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Profit Distribution and Investment Patterns of Unlisted Companies

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Glossary[1]

<table>
<tr><th>Term</th><th>Definition</th></tr>
<tr><td>Close company</td><td>A close company is defined in this research project as a company under the control of 5 or fewer shareholders, or one where all of the directors own more than 50% of the shares.</td></tr>
<tr><td>European Commission company size definitions</td><td>The main factors determining a company’s size are number of employees and either turnover or balance sheet total, as per the table below. More detail on the European Commission definitions of company size can be found here: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm
<table>
<tr><th>Company category</th><th>Employees</th><th>Turnover</th><th>or</th><th>Balance sheet total</th></tr>
<tr><td>Medium-sized</td><td>< 250</td><td colspan="2">≤ € 50 m</td><td>≤ € 43 m</td></tr>
<tr><td>Small</td><td>< 50</td><td colspan="2">≤ € 10 m</td><td>≤ € 10 m</td></tr>
<tr><td>Micro</td><td>< 10</td><td colspan="2">≤ € 2 m</td><td>≤ € 2 m</td></tr>
</table></td></tr>
<tr><td>Family grouping</td><td>A family grouping could include:
a) Spouse or civil partner
b) Any other person with whom the shareholder lives as partner in an enduring family relationship (except for grandparent, grandchild, sister, brother, aunt or uncle, or nephew or niece)
c) Children or step-children aged under-18 (whether the shareholder’s or their partner’s)
d) Parents</td></tr>
<tr><td>Financial assets</td><td>In the survey financial assets were described to the respondent as ‘the bank and cash figure on the company’s balance sheet’ with the clarification if necessary that ‘financial assets are cash and bank accounts including short term bank deposits and bonds’.</td></tr>
<tr><td>Fixed assets</td><td>Fixed assets are tangible physical property owned and used by a company in the production of its profits, for example buildings, plant and machinery (distinct from intangible assets which are not physical in nature). This includes things like vehicles, computers, furniture or shop fittings.</td></tr>
<tr><td>Intangible assets</td><td>Intangible assets are non-financial fixed assets that do not have physical substance, such as brands, copyrights, patents, logos or other intellectual property. This also includes ‘goodwill’.</td></tr>
<tr><td>Remuneration</td><td>Remuneration is the total compensation package which may include salary, dividends, shares, pensions and other economic benefits.</td></tr>
<tr><td>Retained earnings</td><td>In the survey retained earnings was described to the respondent as ‘a cumulative figure specified at the bottom of the company’s profit and loss account stating the retained earnings up until this point in time’.
It is the net earnings not paid out as dividends, but retained by the company to be invested in its core business, or to repay debt. Retained earnings may be invested in new assets, or used for other purposes, such as working capital.</td></tr>
</table>

[1] Readers should note that some of the definitions used in this research report do not necessarily meet the full technical definition generally used by HMRC, as some of these were simplified in the research tools to allow ease of understanding. Where definitions were simplified, this was done consistently in both the survey questionnaire and the qualitative topic guide. Full HMRC definitions may be found on HMRC’s website at: https://www.gov.uk/government/organisations/hm-revenue-customs

Share capital	Share capital is funds raised from the issue of shares. In many smaller companies this may only be £1 or £2.
Share premium	Share premium is the amount paid for shares in a company in excess of their nominal value.
Staff	The number of employees reported in the survey does not include company directors (therefore they will be referred to as 'staff' throughout the report).
The main director	In answering questions on company remuneration, respondents were asked to think about 'the main director', defined as the director with the largest shareholding. If none of the directors held shares, respondents were asked to think about: • the owner with the largest shareholding; • the employee with the largest shareholding; or • if there were no shares, the person able to control the company.
Total net assets/ shareholder equity	Total net assets is the difference between total assets and total liabilities at the bottom of the balance sheet (also known as Shareholder Equity).
Unlisted Company	An unlisted company is a company whose shares are not traded (or quoted) on any public exchange so the shares are not available for public trading. An unlisted company in the UK is one which is not listed on the London Stock Exchange or in the Alternative Investment Market (AIM).

1 Summary

HM Revenue & Customs commissioned Ipsos MORI to conduct quantitative and qualitative research into unlisted companies' profits distribution, investment and retention behaviours and the reasons behind these, including tax-planning and growth plans. The research consisted of a telephone survey of 1,501 unlisted companies, followed up by qualitative interviews with 27 companies which had made a profit of at least £20,000 in the most recent accounting period, and agreed to be re-contacted.

Two-thirds of unlisted companies returned a pre-tax profit in the last full accounting period, with the remainder split evenly between those who broke even and those who made a loss (17% and 16% respectively). Four in five (79%) of the profit-making companies had retained earnings in the last full accounting period, one in ten (10%) did not and eleven per cent refused to say, or did not know. Companies with retained earnings were more likely to have been trading for longer, to have made a larger profit, and to hold more assets, than those without retained earnings. However, they were no more or less likely to expect their company to grow over the next 12 months.

Overall, having financial security for the company was the main driver for keeping some level of retained earnings within the company (mentioned by 50% of those who did so). This was especially common among micro companies (53% compared with 24% of large companies). Around one in five (22% each) considered retained earnings to be helpful as a source of finance for future growth and expansion activities, or for planned future investments.

The qualitative research identified that some companies viewed retained earnings as a 'buffer' to help them with cash flow issues or to fall back on when the business faced economic difficulties, but once these reached a certain level they became a source of investment. This was supported by the survey data which found that two in three companies with retained earnings of up to £10,000 invested in activities additional to the day-to-day operations of the company, rising to almost nine in ten (87%) of those with retained earnings of over £100,000.

Where companies had engaged in activities such as capital spending, investment in intellectual property, and investment in digital technology, they had overwhelmingly financed these through internal funds. This was particularly true of micro enterprises. Although internal funds were also the most common source of investment among larger companies, they were more likely to have also used debt finance such as loans and mortgages, overdrafts, or leasing / hire purchase. The qualitative research found that many smaller companies in particular sought to avoid debt. This was partly because they viewed relying on loan finance as more expensive than funding investment internally. However there was also a sense of caution about borrowing because of the potential risks involved, both as a hangover from the recent recession, and in terms of losing some control of the company.

Salaries were the most common form of director remuneration (provided by 67% of companies), followed by dividend payments (58%); almost half the companies used both (46%). Company remuneration strategies were commonly chosen to maximise tax efficiencies. Around a quarter (26%) of companies whose directors were remunerated cited tax as a factor in their remuneration decisions. This is reflected in the fact that, where paid, salaries tended to be of low monetary value, with two in

five (41%) of these companies stating that their main directors' salary was below £10,000, and dividend payments tended to be higher than salaries.

The overwhelming majority of companies that were still trading expected their company to grow (44%) or stay the same size (46%) in the next twelve months; only 9 per cent expected to decline. Expectations for growth were highest among companies with more than 50 staff, a turnover of more than £1 million, and those trading in the Wholesale & Retail, Transport and Hospitality sector. Nearly half of all companies that expected to grow in the next twelve months were anticipating this to come from higher demand or volume of work (46%). Other reasons given for expected growth included the company actively looking to grow as part of their business plan (35%), investment in expansion (29%) and an improving economic climate (24%). The qualitative research revealed a number of different 'growth mindsets':

- some companies wanted and expected to grow, and were actively working towards this;
- others aspired to grow but were pessimistic about the prospect of doing so because of market conditions; and
- some companies had constraints on their growth, such as limited director time, organisational capacity, or difficulties accessing loan finance.

When looking specifically at companies that expected to grow, the most common barriers to growth cited were lack of working capital (16%), strong competition (14%), poor general economic conditions (13%) and lack of available, skilled employees (13%). A small minority of companies that expected to grow (9%) cited barriers to borrowing as an impediment to growth, and even smaller proportions felt that industry specific regulations (4%) and high tax liabilities (3%) were barriers. Small companies were more likely than large ones to cite industry specific regulations as a barrier, although the percentage concerned was still a minority (10%).

Overall, both the survey and qualitative research identified that tax considerations had a greater impact on decisions around director remuneration than they did on other uses of company profits, such as retention or investment. Wider economic, business and even personal considerations were more important in determining considerations about growth and investment. The qualitative research found that, where tax did play a role in investment decisions, it was cited mainly in relation to the perceived tax and administrative burden of recruiting someone. A handful of companies (in particular those actively seeking to grow) did suggest improvements, such as better incentives for investing in new products, higher capital allowances or more support through the tax system for recruiting apprentices, however none mentioned their awareness and use of currently available tax reliefs[2].

[2] Some examples of current tax reliefs include Annual Investment Allowance (AIA) - https://www.gov.uk/capital-allowances/annual-investment-allowance, Research and Development Relief for Corporation Tax - https://www.gov.uk/corporation-tax-research-and-development-rd-relief and the abolition of employer contributions to National Insurance for apprentices under 25 - https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385150/TIIN_2143.pdf

2 Introduction

2.1 Background

This HM Revenue & Customs (HMRC) report covers findings from Ipsos MORI research into company profit distribution patterns among unlisted companies.

