares' were expected to move between many different segments (although movement towards 'Willing but Need Help' appeared most likely)

Migration	Total	Core
WBNH	50%	64%
W&A	26%	14%
PRB	12%	14%
PD	9%	7%
PPD	3%	0%
RB	0%	0%

Fig. 2; Figures represent Total %/ Core % - with Core defined as those who we are 90% certain belong in the segment based on discriminant possibilities

'Unaware' (Sole Traders 2011)

- Again, the 'Unaware' are a diverse segment, although a relatively high population sit within the 'core' of this segment in comparison to other segments.
- Movement from this segment to 'Willing but Need Help' and 'Willing and Able' is expected but – given the higher levels of attitudinal non-compliance – a high proportion of the 2011 'Unaware' sample are seen to be moving towards 'Potential Rule Breakers'.

Fig. 3

HM Revenue & Customs
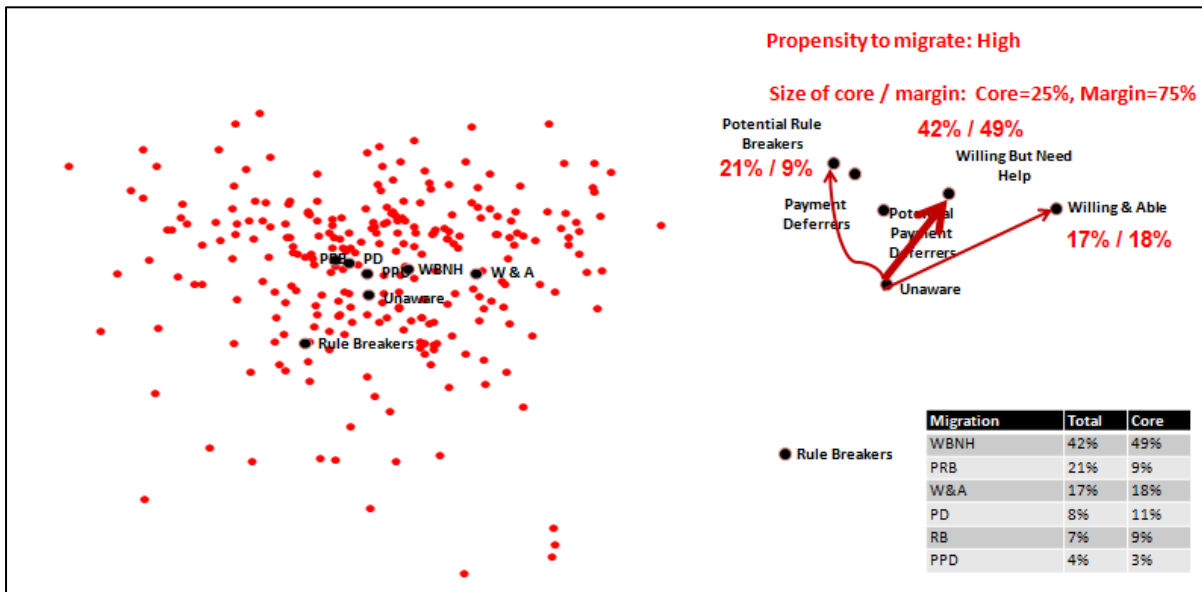
'Potential Payment Deferrers' (All SMEs 2009)

- Group encompassed a number of segment centroids.
- Difficult to predict movement, but likely to see some sharing with 'Payment Deferrers'.
- Economic climate and business health were key determiners of potential movement.

