Unclassified

HM Revenue & Customs

Research Report 305

Understanding mid-size businesses

Qualitative and quantitative research with the mid-size business population

Business Customer & Strategy

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

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Research requirement (background to the project)

HMRC currently uses turnover and number of employees as a way of differentiating the business population to target its resource into Large Business and Small and Medium-sized Enterprises (SMEs). In order to develop more effective and efficient engagement strategies, HMRC sought to understand what other factors influence business customer behaviours and experiences.

This research set out primarily to provide HMRC with **increased understanding of mid-size businesses**. Mid-size businesses, although a relatively small group, make a sizeable contribution to UK turnover and are significant in terms of their growth potential.

To set the parameters for this work, HMRC purposely started with a broad classification of mid-size businesses: *Businesses in the UK with a £10m-200m turnover and/or more than 20 employees*, with the expectation that the parameters would be refined as a product of the research. This definition meant that a wide range of businesses would be involved in the research.

The research sought specifically to understand their characteristics and **provide a more sophisticated way to identify sub-groups** in the population that would enable HMRC to better engage with businesses.

When the research took place

A mixed method research programme was designed in three phases and carried out to the following timeline:

- Phase 1 Set up/immersion: November 2012 – January 2013
- Phase 2 Qualitative research: December 2012 – February 2013
- Phase 3 Quantitative research: February 2013 – June 2013

Who did the work (research agency)

Quadrangle carried out all activities involved in each of the three phases, working in close collaboration with the HMRC project team.

Methodology – Design, participants/sample and data collection

The core methodological components for each phase are as follows:

Phase 1 Set up/immersion:

Purpose:
- To determine the optimum research plan, methodology and sampling strategy

Participants:
- HMRC stakeholders

Data collection:
- Secondary research (using existing HMRC sources and analysis, overlaid with external reporting)
- Consultations with 17 stakeholders from across HMRC
- Workshop with key HMRC stakeholders

Activities focussed on establishing and evaluating what is known/not known about the mid-size business population and identifying the most likely key decisions that would be made based on the research.

Phase 2 Qualitative:

Purpose:
- To develop a deeper understanding of the characteristics, attitudes and behaviours of mid-size businesses, providing a focus for the quantitative research

Participants:

- HMRC staff
- Intermediaries and Agents (to mid-size businesses)
- Mid-size businesses

Data collection:

All interviews were conducted either face-to-face or by telephone and lasted up to one hour.

- 10 consultations to further the understanding of operational issues for mid-size businesses, with HMRC Customer Coordinators, HMRC Strategy and Compliance staff and external Intermediaries
- 4 case study visits to explore decision making in depth, including visits to businesses, discussions with different finance/management roles in the business, and consultations with Agents
- 60 depth interviews; 44 with mid-size businesses and 16 with Agents

Activities focussed on providing insights into the characteristics, attitudes and behaviours of mid-size businesses, enabling an assessment of the potential for a segmentation model, and providing a rationale and focus for the quantitative research.

Phase 3 Quantitative:

Purpose:

- To provide a rich and detailed understanding of the population, decide where and how lines should be drawn to define distinct sub-groups in the population and create a model that will enable HMRC to develop a more customer-focused and targeted approach for mid-size Businesses

Participants:

- A representative sample of mid-size businesses – respondents were finance leads including owner-managers, finance directors/controllers and heads of tax who were making key decisions about financial management in their business

Data collection:

- A quantitative survey, with a random probability design, of 1,860 mid-size businesses conducted by telephone and lasting an average of 25 minutes.

The survey questionnaire focussed on collecting information on the characteristics of mid-size businesses, their management of tax obligations, attitudes towards compliance and their relationship with HMRC.

Analysis activities provided an understanding of the population at the overall level, with further analysis and modelling redefining the population and revealing distinctive segments in the population. These segments will inform how HMRC could develop more effective and efficient engagement strategies.