Of the UK's 1.5 million actively trading companies[3], most are not listed or quoted on tradable equity markets, and are therefore referred to as 'unlisted'. The overwhelming majority of the companies are small and medium size enterprises (SMEs) or start-up companies, many of which remain under the ownership and control of the founder or founding family. Such unlisted companies lie at the heart of the UK economy. They account for a significant proportion of its GDP and employment. Furthermore, they are a key source of entrepreneurship[4]. However, there is a lack of public information on how unlisted companies retain, distribute or invest their profit, and the extent to which their decisions are influenced by the tax regime.

This research aims to bridge this knowledge gap, and in doing so to assist HMRC in delivering a tax system that helps these businesses to invest and thrive, ultimately supporting economic growth. The key research objectives were to investigate:

- how unlisted companies distribute, retain and invest profit;
- differences in the composition of unlisted companies' balance sheets;
- the relationship between unlisted companies investment strategies and their growth plans; and
- the reasons, including tax-planning and growth plans, that companies exhibit particular profit-distribution and investment behaviours.

2.2 Acknowledgements

Ipsos MORI would like to thank Megan Gray, Corinne Wilkins and Hannah Rhodes at HMRC for their helpful comments and assistance throughout the research.

We would also like to thank all of the representatives of unlisted companies who gave their time to participate in the survey or qualitative interviews.

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[3] Please refer to the worksheet titled 'UK Legal Status' in the following link: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/378063/bpe_2014_detailed_tables.xls

[4] See, for example, Deloitte/ London Business School (2014) Entrepreneurship UK Survey 2013/14, and Institute of Directors (2010) Corporate Governance Guidance and Principles for Unlisted Companies in the UK.

3 Methodology

There were two main elements to this research:

- a random-probability telephone survey of 1,501 unlisted companies; and
- qualitative interviews with 27 profitable companies that had agreed to be re-contacted.

3.1 The telephone survey

Questionnaire development for the telephone survey was informed by cognitive interviews with five unlisted companies and a small-scale pilot. These cognitive interviews found that participants had difficulty in understanding some of the technical terms used in the questionnaire, such as retained earnings and close company, as well as problems in providing exact figures in response to some of the more specific financial questions, in particular questions about share capital and share premium. In order to ensure financial figures could be reported as accurately as possible, an information sheet was emailed to businesses in advance of the telephone interview. This explained what questions on the financial performance of their business would be asked, gave simple definitions for difficult terminology and encouraged respondents to look up figures in advance. In addition, a number of range prompts were added to the questionnaire in order to increase the proportion of responses that were useable in the data analysis, among people who could not provide a specific figure. These measures resulted in over half of the sample giving exact estimates in relation to their retained earnings, net assets and financial assets, with a further 20% to 25% able to provide a banded estimate.

Fieldwork for the survey took place between 30 October and 12 December 2014, and interviews were conducted with a Company Director, Finance Director, or the main shareholder. The average interview length was 20 minutes.

A stratified random sample of 11,912 leads was drawn by HMRC from the 2011/12 Corporation Tax and Companies House records. The sample was selected randomly to populate strata provided by Ipsos MORI. The sample was designed to be representative of the population of unlisted companies by region, size and sector, though Medium and Large companies[5] were purposively over-represented to make up for their relatively low incidence within the representative population as they were of equal interest to the study.

Relatively few of these records (2,299) had phone numbers, so tele-matching using publically available data provided by UK Changes was conducted on the whole sample. This provided an additional 5,848 leads with phone numbers. A small number of leads were removed due to duplication or ineligibility (e.g. the contact details were for an agent rather than the owner of a business). The final 8,147 companies were sent an advance letter before fieldwork began, asking if they wished to opt out of the study.

Following the opt out, 7,062 sample leads with phone numbers were available for interviewing. The distribution of the available sample by key demographics of region, size and sector was monitored

[5] European Commission definitions of company by size can be found in the glossary as well as via this link: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm

throughout these processes. A breakdown of the sample used and response rates can be found in Appendix 1 in Table A.1.

Prior to analysis data were weighted to be representative of the sample by region and company size indicator based on the sample profile. Weighted and unweighted profile figures are presented in Appendix 2 (Tables A.2 and A.3).

3.2 Qualitative follow up interviews

The 27 qualitative follow-up interviews were also conducted by telephone with companies drawn from the quantitative survey who agreed to be re-contacted. Interviews were recorded, with the permission of participants, and lasted around 45 minutes. The sample was drawn from close companies with profits greater than £20,000 in the last full accounting period. This threshold was set to ensure companies who had a reasonable amount of income to distribute or retain were chosen, as these individuals were more likely to have gone through the decision processes of interest in the qualitative study. It was structured to ensure coverage of key subgroups, including family companies, expectation of company growth and companies with different levels of retained earnings and assets, to better explore and understand these issues. For a full description of the qualitative sample please refer to Appendix 2 (Table A.4).

3.3 Interpretation of findings

This report only comments on subgroup differences that are statistically significant at the 95% level of confidence. Statistical significance calculations were carried out based on the effective sample size, that is, the sample size once the effects of design and non-response weighting were taken into account. Note that throughout the report, findings marked with an asterisk (*) represent a result of less than half a per cent, but more than zero.

The sample for the qualitative research was purposively selected to focus on key groups of interest. While some inference can be drawn from the findings, they are not statistically representative.

4 Main findings

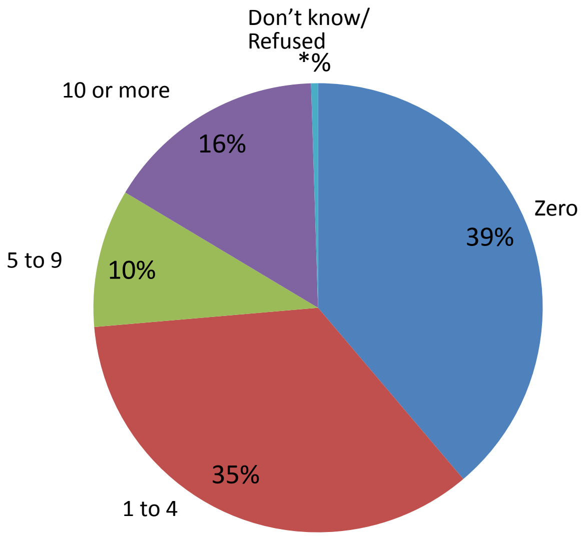
4.1 Unlisted companies' size, turnover and profits

4.1.1 Company size

The vast majority of unlisted companies employed four or fewer staff (74% in total) including 39% with no staff at all, other than the company director(s) (Figure 4.1).

Figure 4.1 – The number of company staff

How many employees does/did the company have in total? Please include yourself in your answer if you are not a company director.



Base: All respondents (1,501)

Unlisted companies most commonly had just one or two company directors, with the number of directors increasing with company size (Table 4.1). Companies with 10 to 49 staff were twice as likely as average to have three or more directors (36% compared with 18% overall), and those with 50 or more staff, even more so (76% had three or more directors).

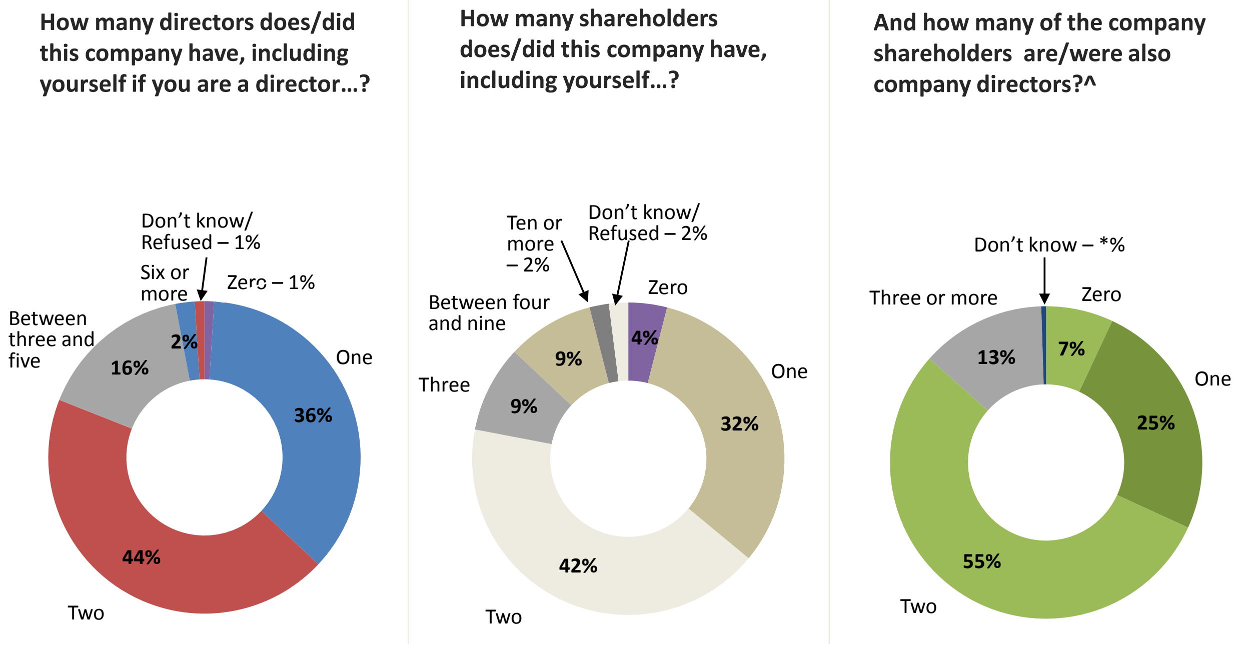
Table 4.1 – Number of company directors by number of staff

	All	One director	Two directors	Three or more directors
Base	*1,501*	*485*	*630*	*369*
No staff	39%	39%	42%	32%
1 to 4 staff	35%	44%	35%	17%
5 to 9 staff	10%	9%	11%	11%
10 or more staff	16%	8%	12%	41%

Base: All respondents (1,501). Don't know, refused and zero directors not shown.