Propensity to migrate: Extremely high

Size of core / margin: Core=13%, Margin=87%

Payment Deferrers
27% / 57%

Potential Payment Deferrers   **61% / 35%**

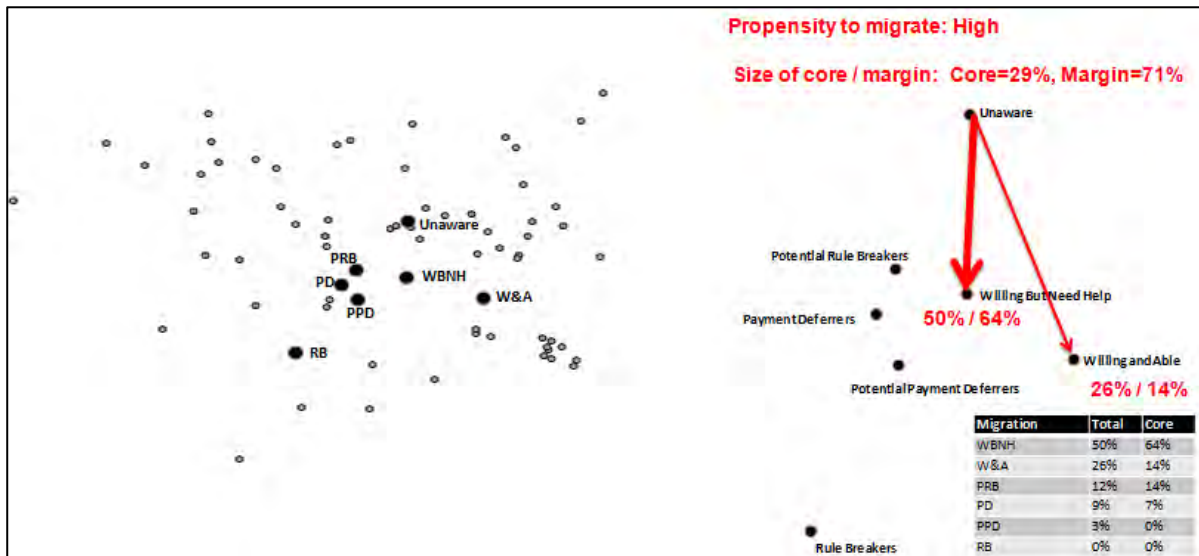| Migration	Total	Core
W&A	61%	35%
PD	27%	57%
RB	7%	9%
PRB	3%	0%
Unaware	1%	0%
WBNH	1%	0%
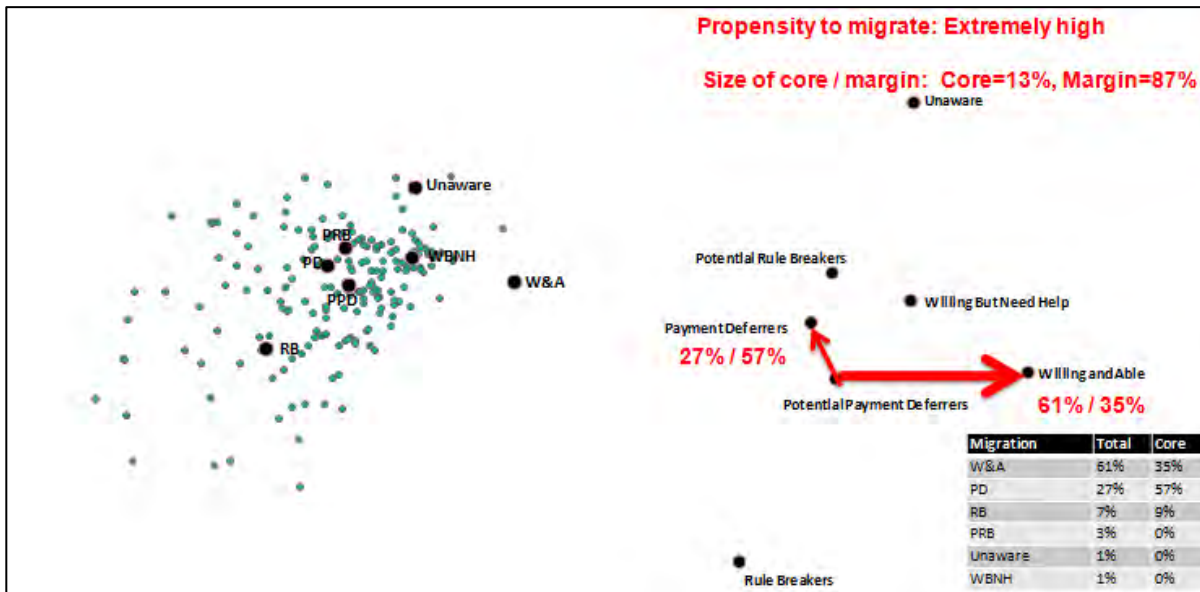
Fig. 4; Figures represent Total %/ Core % - with Core defined as those who we are 90% certain belong in the segment based on discriminant possibilities

3/E04, 100 Parliament St. London, SW1A 2BQ

'Potential Payment Deferrers' (Sole Traders 2011)

- The range of attitudes displayed by this segment in the 2011 study is more diverse, with some showing stronger non-compliant attitudes, as illustrated in the distribution pulling down towards the 'Rule Breakers' centroid. This is evident also in the likely movement of the core towards 'Potential Rule Breakers', rather than 'Willing and Able' (or 'Payment Deferrers').
- This segment is potentially the least stable, with only 1% sitting in the core of the segment.