Main Findings

6 key insights from the Set-up and Qualitative phases

1. Mid-size businesses are an important contributor for the economy (‘*engine of growth*’[1]).

2. Within the broad parameters set for understanding mid-size businesses, there are those which are sufficiently different to both large *and* small businesses and so a differentiated approach is likely to result in increased yield, better customer experience and more efficient use of HMRC resources.

3. Mid-size Businesses require a level of engagement that reflects their level of sophistication and consequently demand a prompt response and speedy resolution on both administrative and strategic tax issues.

4. An appropriate engagement does not require an *on-going* relationship with a nominated individual at HMRC (as it does for the largest businesses via a Customer Relationship Manager).

5. Some mid-size businesses want and need enhanced engagement to better facilitate the resolution of issues and to achieve certainty on more complex issues, such as life events encountered for the first time (e.g. opening operations outside the UK, acquiring or merging with another business). These are likely to be infrequent and require responses from tax specialists (not a call centre).

6. For some, all engagement with HMRC is outsourced to Agents who are asking for similar differentiation from HMRC as the businesses they represent, as well as knowledge of issues specific to more complex mid-size businesses.

A number of characteristics were identified by the Set-up and Qualitative phases, including physical, performance and competency characteristics. These combined to create a ‘Complexity Framework’ and each feature in the Framework was carried forward into the quantitative stage.

[1] *CBI Future champions report – http://www.cbi.org.uk/media/1125696/cbi_future_champions_report.pdf*

Key insights from the Quantitative phase

Overview of mid-size business population

1. **Size characteristics**: Using the broad definition of size selected for this project, most businesses are eligible for potential mid-size categorisation because of the number of people they employ rather than their turnover. The lower threshold for eligibility is £10m and yet the average turnover is just above that at £11.58m. As many as 2 in 3 businesses have a turnover *below* £10m, while the average number of employees is 98.

2. **Structural complexity**: Businesses are more likely to be single entities than groups, and the population is dominated by limited companies and private ownership. There is a clear UK focus, although 1 in 3 businesses offer products and services internationally. While the nature of trading is varied, more than half the businesses operate within 5 sectors: Health and social work activities, Other service activities, Wholesale and retail trade, Manufacturing and Professional, scientific and technical activities.

3. **Growth/ life events**: Looking at turnover from the last two tax years, businesses are more likely to be growing than in decline. Around 2 in 3 increased their turnover in the last year, whilst 1 in 3 reduced their turnover. 'Life events' (both positive and negative) are experienced, although these are fairly infrequent with an average of 2.5 events experienced in last 3 years. The most frequent events experienced are cash flow problems, profit reduction and significant capital investment.

4. **Tax management**: Most businesses have good internal capabilities with 6 in 10 businesses reporting that they have someone with professional tax or accountancy qualifications involved in business tax and financial affairs. Businesses self-report high levels of understanding about their tax obligations and almost all businesses use an Agent; most use Agents for auditing purposes but more than half receive tax strategy advice.

5. **Service considerations for HMRC**: Around 2 in 3 businesses are satisfied with their dealings with HMRC, however, there is room for improvement. While views are diverse in terms of what HMRC could do to better to support businesses, the most frequent views involve named contacts for engagement when required, improved access to and quality of response from the Helpline and contact with tax specialists on technical issues.

This overview of the population is useful in that it begins to provide some understanding of what the population looks like overall (e.g. main business characteristics and performance levels). This broad, top-level overview also creates context for understanding the environment in which these businesses operate.

It is certainly clear from the research that a differentiated approach would be beneficial for both HMRC and Mid-size Businesses, and whilst size (the basis for current differentiation) still matters it is not everything. It is through understanding *complexity* within a business that HMRC can develop a more targeted approach.

There is clear evidence to support a refined approach to what constitutes a mid-size business and strong indicators that there are sub-groups within the population that are distinct enough to allow scope for differentiated treatment by HMRC. The creation of a new complexity-based model for mid-size businesses, reflecting various identified characteristics that could affect tax attitudes and behaviours, reveals these distinct and meaningful sub-groups.