The majority (74%) of unlisted companies also had one or two shareholders (Figure 4.2). Most company directors were also shareholders; indeed almost a quarter of companies (23%) were run by a single director-shareholder. In only 7% of cases, no director owned shares in the company.

Figure 4.2 – The number of company directors and shareholders



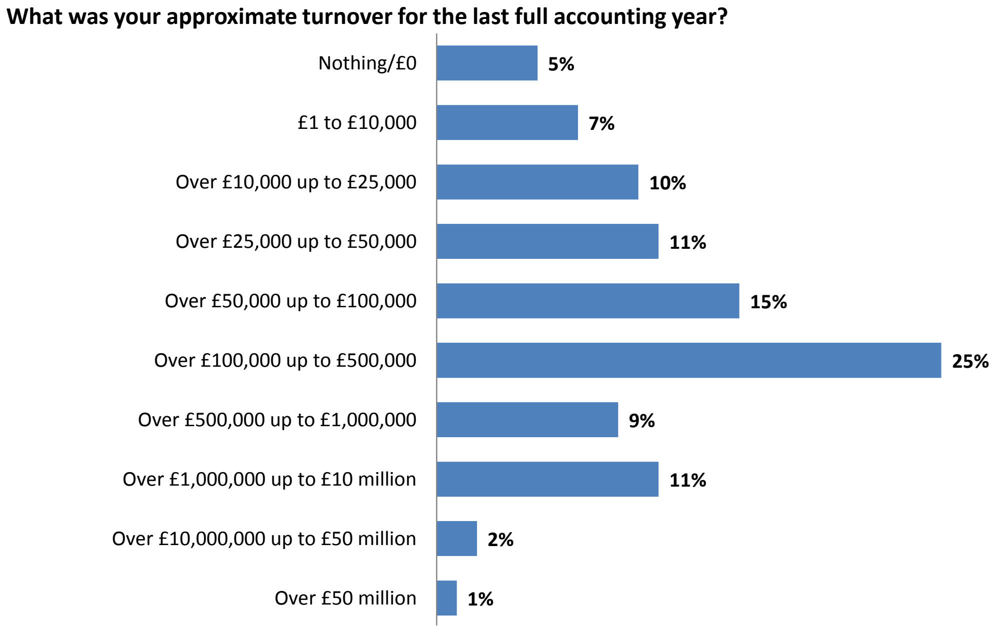
Base: All respondents (1,501); ^All respondents that are not sole traders and whose company has at least one shareholder (1,116)

Nine in ten companies with shareholders (89%) issued full voting shares; only 2% issued preference shares and other types of shares respectively. Reflecting the predominance of director-shareholders, nine in ten of all companies said the company directors had overall control of the company (92%). The remainder were controlled by investors who either worked (2%) or did not work (3%) for the company, or by a parent, stakeholder or holding company (1%).

4.1.2 Turnover

Median company turnover was £200,000: however, almost half of companies surveyed (47%) had an annual turnover below £100,000. A further 25% had an annual turnover of between £100,000 and £500,000 and 9% had between £500,000 and £1 million. Only one in seven (14%) had an annual turnover over £1 million.

Figure 4.3– Distribution of companies by gross turnover



Base: All respondents (1,501). Don't know (3%) and refused (2%) not shown.

Five per cent of companies reported zero turnover in the most recent full accounting year (in instances where the company had ceased trading or was sold on, turnover was reported for the last full accounting year *before* this). Among these zero turnover companies (n=67), the most common sector was business, finance and real estate (28%) followed by Information & Communication services (16%). Most companies with zero turnover broke even (47%) or made a loss (42%) with just 7% (n=5) reporting a profit. It is possible that some of these zero turnover companies may have been dormant or non-trading in the accounting period covered by the survey, given that they were also more likely than average to have no fixed assets (63%), no intangible assets (79%) and zero net assets (32%).

As might be expected the number of staff increased with turnover. Three-quarters (76%) of companies with a turnover of £1 to £10,000 had no staff, and almost none of these companies had more than five staff. Conversely, just 6% of companies with a turnover of over £1 million had no staff, while 87% had more than 50 staff.

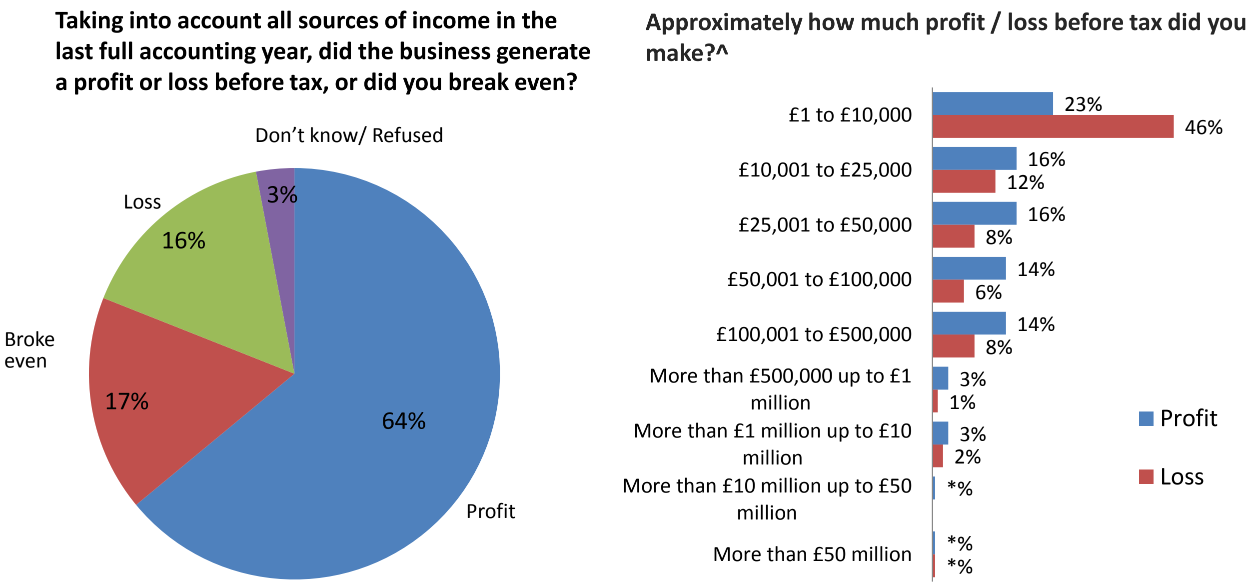
4.1.3 Profits

Figure 4.4 outlines the pre-tax profit and loss of those companies surveyed. Two-thirds (64%) returned a pre-tax profit in the last full accounting period, with the remainder split evenly between those who broke even and those who made a loss (17% and 16% respectively). Very small companies with no or 1 to 4 staff were less likely than average to return a pre-tax profit (56%) and more likely to break even (22%), although they were no more or less likely to make a loss.

Almost all companies that recorded a profit generated this profit from normal day-to-day trade (95%) although 6% made money from property investments and 3% from other investment activities. Making profits from property investments was more common among companies with smaller turnovers – 13% of those with a turnover of up to £25,000 and 10% of those with a turnover of more than £25,000 up to £100,000 made profits from property investment, compared to just 3% of those with higher turnovers.

Manufacturing was the most common sector for companies to report a pre-tax profit (74%) whereas Arts, Leisure and Other Services companies were more likely than average to break even (28%) – many such companies may be run on a not-for-profit basis.

Figure 4.4– Company profit and loss



Base: All respondents (1,501); ^All respondents who generated a profit before tax in the last full accounting year (996); all respondents who generated a loss in the last full accounting year (234). Don't know/refused not shown for profit (11%) and loss (14%)

Just over half the profit-making companies (55%) made less than £50,000, with the median profit at £46,000. Companies with retained earnings typically reported larger profit (see Section 4.2.1). Among loss-making companies, the median loss was £15,000, and almost half (46%) made a relatively small loss of £10,000 or less.

The number of staff increased with gross profit. Those with no staff tended to have had relatively low profit in the last accounting period – 37% of them had a profit of £10,000 or less compared with just 5% of those with 10 or more staff. By contrast, around half of those with 10 or more staff yielded profits of £100,000 or more in their last accounting period, compared with 8% of those with no staff.

