



Research report

SME Always Need Help

Research to identify the unique or particular characteristics of the SME population who 'Always needs help'.

Business Customer & Strategy

February 2012

SME Always Need Help***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 is done by developing business tax strategies through customer understanding, working with teams in HMRC and across government departments.

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Who did the work

The research was conducted by Quadrangle, an external research agency.

When the research took place

December 2011.

Objective

To identify the unique or particular characteristics of the SME population who ‘Always needs help’ that can be used to help HMRC pro-actively identify this group in the SME population.

Awareness and Ability

The first step in meeting this objective is to define what we mean by an SME business that ‘Always needs help’. To help us do this, we looked at two indices; Awareness and Ability. These indices were developed from the statements given in tables 1 and 2 below.

Table 1

| | |
|----------------|---|
| Ability | I often need help understanding official forms |
| | I am very confident in dealing with my finances |
| | How difficult you find it to understand legislation |
| | The business can easily cope with fulfilling its obligations to HMRC |
| | The business has the financial skills to stay on top of its obligations to HMRC |

Table 2

| | |
|------------------|--------------------------------|
| Awareness | Collect National Insurance |
| | Collect Income Tax |
| | Pays out Tax Credits |
| | Collects Corporation Tax |
| | Collects PAYE payments |
| | Collects VAT |
| | Collects Self-assessment tax |
| | Collects Excise duty |
| | Pays job seekers allowance |
| | Sets the tax rates |
| | Administers statutory Payments |

The five ability statements were asked on a 9 point scale, they were coded such that scoring at the lower end of each scale indicates less ability, and scoring at the top end higher ability. The final Ability score was simply an average of the responses to these five statements.

The 11 Awareness statements were asked on a true or false scale. A higher score on the Awareness index indicates that the SME business has correctly identified a greater number of HMRC’s responsibilities. Two of the Awareness statements, the 9th and 10th in the list above,

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are not responsibilities of HMRC and therefore to score a point a SME would have to correctly identify them as false.

The statements used to build both were given equal weight in their construction. Both Indices were then re-scaled to take values between 0 and 100. The frequency distributions for each index are shown below.

As we can see the Ability Index is less skewed with scores distributed more widely across the 0-100 plane, whilst the Awareness Index is heavily left skewed; with the majority of SMEs having a fairly good understanding of the responsibilities of HMRC. This suggests that for the purposes of identifying a 'Always Need Help' group of SMEs the Ability Index is likely to be a better discriminator.

Chart 1: Ability Index

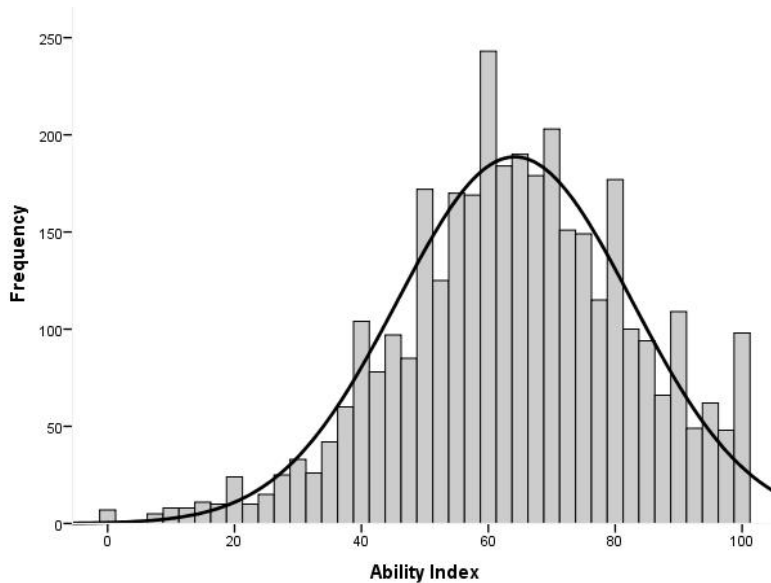
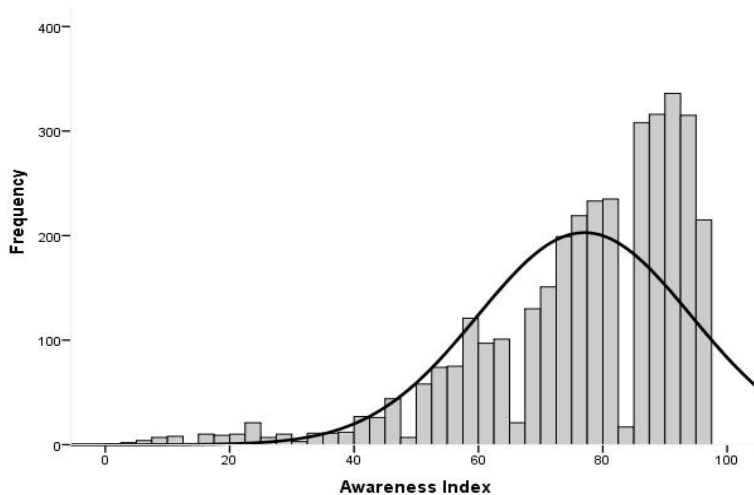