Building the model

Principles of the approach

The fundamental principle of the approach is to create a model that HMRC can operationally use. This means that any solution primarily needs to:

- Use variables that are visible in HMRC's data
- Have a manageable number of variables and sub-groups

The model

The model comprises three dimensions applied with a clear hierarchy.

1. Size

- Size is not everything; but it does still matter and plays an important role in the model
- As a simple and stable measure, size is used as the first step in the build and begins to pull apart the population to create the sub-groups
- The size dimension is created using HMRC's 2010-11 data for turnover and number of employees

2. Structural complexity

- The second dimension is a multi-faceted measure condensed into one score
- The structural complexity dimension is determined by the existence of certain characteristics involving:

  a. Group Structure
  b. Trading area
  c. Ownership
  d. Structural change in last 3 years
  e. Taxes liable for

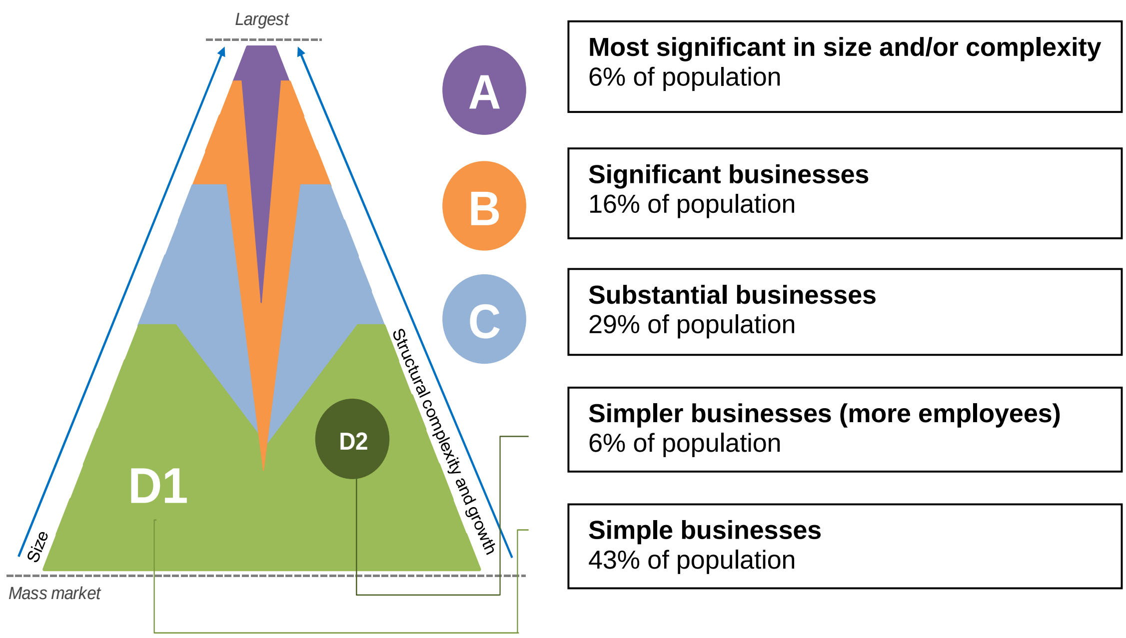
3. Growth

- The third and final dimension is growth; specifically, rapid growth
- Rapid growth can impact a business in different ways, including creating opportunity for risk of error and avoidance
- This growth dimension, created with HMRC turnover data from 2009-10 to 2010-11, placed businesses in their final sub-group

Building this model enables HMRC to recognise the complexity that exists *throughout* the potential mid-size business population. By overlaying *size* with *structural complexity* and *growth*, HMRC can recognise that within this population, ‘smaller’ businesses can be significant businesses and share many issues and needs with ‘larger’ businesses.