Migration	Total	Core
W&A	50%	0%
PD	20%	0%
PRB	17%	100%
RB	6%	0%
WBNH	5%	0%
Unaware	3%	0%
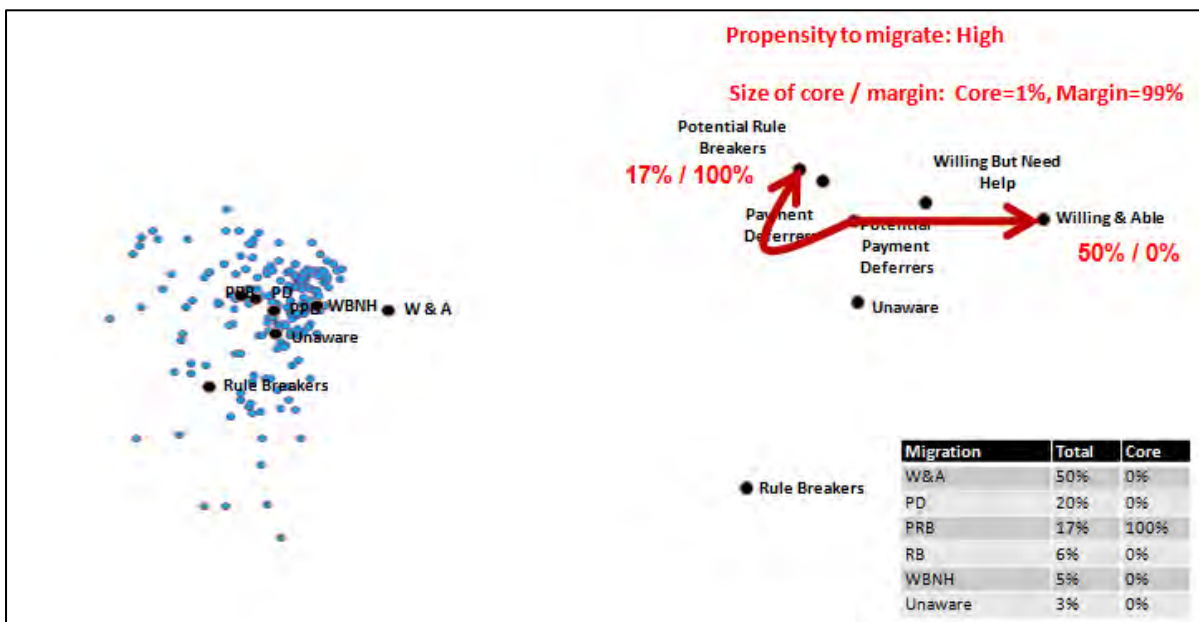
Fig. 5

Profiling the segments

The following charts show members of the 'Willing and Able' and 'Potential Rule Breakers' segments who potentially could move, and highlight those areas in which we have found real differences between the second segments and the core profile. (Note: sample sizes dictate that we can only confidently look at actual profiles on the 'Willing and Able' and 'Potential Rule Breakers' segments, as the biasing means other segments are not of sufficient size to accurately profile.)

'Willing and Able'

- 'Willing and Able' is the SME segment displaying the most desirable tax behaviours – any migration from this segment is a cause for concern.
- The most popular second segments for 'Willing and Able' SMEs are:
    - 'Potential Payment Deferrers' (32%)
    - 'Willing But Need Help' (22%)
    - 'Potential Rule Breakers' (21%)
   - 'Payment Deferrer' (19%)

The following charts analyse the profiles and highlight some key characteristics of these SMEs whose second segments are 'Potential Payment Deferrers' and 'Willing but Need Help', characteristics which form a key means of predicting potential migration.