Chart 2: Awareness Index



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Setting threshold values for the indices

For each index we looked at a number of potential thresholds to determine the most appropriate to define the Always Need Help group of SMEs.

Table 3 shows the threshold scores we used to define the Always Need Help group and the estimated count of SMEs in this group for various threshold values.

Table 3

| Index | Threshold Scores | % of Population | Population Estimates |
|------------------------|------------------|-----------------|----------------------|
| Ability Index | <=30, >30 | 3.5% | 155,990 |
| | <=35, >35 | 5.1% | 227,765 |
| | <=40, >40 | 7.9% | 352,696 |
| | <=45, >45 | 10.3% | 462,186 |
| | <=50, >50 | 15.7% | 699,993 |
| | <=60, >60 | 39.1% | 1,748,204 |
| Awareness Index | <=40, >40 | 4.6% | 204,072 |
| | <=45, >45 | 5.2% | 230,892 |
| | <=50, >50 | 7.0% | 315,067 |
| | <=55, >55 | 9.9% | 440,727 |
| | <=60, >60 | 15.7% | 701,340 |
| | <=65, >65 | 20.7% | 923,904 |

To identify an appropriate threshold(s) we looked at two metrics and compared SMEs that fell into the Always Need Help group to those who didn't on each of them.

1. The distribution of responses to each of the statements that make up Ability and Awareness
2. The characteristics of SMEs and the demographics of the individual

We found the following characteristics consistently more prevalent in the low **ability** SME group, regardless of the threshold we used.

- Sole traders with no employees who use sub-contractors
- SMEs in the Construction Industry
- Start up SMEs
- SMEs who have had strong contraction over the last 2 years
- SMEs not confident enough to do their tax returns completely by themselves so get an advisor to check and sign it off.
- Male respondents
- Respondents below 55
- Respondents with few or no qualifications

We found similar characteristics in the low **awareness** SME group, regardless of the threshold we used.

- Sole traders with no employees who use sub-contractors
- SMEs in the Construction Industry
- Start up SMEs
- SMEs use external accountant or tax advisor

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- Male respondents
- Respondents below 40
- Respondents with few (especially vocational qualifications) or no qualifications

Tables 4 and 5 in the appendix provide the uplift figures for these characteristics. The uplift figures are calculated based on the ratio of the penetration figures for each characteristic, as shown below.

$$\text{Uplift} = \left(\frac{\text{Penetration of characteristic in SMEs} < \text{threshold}}{\text{Penetration of characteristic in SMEs} > \text{threshold}} \right) * 100$$

Example

40% SMEs with ability score < 35 are in construction

28% SMEs with ability score > 35 are in construction

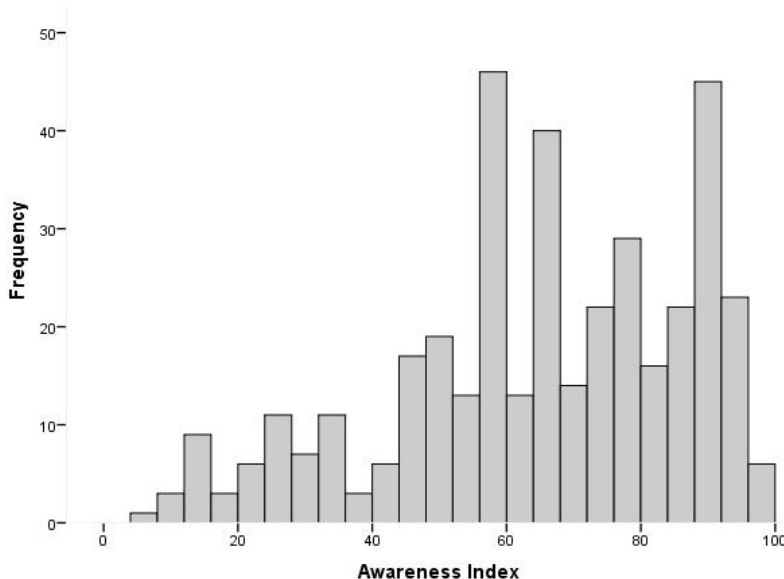
$$\text{Uplift} = \left(\frac{0.4}{0.28} \right) * 100 = 143$$