4.2 Company Profits Distribution

4.2.1 Company dividend distribution

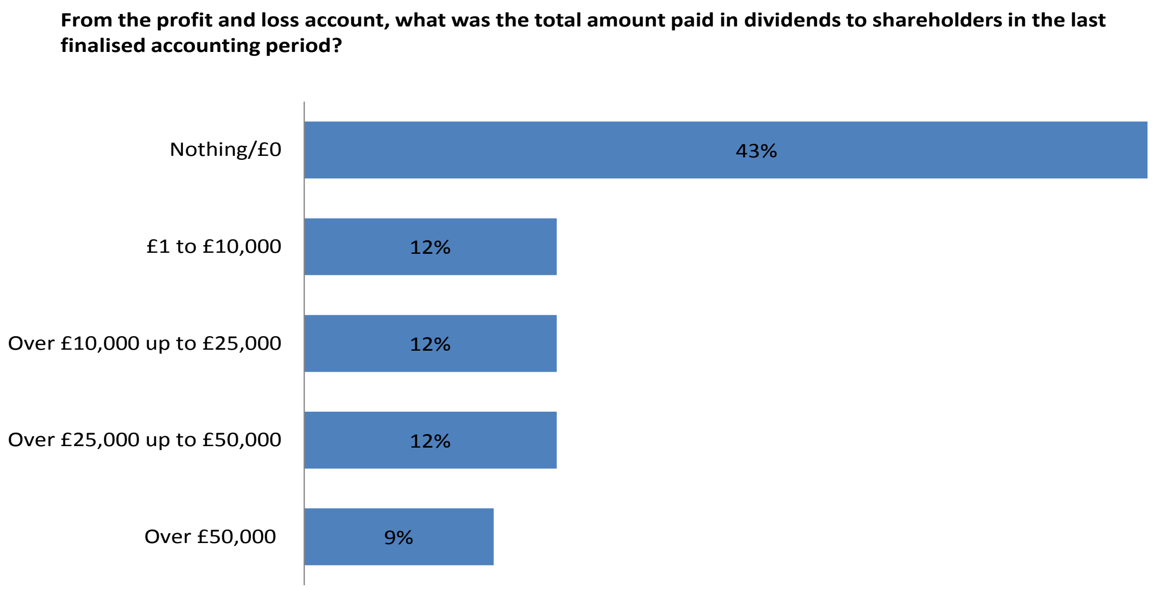
One of the ways a company can distribute their profit is by paying dividends to their shareholders. Just under half the companies (45%) had paid a dividend to shareholders during the last finalised accounting period, while 43% had not, and the remainder did not know or refused (12%).

Not paying a dividend was more common among companies who made a loss (82%) or broke even (58%) compared with companies who made a profit (30%). Companies which made lower profits were more likely to pay no or low dividends than those which made larger ones: 32% of those with a profit below £30,000 did not pay out a dividend; compared with just 9% of those with a profit of between £50,000 up to £100,000 (though it rose to 21% among those with a profit of more than £100,000).

Furthermore, companies that did not pay any dividends were more likely to be medium (55%) and large (70%) companies, and to expect their company to decline within the next 12 months (54%). Companies with retained earnings were more likely than average to have paid out a dividend (just 29% had *not* done so, compared with 58% of companies with no or unknown retained earnings). Where dividends were paid these also tended to be higher, on average. Indeed the median dividend for those with retained earnings was £17,500 while it was £8,000 for those without.

Just over two fifths of companies (43%) paid no dividends to shareholders during the last full accounting period. Twelve per cent of companies each paid out less than £10,000, more than £10,000 up to £25,000, and more than £25,000 up to £50,000, whilst just 9% of companies paid out more than £50,000. Paying out a large dividend of more than £50,000 was more common among small companies with between 10 and 49 staff (17%) and with turnover of between £500,000 and £1million, or above £1 million (18% respectively).

Figure 4.5– The distribution of total dividend payments to all company shareholders



Base: All whose company had at least one shareholder (1,418). Don't know (10%) and refused (2%) not shown.

4.2.2 Company profit to dividend ratio

In Table 4.2, we have calculated a ratio of each company's pre-tax profit divided by the total amount it paid in dividends to shareholders in the last finalised accounting period, in order to analyse which companies are more likely to retain and invest profit. This shows that non-family businesses were more likely than family businesses to keep profit in the business (34% compared with 22%). Otherwise there was little difference in how much of their pre-tax profit went on dividends, though family businesses were more likely to pay between 25% and 50% of their profits as dividends (9% compared with 5%).

In terms of the staff numbers, it was companies at the extreme ends of the scale – with no staff or more than 10 – who were more likely to keep profits in the business. Companies with more staff were more likely to have paid a smaller proportion of their pre-tax profit as dividends (19% of the largest companies with ten or more staff paid less than 25% of their profits as dividends, compared with just 5% of those with no staff). Smaller companies were more likely to have paid dividends that were a larger proportion of their profits, or in some cases, even higher than their profits.

Table 4.2 – Profit to dividend ratio by whether or not a family business and number of staff[6]

	All respondents	Family business	Not a family business	No staff	1-4 staff	5-9 staff	10+ staff
Base	*(819)*	*(510)*	*(309)*	*(237)*	*(246)*	*(96)*	*(237)*
Zero (i.e. paid no dividends)	27%	**22%**	**34%**	30%	**20%**	22%	**35%**
Less than 25% of profits as dividends	10%	11%	10%	**5%**	9%	**18%**	**19%**
Between 25% and 50% of profits as dividends	7%	9%	5%	6%	9%	9%	8%
Between 50% and 75% of profits as dividends	9%	10%	9%	9%	11%	8%	9%
More than 75% of profits as dividends	10%	10%	10%	**14%**	10%	7%	**5%**
Dividends higher than profits	13%	13%	13%	16%	16%	9%	**6%**

Source: Ipsos MORI.
Base: All respondents with a profit in the last full accounting year and a numeric answer or Don't know/refused given for dividend (819). Don't know/refused not shown (between 18% and 29%)

There were few significant differences by asset base, with the one notable difference being that those with higher levels of assets were more likely to have paid a smaller proportion of their pre-tax profit as dividends. In both cases those with assets of low value were more likely to pay out most of their pre-tax profits in dividends (i.e. 75% or more, including over 100%). For example, among those with *fixed assets* of up to £25,000, one-third (28%) paid out 75% or more of their profits in shareholder

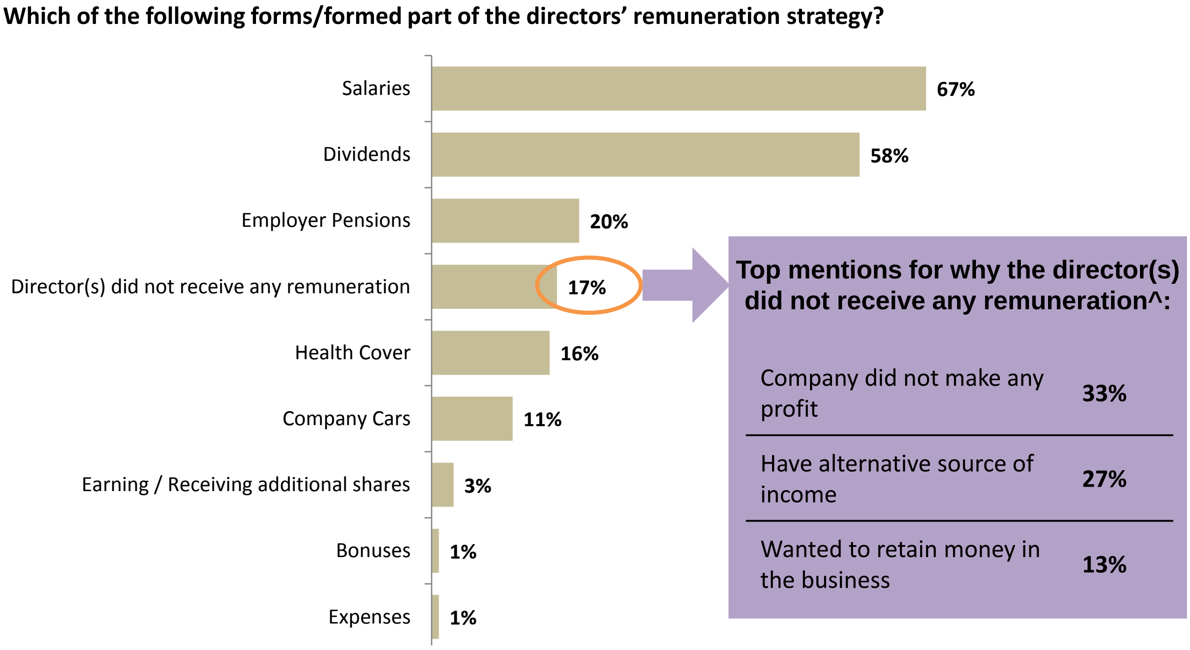
[6] Significant differences, compared with the total for all respondents, are highlighted in bold.

dividends, twice as many as among those with fixed assets of more than £25,000 (14%). Similarly, among those with *financial assets* of up to £25,000, two in five (35%) paid out 75% or more of their pre-tax profits in shareholder dividends, compared with 17% of those who held financial assets of more than £25,000.