	More likely to...	Less likely to...
Firmographics	•Be in the primary industries (118), Business Activities (132) or Health and social work (117) •Report strong/modest business growth (115/126) •Prefer online advice/training (115) or face-to-face seminars (114)	•Be in Community, Social and Personal Services (78) •Be a start-up business (83) •Report strong business contraction (71) •Have reduced their workforce (83) •Have recently moved business premises (70)
Finances	•Complete tax return themselves (110)	•Have problems with paying bills/suppliers (41) and/or cash flow (48) •Have recently had contact with collection agencies (53) •Know of another business evading tax (81)
Demographics	•Be aged 65+ (123-157) •Refuse to give their age (150) •Have a higher degree (130) •Be from Scotland (133) or Yorkshire (128)	•Be in their fifties (65-83) •Have experienced change in personal circumstances, e.g. Divorce (74) •Have no qualifications (83) •Be from N.West (52)

Fig. 6; Indexed scores: 100=Average

Fig. 7; Indexed scores: 100=Average

'Potential Rule Breakers'

- The consequences of tax evasion deter 'Potential Rule Breakers' from non-compliance, although they do not disagree with it in principle. As such, a slight attitude or behaviour change could result in these SMEs shifting to either the very desirable or very undesirable segments.
- The most popular second segments for 'Willing and Able' SMEs are:
  - 'Rule Breakers' (29%)
  - 'Willing and Able' (24%)
  - 'Payment Deferrer' (17%)
  - 'Willing but Need Help' (14%)

The following charts analyse the profiles and highlight some key characteristics of these SMEs whose second segments are 'Rule Breakers' and 'Willing and Able', characteristics which form a key means of predicting potential migration.
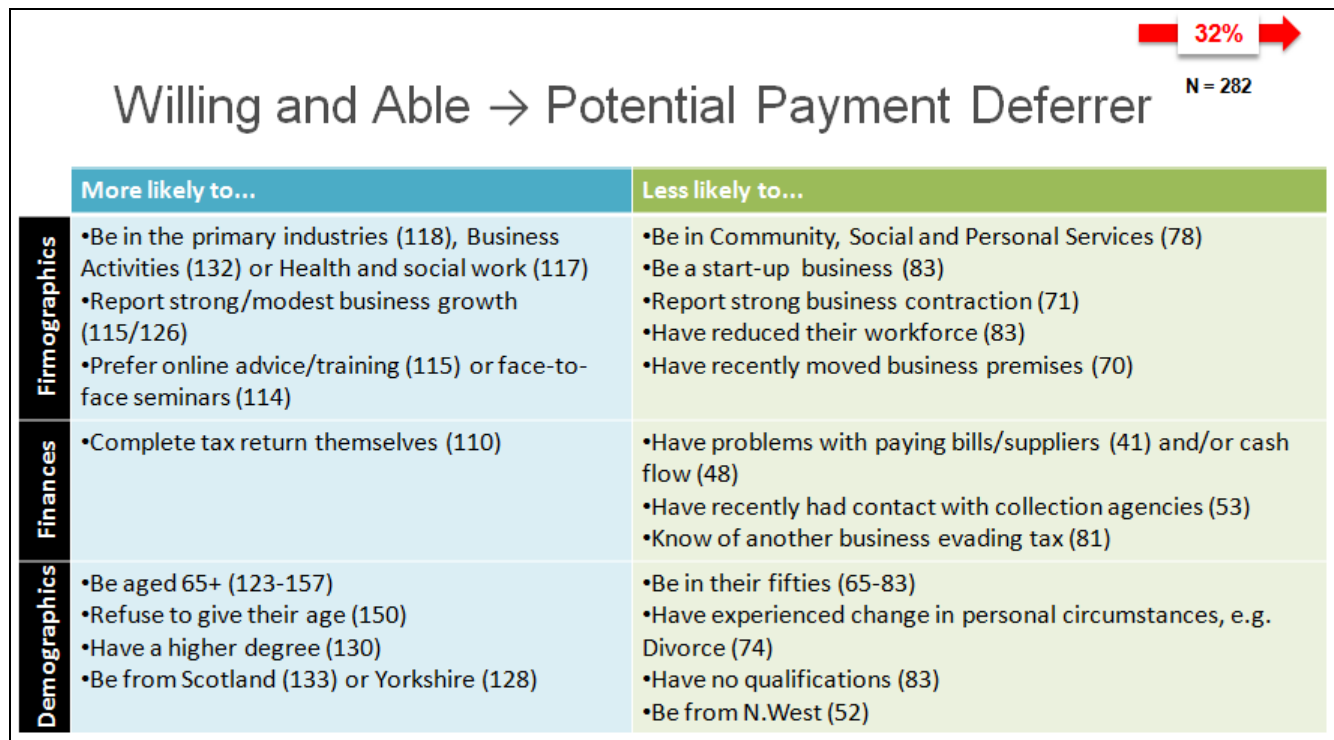
3/E04, 100 Parliament St. London, SW1A 2BQ