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Defining the Always Need Help Group

On review of the work we have done, we felt that the best measure for defining the Always Needs Help group is the Ability Index. We have chosen not to use the Awareness index for a number of reasons. Firstly there are a number of SMEs who have a low ability score but score highly on the Awareness Index. Secondly the statements used to define awareness refer to the awareness of what the HMRCs role is rather than awareness of the SMEs tax responsibilities; they are therefore perhaps not so useful for identifying SMEs that will Always Need Help. It is worth noting that there is evidence to suggest that SMEs with low ability will on average have lower awareness. Chart 3 shows the distribution of awareness scores for SMEs that have an ability score below 40. If we compare this to chart 1 we can see that the distribution of the scores is less skewed to the left.

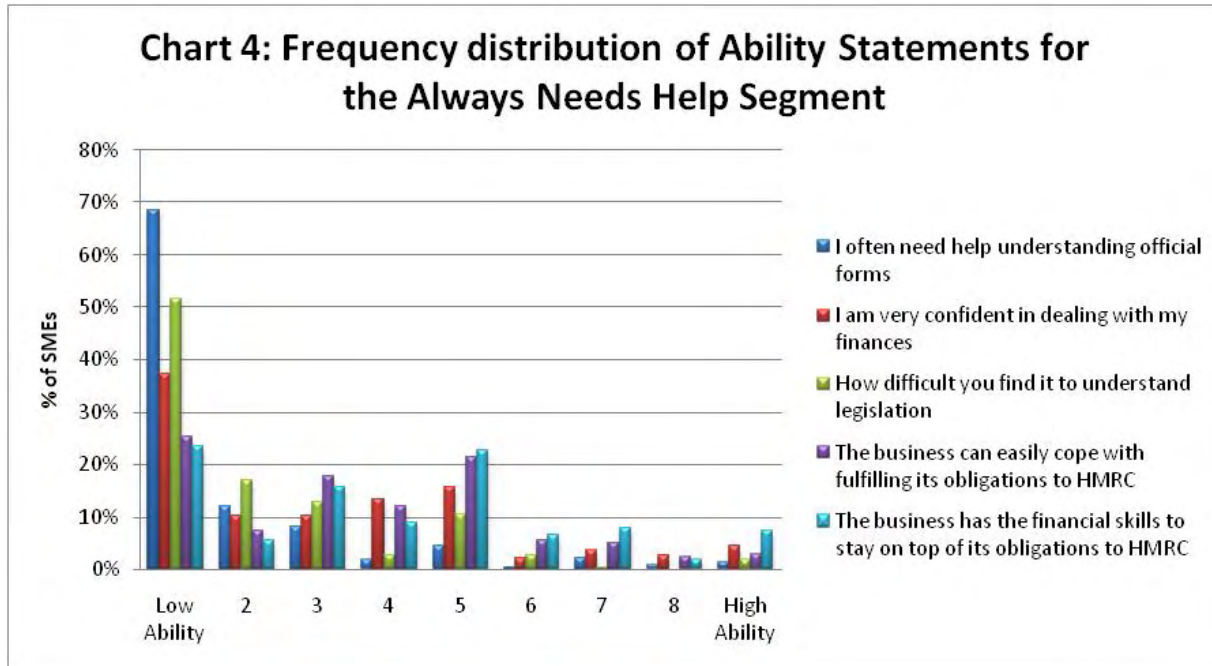
Chart 3 Ability Score below 40 – Histogram of Awareness Index



The threshold on the Ability Index we have set to define the **Always Need Help group is a score of 35 or less**. Therefore we estimate that there are approximately 227,765 SMEs who fall into this group, circa 5.1% of the SME population¹. Of the businesses that fall below the threshold value circa 175,638 or 2.87% of the SME population are attitudinally compliant.