4.2.3 Director remuneration (salary and dividend)

Companies can include dividends as part of shareholding directors' remuneration packages, along with other forms of remuneration such as salaries, pensions and company cars. As Figure 4.6 shows, dividends were the second most common form of remuneration, behind salaries.

Figure 4.6– Methods of director remuneration



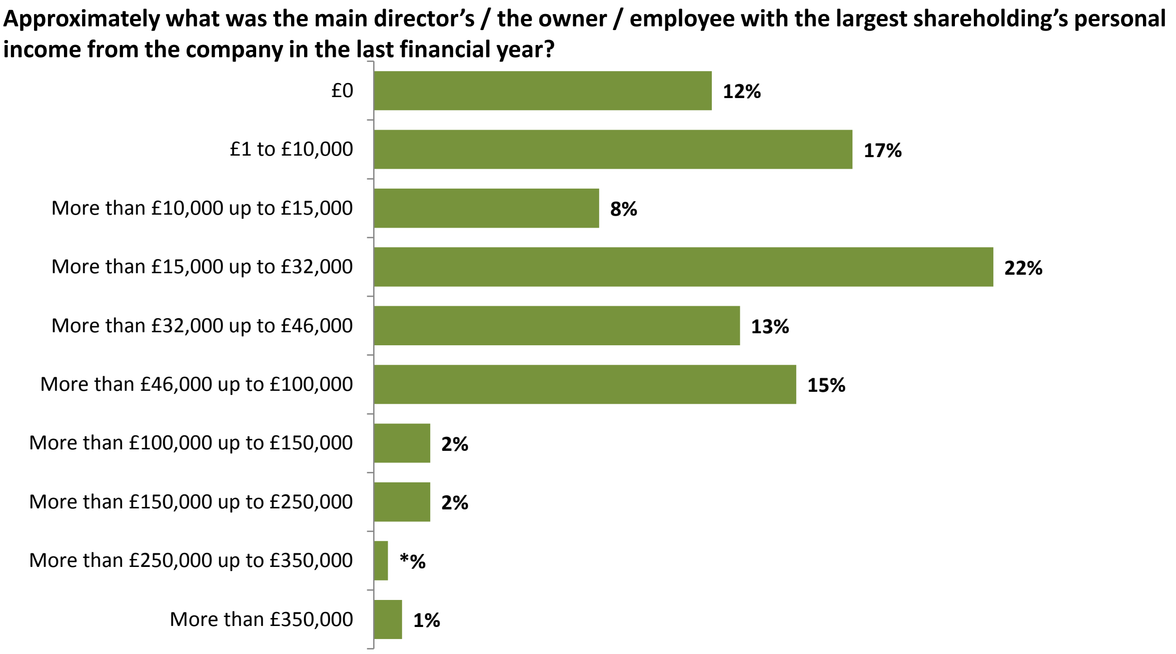
Source: Ipsos MORI.
Base: All respondents (1,501); ^All respondents whose company directors are not remunerated (238) – three top answers shown only.

Over half the companies used more than one type of remuneration for directors (57%) including one-third (32%) who used two different types of remuneration; 16% who used three and 10% who used more than three. Where two or more types of remuneration were used the most popular combination was salaries and dividends, used by 46% of companies overall. The next most common two-way combination was salaries and employer pensions (19%) followed by salaries and health cover (15%).

Less than one in five companies (17%) reported that the director(s) did not receive any remuneration. The most frequent reasons for this (unprompted) were that the company did not make any profit (33%), the director already had an alternative source of income (27%) or that the company had decided to retain as much money as possible (13%).

In around one in five companies, the main director (or equivalent person able to control the company, if the directors held shares but were not remunerated) had a personal income[7] from the company of between £15,000 and £32,000 (Figure 4.7). Generally, companies with retained earnings tended to have higher levels of remuneration – the mean personal income for the main director in companies without retained earnings was £21,504 while it was £25,758 for those with retained earnings (note however that the medians were similar, £10,000 and £11,000 respectively, so the difference may be driven by a small number of higher profit companies among those with retained earnings).

Figure 4.7 – Total profits drawn from company for the main company director or equivalent person able to control the company[8]

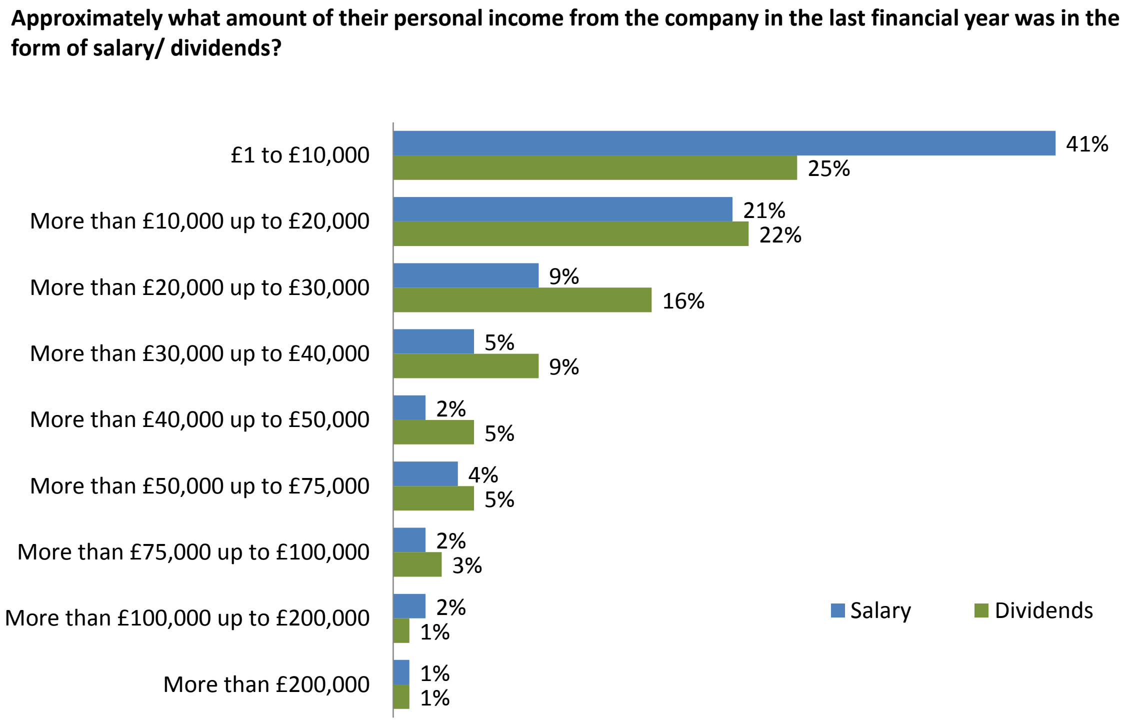


Base: All respondents except those whose company directors hold shares but are not remunerated (1,341). Don't know/refused not shown (9%)

Where paid, salaries tended to be of relatively low monetary value. Two in five (41%) of these companies stated that their main directors' salary was between £1 and £10,000[9]. A further 21% paid between £10,000 and £20,000. Only 9% paid salaries more than £50,000. Dividend payments tended to be higher than salaries (for tax reasons); a quarter (25%) of companies who remunerated their main director this way stated that the dividend amounted to between £1 and £10,000, while 22% paid between £10,000 and £20,000, a further 16% paid between £20,000 and £30,000, and 8% paid dividends of £50,000 or more.

[7] This included any salary, dividends and any payment of new shares during the year.
[8] If the directors held shares but were not remunerated, respondents were not asked this question. If the directors did not hold any shares at all, respondents were asked to answer in relation to an alternative person – either the owner, the employee with the largest shareholding, or someone else who was able to control the company.
[9] *Within* this group of companies which paid their main director a salary of below £10,000, very few provided a salary below £4,000 (11%) and the rest were fairly evenly distributed between £4,000 and £10,000.

Figure 4.8 – Total salary and dividends paid to the main director or equivalent among those who used these forms of remuneration



Base: All respondents who pay a salary to their main director or equivalent (1,039); All respondents who pay dividends to their main director or equivalent (714). Don't know/refused not shown (13% for salary and 14% for dividend)

Company remuneration strategies were commonly chosen to maximise tax efficiencies. Around a quarter (26%) of companies whose company directors were remunerated cited tax as a factor in their decisions. Companies in the professional, scientific & technical activities sector (36%) and companies with retained earnings (31%) were most likely to say that remuneration strategies were geared to maximise tax efficiency. The qualitative research revealed that such decisions were not just influenced by the respective tax rates on salaries and dividends, but by wider considerations such as pensions and the thresholds for withdrawal of child benefit.

The other main influences on remuneration strategies were external advice from accountant or tax agents (23%) or companies taking what they perceived to be the most convenient approach (12%).

The qualitative research identified three broad strategies in relation to director remuneration:

- Take out the maximum amount possible from the company for personal remuneration, such as to fund a particular lifestyle. This could be the case, for example, of an individual post-retirement age, who was now working as a consultant;
- Take out however much the participant (and other directors/shareholders) needed to live on; and
- Paying no dividends and/or salary. This was usually the case where participants had other sources of income and/or wanted to keep money in the company.