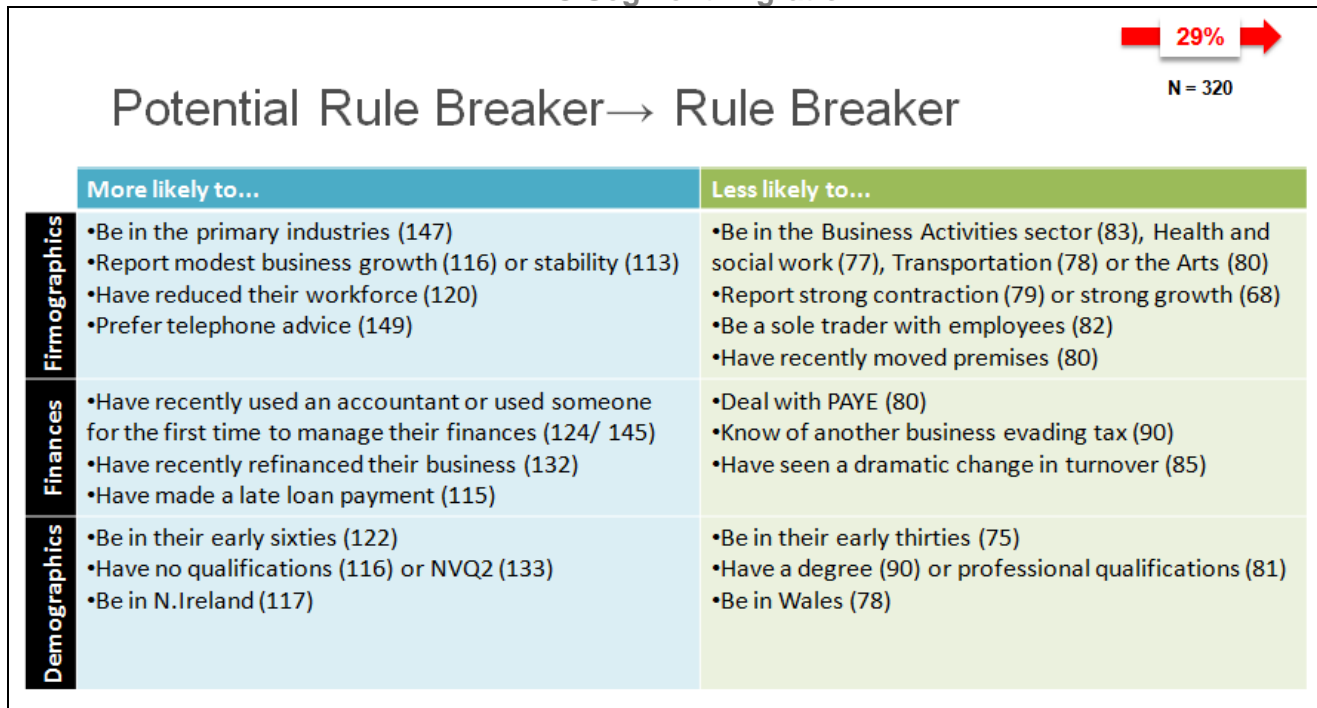## Potential Rule Breaker→ Rule Breaker

29% ▶ N = 320

More likely to...	Less likely to...
Firmographics •Be in the primary industries (147) •Report modest business growth (116) or stability (113) •Have reduced their workforce (120) •Prefer telephone advice (149)	•Be in the Business Activities sector (83), Health and social work (77), Transportation (78) or the Arts (80) •Report strong contraction (79) or strong growth (68) •Be a sole trader with employees (82) •Have recently moved premises (80)
Finances •Have recently used an accountant or used someone for the first time to manage their finances (124/ 145) •Have recently refinanced their business (132) •Have made a late loan payment (115)	•Deal with PAYE (80) •Know of another business evading tax (90) •Have seen a dramatic change in turnover (85)
Demographics •Be in their early sixties (122) •Have no qualifications (116) or NVQ2 (133) •Be in N.Ireland (117)	•Be in their early thirties (75) •Have a degree (90) or professional qualifications (81) •Be in Wales (78)