Focussing on complexity in this way will enable HMRC to be rounded in its approach – in responding to customer needs but also in taking a risk-based approach to treatment strategies.

The 4 Tier Model



Profiling the tiers

Tier A: Most significant in size and/or complexity

Size	The most significant of all Tiers in terms of size; over half report a turnover of £75+million (and/or) 200+ employees
Structural complexity	The most significant Tier in terms of structural complexity with the highest score of all the Tiers. Businesses are more likely to have a group structure and to sell products/services internationally
Growth/ life events	The fastest growing of all Tiers. Businesses are more likely to encounter and anticipate strategic life events
Tax management	The most capable Tier with the highest proportion of qualified professionals in-house and most likely to use multiple Agents and Advisors. The majority feels they understand their tax obligations well
Service considerations	More likely to rate dealings with HMRC as poor than the average and require a 'way in' to talk to tax specialists on more complex technical issues

Tier B: Significant businesses

Size	Around half the businesses have a turnover of £30-74m; for size, the real focus is on workforce – the average workforce size is high and not too dissimilar to Tier A
Structural complexity	Around average structural complexity. Businesses are just as likely to be group owned as to be a single entity and to sell products/services internationally as to be UK only
Growth/ life events	Above average rapid growth and less likely than lower Tiers to be in decline. In common with Tier A, but in contrast with lower Tiers, they are likely to encounter and anticipate strategic life events
Tax management	A very capable Tier: They have the second highest proportion of qualified professionals in-house and are likely to use multiple Agents and Advisors. The majority feels they understand their tax obligations
Service considerations	Satisfaction when dealing with HMRC is in line with the average but like Tier A, they want access to an expert for more complex technical issues – this access is likely to be less regular than Tier A

Tier C: Substantial businesses

Size	Many businesses are located in this Tier as a result of structural complexity and/or growth: mean and mode turnover and employee number levels are relatively low
Structural complexity	The second highest Tier in terms of structural complexity; lower only than Tier A. Businesses are more likely to be single entities and to sell products/services in the UK only
Growth/ life events	A Tier with high levels of rapid growth. Businesses are more likely than lower Tiers to encounter and anticipate strategic life events
Tax management	A capable Tier: almost 2 in 3 have qualified professionals in-house and are very likely to use multiple Agents and Advisors
Service considerations	More likely than average to rate dealings with HMRC positively. Less need than Tiers A and B for access to technical experts but sustained growth and life events may require infrequent support

Tier D2: Simpler businesses (more employees)

Size	Turnover is less than £10m, but all have more than 100 employees
Structural complexity	With lower complexity scores, these simpler businesses are less likely than average to be group owned and to sell products/services internationally
Growth/ life events	Growth is moderate at best and they are more likely than all Tiers to have experienced decline. They have also experienced fewer life events than average, aside from capital investment
Tax management	Levels of internal competency are in line with the average and higher than D1 – they are also more likely than D1 to use multiple Agents or advisors. Understanding of tax obligations is in line with the average
Service considerations	Satisfaction when dealing with HMRC is lower than average and simpler businesses seek more appropriate educational tools and greater commercial understanding from HMRC

Tier D1: Simple businesses

Size	Made up of the smallest businesses in terms of turnover and employee numbers; all are <£10m with <100 employees
Structural complexity	Simpler than the rest of the survey population, they are not materially different to Small businesses in terms of their structural complexity. They are less likely than average to have a group structure and to sell products/services internationally
Growth/ life events	Growth is moderate at best and they are more likely than higher Tiers to have experienced decline. Less likely to experience life events overall, except cash flow problems or declining performance
Tax management	They have the lowest proportion of qualified professionals in-house and are least likely to use multiple Agents and Advisors. However, the majority feels their tax obligations are well understood (in line with average)
Service considerations	Satisfaction when dealing with HMRC is in line with the average. With much less need for access to technical experts, this Tier is more likely to want improvements to mass market channels e.g. want it to be easier and quicker to get through on the Helpline