It's not the retained earnings figure that is decided, it's the dividends figure…the first thing is, has the company made sufficient money to pay me the dividend that I want of £30,000.

Small company, non-family company

I draw a salary and I've got part of the dividend, nearly half of the dividend and I don't live an exotic lifestyle so I don't need it, so I don't take it. I leave it where it is.

Medium-sized company, family company

As intimated, the qualitative research painted a more nuanced picture about the role of tax in remuneration decisions, with personal financial needs, business needs, and lifecourse factors such as retirement planning also being taken into account. This is not to say that tax was not mentioned in the qualitative research, in fact some did state explicitly that the remuneration package – tending to be a salary of up to around £12,000 with the remainder of the remuneration in dividends which are taxed at a lower rate – was constructed with tax efficiency in mind.

I pay myself a salary so I don't attract personal taxation so that's what limits my salary. The rest is just the extra I need to be able to live….Personal allowances is nearly £8,000 now and so what they say is £8,000 divided by 12, pay yourself a salary of that and you won't attract personal taxation and then any other money you need you take out as a dividend split between myself and my wife.

Micro company, family company

For tax reasons, we pay small salaries to the three of us, small salaries and quite large dividends, because you don't get the National Insurance on that.

Small company, non-family company

Many of the companies with this remuneration structure stated that it was designed following the advice of an accountant.

The salary level we pay just… our accountant sets the director's salary, so we pay up to the personal allowance if you like of salary and then the directors decide each month whether they're going to take dividends out and that purely depends on how much cash we've got and what bills we've got coming up.

Micro company, family company

4.3 Company Investment Patterns

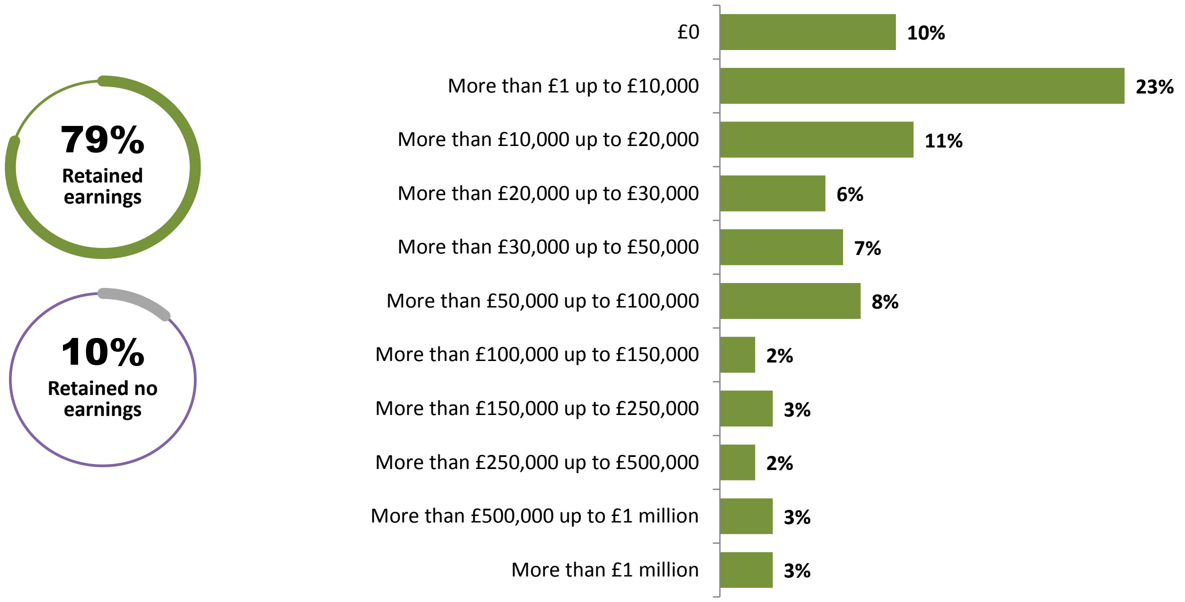
4.3.1 Retained Earnings

Respondents were asked for the cumulative figure specified at the bottom of the company's profit and loss account, stating the retained earnings up until this point in time.

Four in five (79%) profit-making companies reported a proportion of their earnings had been retained over the lifetime of their company on their balance sheet for the last full accounting year. One in ten (10%) did not retain any of their earnings and eleven per cent refused to say, or did not know.

Figure 4.9– Distribution of retained ‘earnings’

What is the retained earnings figure for the last full accounting year? This is a cumulative figure specified at the bottom of the company’s profit and loss account, stating the retained earnings up until this point in time.



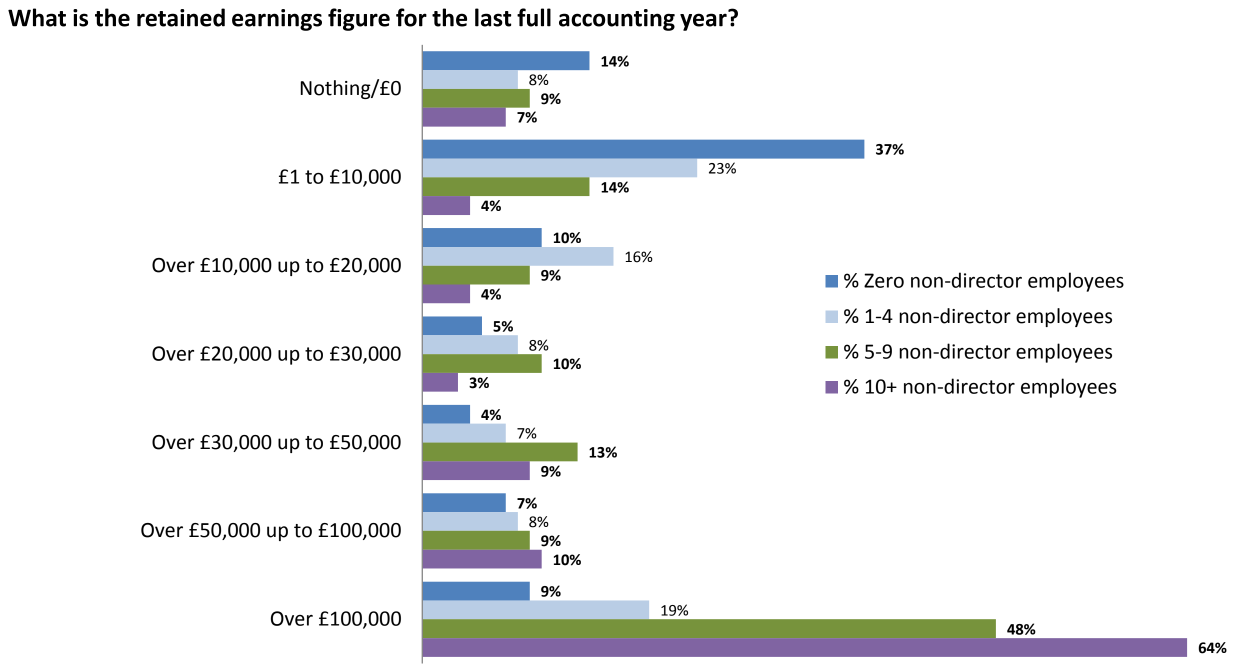
Base: All respondents whose business generated a profit in the last full accounting year (996). Don’t know/refused and ‘Don’t know amount, but some earnings were retained’ not shown (both 11%)

Those companies with retained earnings differed in some ways to those that did not have retained earnings. Companies *with* retained earnings tended to report higher profit overall. For example just over a third (35%) with retained earnings made a profit of £50,000 or more in the last full accounting year, compared to one fifth of those without retained earnings. Furthermore, the median profit for those with retained earnings was £50,000, compared with £27,000 for those without.

Similarly, companies that retained a proportion of their profit also tended to report higher turnover; the median turnover for those with retained earnings was £300,000 compared with £75,000 among those without.

Smaller companies were less likely to retain a proportion of their profit, or where they did, the amount retained was small. This is shown in Figure 4.10 where companies with no staff were more likely to retain none of their profit (14% compared with 8% of those who did have staff) and a further 37% only retained up to £10,000. At the other end of the scale, only 4% of companies with ten or more staff retained up to £10,000, whereas two-thirds of them (64%) retained over £100,000, including more than one in ten (13%) that retained over £1 million.

Figure 4.10 – Level of retained earnings by number of staff



Base: All companies who made a profit in the last accounting period (996). 'Don't know amount, but had retained earnings' (9% for zero non-director employees, 12% for 1-4 non-director employees, 14% for 5-9 non-director employees and 12% for 10+ non-director employees), 'Don't know if had retained earnings' (6% for zero non-director employees, 10% for 1-4 non-director employees, 9% for 5-9 non-director employees and 8% for 10+ non-director employees) and Refused (2% for zero non-director employees, 3% for 1-4 non-director employees, 1% for 5-9 non-director employees and 4% for 10+ non-director employees) not shown.