Fig. 8; Indexed scores: 100=Average

Potential Rule Breaker→ Willing and Able

24% ▶ N = 262

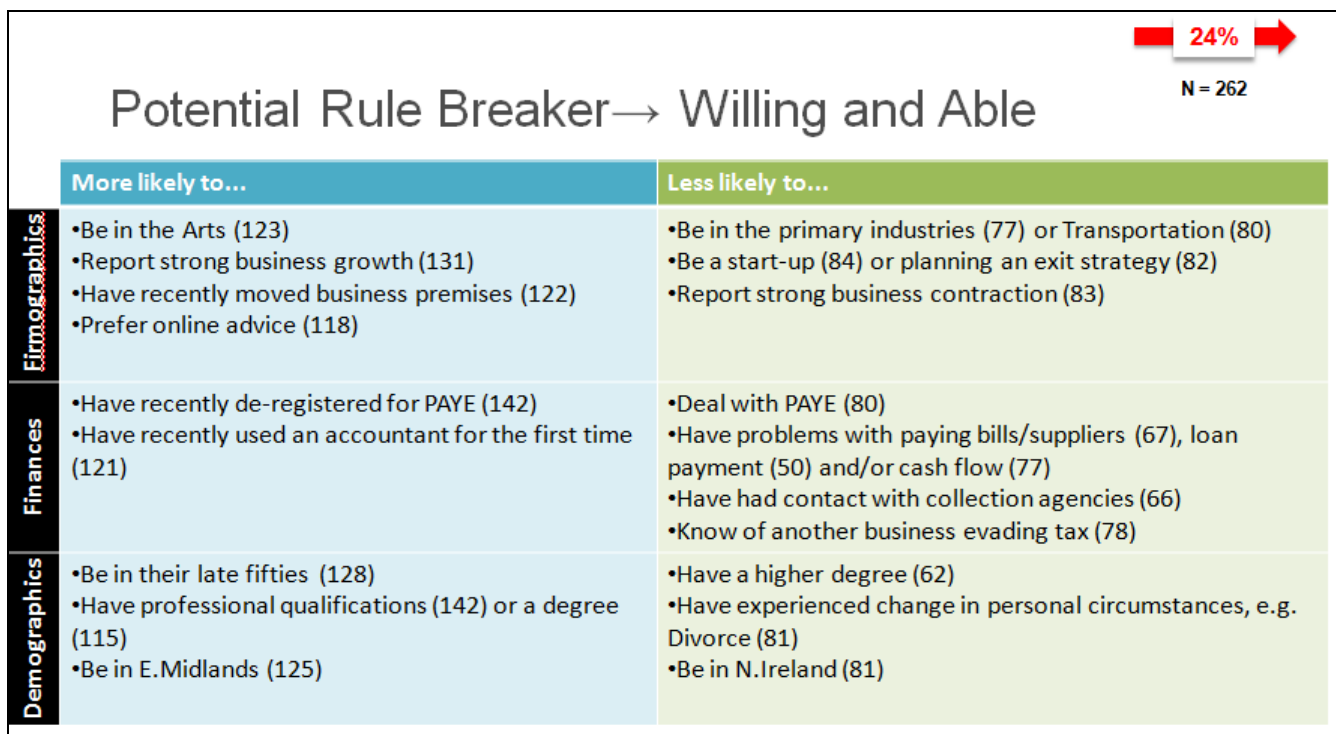| More likely to...	Less likely to...
Firmographics •Be in the Arts (123) •Report strong business growth (131) •Have recently moved business premises (122) •Prefer online advice (118)	•Be in the primary industries (77) or Transportation (80) •Be a start-up (84) or planning an exit strategy (82) •Report strong business contraction (83)
Finances •Have recently de-registered for PAYE (142) •Have recently used an accountant for the first time (121)	•Deal with PAYE (80) •Have problems with paying bills/suppliers (67), loan payment (50) and/or cash flow (77) •Have had contact with collection agencies (66) •Know of another business evading tax (78)
Demographics •Be in their late fifties (128) •Have professional qualifications (142) or a degree (115) •Be in E.Midlands (125)	•Have a higher degree (62) •Have experienced change in personal circumstances, e.g. Divorce (81) •Be in N.Ireland (81)

Fig. 9; Indexed scores: 100=Average

In summary

Exploring the differences between those who are likely to migrate to different segments will enable HMRC to identify the types of businesses who are likely to move to non-compliant segments. This will help HMRC to ensure that this sort of migration is addressed and minimised by focusing on more at-risk groups and developing strategies to move people towards 'Willing and Able'.

The results of this work will be used as stimulus to inform campaign planning and to define the most appropriate means of managing segment shift over time. Understanding segment migration will enable HMRC to influence real and practical change to drive up efficiencies (through the reduction of error) and increase yield (through improved targeting and compliance messaging).