We have set this as the threshold value for two reasons. Firstly if you look at table 4 in the appendix the uplift figures tend to be at the highest for this threshold across the majority of the key characteristics that define the 'Always Need Help Group'. Secondly the responses SMEs gave to the 5 statements that make up the Ability Index are highly right skewed, with the majority of SMEs scoring 5 or less on each statement. We can see this very clearly in chart 4 below.

¹ Based on the 2010 BIS SME population figures <http://www.bis.gov.uk/analysis/statistics/business-population-estimates>

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Implications

From the analysis we have undertaken there is evidence to suggest that SMEs with a lower level of ability (especially those with a score of 35 or less) have certain characteristics that set them apart from SMEs with a higher ability and these characteristics could be used to improve any targeting HMRC intend to do for this segment. Certainly at the very least the size, sector and length of time a SME business has been running are all useful characteristics that can be used and are likely to be available and up to date (at least annually) on most business databases. HMRC should concentrate their efforts in the construction (F), manufacturing (C) and transportation and storage (H) sectors and put less effort into the financial/insurance (K) and professional, scientific and technical activities (M) sectors. In general when targeting sole traders or the self employed they should target those who sometimes use sub-contractors rather than those who don't use them. There is also some evidence to suggest that if they are a start-up company, operating for less than 2 years, they are also more likely to have a lower level of ability.

HMRC should also be able to ascertain (with reasonable accuracy from tax returns) whether a SME has seen growth, stability or contraction in the last few years, and target those who have seen a strong contraction; who are therefore more likely to have made redundancies and other cost savings that impact on their ability to deal with tax returns.

Other factors of interest tend to relate more directly with the characteristics of the person responsible for the tax returns, and so might well be more difficult for HMRC to obtain. However it's worth keeping in mind that characteristics like education, gender and age all seem to have some relationship with ability, with those who are younger, male and with low or no education more likely to be less able.

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Appendix
Table 4 - SMEs with low Ability

| Characteristics more prevalent in SMEs with low Ability | Threshold | | | | | |
|---|-----------|------|------|------|------|------|
| | <=30 | <=35 | <=40 | <=45 | <=50 | <=60 |
| Sole trader (self-employed) with no employees but sometimes use sub-contractors | 125 | 139 | 121 | 113 | 106 | 112 |
| Construction (e.g. building, plumbing, electrical) | 137 | 145 | 129 | 130 | 125 | 120 |
| Start up (i.e. less than 2 years operation) | 183 | 160 | 150 | 148 | 156 | 161 |
| Strong contraction | 199 | 180 | 156 | 145 | 150 | 130 |
| SME prepares majority of the tax return but checked by tax advisor | 149 | 150 | 133 | 120 | 117 | 110 |
| Male | 110 | 106 | 105 | 104 | 106 | 104 |
| 1-4 O levels / CSEs / GCSEs, Entry Level, Foundation Diploma | 140 | 125 | 123 | 118 | 121 | 130 |
| No qualifications | 137 | 126 | 136 | 131 | 135 | 145 |

Table 5 - SMEs with low Awareness

| Characteristics more prevalent in SMEs with low Awareness | Threshold | | | | | |
|---|-----------|------|------|------|------|------|
| | <=40 | <=45 | <=50 | <=55 | <=60 | <=65 |
| Sole trader / self-employed with no employees but sometimes use sub-contractors | 118 | 112 | 100 | 116 | 107 | 98 |
| Construction (e.g. building, plumbing, electrical) | 135 | 142 | 137 | 138 | 144 | 138 |
| Start up (i.e. less than 2 years operation) | 179 | 175 | 155 | 147 | 145 | 147 |
| I use an external accountant or tax advisor to prepare and send off the return | 119 | 116 | 117 | 116 | 110 | 109 |
| 20-39 | 121 | 131 | 121 | 120 | 122 | 118 |
| Vocational qualifications | 155 | 150 | 152 | 147 | 139 | 135 |
| No qualifications | 217 | 229 | 206 | 185 | 171 | 158 |
| Greater London | 157 | 166 | 152 | 122 | 115 | 121 |
| Northern Ireland | 134 | 115 | 116 | 133 | 139 | 127 |