Those companies with a *relatively small* amount of retained earnings, of up to £10,000, had some significant differences when compared to those that retained amounts over £10,000, as follows:

- They tended to be newer – 31% of those with retained earnings of this level had been in business for up to five years compared to 19% of those with higher retained earnings;
- They were more likely to have no staff; this was the case for 54% compared with 25% of those with higher retained earnings;
- They were less likely than those with higher retained earnings to hold fixed assets such as buildings (13% compared with 27% of those with higher retained earnings) and company vehicles (18% compared with 32%) and were less likely to own or rent premises or plant, machinery and fixtures and fittings; and
- They were neither more nor less likely to hold intangible assets, though among those that *did* hold an intangible asset they were *more* likely to have assets of copyright (47% compared with 31% of those with higher retained earnings) and logos (63% compared with 43%).

Those *without* retained earnings were likely to be older companies; 22% of those with retained earnings had been operating for up to five years compared with 13% of those without retained earnings. Furthermore 33% of those with no retained earnings had been operating for 20 years or more compared with 22% of those with retained earnings.

Four in five companies (80%) that had retained earnings in the last accounting period considered it important to retain the level they did, with around half (51%) saying it was *very* important to them.

Overall, having financial security for the company was the main driver that was reported unprompted for retaining earnings (50%). This was especially common among micro companies (53% compared with 24% of large companies). Retained earnings were also deemed as important for future growth - just under a quarter of companies (22%) considered retained earnings to be a helpful source of finance for future growth and expansion activities, or for planned future investments. It is important to note, however, that this does not establish causality and the follow up qualitative research found that it was common for growth to be the driving factor in retained earnings.

Some small companies viewed annual retained *profits* as what was 'left over' after essential costs had been met (for example bills and salaries), and this was their primary source for topping up director income (through dividends). This is not exactly the same as retained *earnings* which – over time – are accumulated on the balance sheet for investing in growth or as a means of providing general financial security. Larger companies – perhaps because they were less subject to income uncertainty – more often set out with a plan to keep aside a certain amount of annual profits to increase their retained earnings, but were essentially motivated by the same factors as small companies, such as financial security. Indeed in the qualitative research, few of the company representatives were attracted to external sources of capital, and some spoke of previous bad experiences with having debts.

Our money's our money so if it's not there then we don't spend it, but if it is then we like to see how we're going to invest it to make the company grow…It would be a case of if we had the cash then we would spend it.

Small company, family company

[Money to fund capital investment] it's from profits earned that have not been paid out in dividends or on salary or bonus or whatever, which I am of the old school in these terms in that we like to keep some with us, some money about us, I can't be doing without any of that and I follow JP Morgan's advice to Henry Ford which was you need to keep a million about you. So I always try and keep a million or two … it's no good rushing around thinking you're going to find £1 million or something in seven days so [in the past] we already had it and it got us out of the woods.

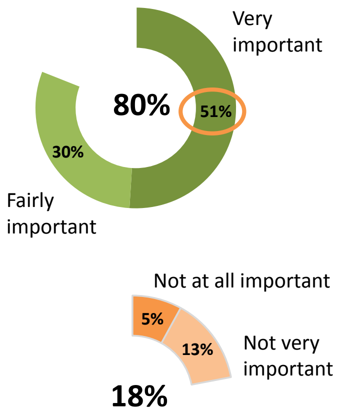
Large company, non - family company

Figure 4.11 – Main reasons for and importance of retained earnings

Why do/did you retain earnings within the company?

Financial security for the company	50%
Source of finance for future growth / expansion activities	22%
Source of finance for planned future investments	22%
Want to build up reserves due to concern about future cash flow	15%
Want to maintain / increase working capital	10%
It is more tax efficient / advised to do so by accountant	6%
To secure better borrowing terms from banks / other lenders	4%
To fund pensions / remuneration	3%
Liked flexibility in how they can be reinvested	2%
To pay bills	2%
Regulatory requirements	1%
Want to build up reserves as seeking to sell the company in the future	1%
Other	3%

…how important if at all would you say it is/was to have this level of retained earnings?



Base: All respondents whose company retained a proportion of its profits (803). Don't know (5% for why retained earnings and 2% for how important) not shown.

Companies with turnover of between £500,000 and £1 million (34%) and over £1 million (29%) were especially likely to cite retained earnings as a source of finance for future investment / company growth. Among companies which expected to grow over the next year, growth was also more likely to be part of the business plan for those with retained earnings (40% compared to 29% of companies without any retained earnings).

Other common reasons for having retained earnings were due to concerns about future cash flow (mentioned by 15%) or to maintain or increase current levels of working capital (mentioned by 10%).

The qualitative interviews explored the reasons for retaining earnings further and found that some companies' retained earnings were used for day to day working capital, that is the pot of funds they held in the company to smooth their cash flow and to pay future taxes, loans/mortgages and suppliers, in case of an unforeseen loss of business.

If something happened…for instance, if we have an accident here, that obviously could put a lot of customers off…if suddenly like fuel prices doubled, or all the teachers went on strike…So you suddenly lose a big chunk of business…we don't have to instantly go out and make dramatic cost cutting.

Small company, non-family company

In the case of tax some companies considered that tax bills were frequent and – such as in the case of VAT – could be variable and hard to predict. They were anxious that there might be a mismatch of when their profits are received and when taxes are due, as well as that their payment terms were usually inflexible (i.e. there are no options to pay tax bills in instalments). Therefore retained earnings were considered a useful 'buffer' to make future payments.

To give ourselves a little bit of breathing space on cash flow, so we don't have to worry about the VAT quarters and the Corporation Tax, they are the two big ones, and self-assessment in January. You know, December/January, for us is a difficult time because we get Corporation Tax, self-assessment and VAT all falling at the end of January…just so that we've got a bigger comfort level.

Micro company, family company

You have to make sure you've got enough money as a buffer. Similarly with VAT, you know every quarter you're going to have to work out, and because of the way that people pay us, they don't necessarily pay us on a regular basis, the VAT goes very much up and down.

Micro company, family company

Most of the companies had made a conscious decision to set money aside from profits when possible. Some worked on the basis of retaining a specific percentage of profits, others had a minimum level of retained earnings which they did not want to dip below. Another approach was simply seeing what was left over once dividends were paid.

I think it's wetting your finger and standing up in the breeze. We don't have a method, we haven't got a method but I would want to be sure that we had plenty of cash in the business, I think that's absolutely vital … we've got to reduce our borrowings and we need to retain cash for our capital expenditure.

Medium-sized company, family company

The qualitative interviews further showed that having retained earnings was very much perceived as a safety cushion. It provided a buffer if there was a downturn in turnover and could also help maintain cash flow if and when customers took a long time to pay. For companies with employees or contractors, having enough money to pay salaries and fees was another key factor.

You have to keep some retained earning 'cause you don't know what your next year is going to be like, …it's making sure that you've got enough to cover if your next few months aren't so good.

Micro company, family company

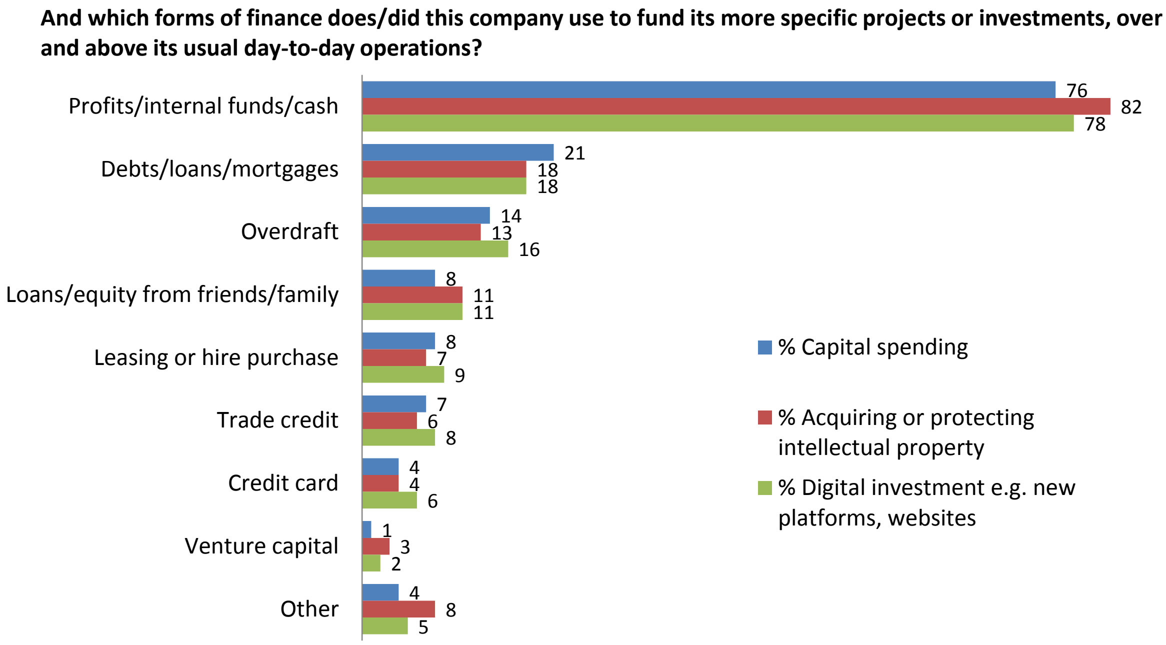
Another benefit in retained earnings for some participants was that they perceived that it provided reassurance to customers, suppliers, and staff. This was partly for the reasons given previously but also because participants viewed retained earnings as a gauge of the company's financial health and security, which would be noted by suppliers, consumers and staff. Some also noted that retained earnings can be used as security for raising external finance.

We like to retain something. It always looks good for both our customers and our suppliers. It gives them confidence if you retain some earnings which shows that you've got some you know, that the company is slowly growing, a slow, steady growth..

Small company, family company

Two thirds of companies (67%) funded projects or investments over and above their usual day-to-day company operations, and among these the most common were: capital investments (45%); training or staff development (38%); marketing (34%); and digital investment (31%). One in ten (11%) spent money on acquiring or protecting intellectual property. The importance of internal funds like retained earnings can be seen in Figure 4.12, as they were used overwhelmingly to fund capital spending, investment in acquiring intellectual property, and digital investments. Loans/mortgages and overdrafts were the next most common sources used to fund these types of expenditure.

Figure 4.12– Sources of finance for specific projects and investments beyond the usual day-to-day running of the business



Base: All whose company does/did fund capital spending over and above its usual day-to-day operations (729); All whose company does/did fund acquiring or protecting intellectual property over and above its usual day-to-day operations (182); All whose company does/did fund digital investment over and above its usual day-to-day operations (491)

Among companies that funded specific projects or investments, micro enterprises were especially likely to use internal funds – 78% did so compared with 67% of larger companies. These larger companies were more likely to instead use debts, loans and mortgages, overdrafts and leasing or hire purchase.

Table 4.3 shows how the likelihood of investing in more specific projects or investments, over and above the usual day-to-day running of the business, increased with retained earnings levels. Two in three with retained earnings up to £10,000 invested in additional activities, but this rises to seven in ten for those with retained earnings of between £10,000 and £30,000, and almost nine in ten (87%) for those with retained earnings of over £100,000.

Table 4.3 – Investing in specific projects or investments over and above usual day-to-day operations, by retained earnings level

	Nothing/ £0	£1 up to £10,000	Over £10,000 up to £20,000	Over £20,000 up to £30,000	Over £30,000 up to £50,000	Over £50,000 up to £100,000	Over £100,000
Base (All who made a profit in the last full accounting year – DK/Refused retained earnings level not shown)	*(93)*	*(191)*	*(100)*	*(57)*	*(77)*	*(85)*	*(181)*
Yes, fund specific projects/investments	65%	65%	70%	71%	83%	71%	87%
No, fund no specific projects/investments	35%	35%	30%	29%	17%	29%	13%

The relationship between size and spending money on activities or investments additional to the day-to-day running of the business was also noticeable on other measures:

- micro companies were particularly less likely to invest over and above their usual operations (35% compared with 19% of small and 18% of medium-sized companies, though large companies were also less likely than small and medium-sized companies to invest, at 30%);

- 52% of companies with a turnover of up to £25,000 did not invest in additional projects or investments, compared to 38% of those with a turnover of more than £25,000, and just 14% of those with a turnover of more than £1m;

- 39% of those with zero to four employees did not invest, which falls to just 6% of those with 50 or more employees.

However, there was little relationship between the likelihood of investing and length of trading, which stayed fairly constant. Only those trading for more than 15 years up to 20 were distinct, and were more likely to be investing (77% compared with 66% overall).

Many of the participants in the qualitative research used retained earnings to fund investment in the company. Some companies had taken the decision to only fund investment from profits.

So in terms of the business, we don't do anything until we've paid for it. That, I know, has made our growth slower, but I also know that I'll never have to make someone redundant. This boat is copper-bottomed, absolutely copper-bottomed.

Medium-sized company, family company

A key factor for many companies was the avoidance of debt. This was partly because relying on loan finance was seen as more expensive than funding investment from profits. However there was also a sense of caution about borrowing because of the potential risks involved, which include losing some control of the company. A couple of companies commented on the difficulties of getting loan finance, which led them to rely on retained earnings for funding investment in growth.

The banks don't lend money for anything at the moment, so the only way we can grow is organically through keeping the profits in the business.

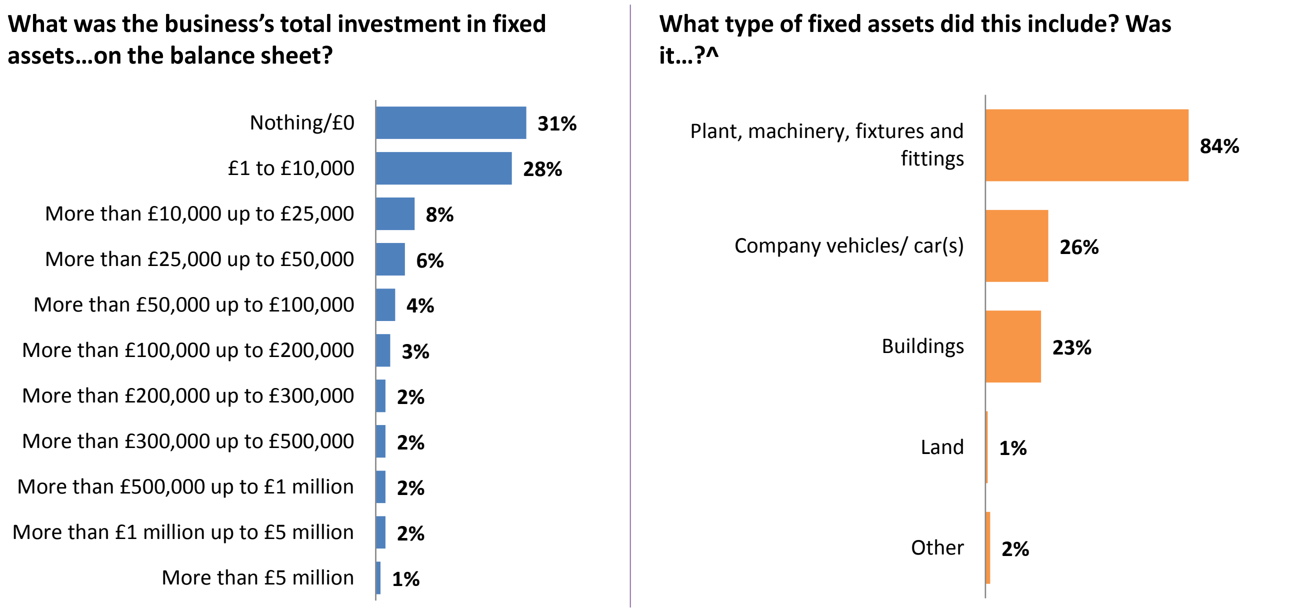
Medium-sized company, family company

4.3.2 Fixed assets

Over half of companies (57%) stated they had invested in fixed assets such as buildings, plant or machinery on their balance sheet (Figure 4.13). The most common level of investment was between £1 and £10,000 (28%). The median investment was valued at £10,000.

The most common fixed assets were plant, machinery, fixtures and fittings (84%), followed by company cars (26%) and buildings (23%). Companies that expected to grow tended to have invested higher levels into fixed assets and were especially more likely to have invested in plant, machinery, fixtures and fittings (89%).

Figure 4.13– Investment in fixed assets



Base: All respondents (1,501). Don't know/refused not shown (12%); ^All respondents whose company invested in fixed assets (917). Don't know not shown (1%)

Having fixed assets, and the amount of investment in fixed assets on the balance sheet, was related to turnover and profit. Just 31% of those with turnover of below £10,000 (including zero turnover) had any fixed assets, compared with 69% of companies with a turnover of more than £100,000. There was a similar pattern according to whether or not the company had made a profit. Furthermore, those with lower profits also had a lower value of fixed assets – 82% of those with a profit of up to £10,000 had fixed assets of up to £25,000 (including having zero fixed assets), compared with 64% overall. By contrast, 41% of those with a profit of more than £100,000 had fixed assets of more than £100,000, compared with 15% overall. This pattern of fixed assets and profits rising together held for all company sizes.

Companies that had invested in fixed assets also tended to have more staff, as might be expected. Three-quarters (76%) of those with 10 or more staff had fixed assets, compared with 46% of those with no staff and 58% of those with between one and four staff. Companies that had fixed assets were also more likely to be in construction, manufacturing, or retail. Newer companies (trading for less than five years) were more likely than average to have no fixed assets (41%, compared with 31% overall).

Two-thirds (66%) with retained earnings had invested in fixed assets, compared with just over half (53%) of those with no retained earnings. Among those with retained earnings, companies which had more than £100,000 were more likely to have invested in fixed assets than those who retained less (81%, compared with 66% of those with retained earnings below £100,000). Accordingly, companies with retained earnings were more likely to own premises (25% compared with 17% of those without retained earnings), and to own plant, machinery, fixtures and fittings (82% compared with 70%). Owning their own premises was more common among companies with over £100,000 in retained earnings (37%) whereas ownership of plant, machinery, fixtures and fittings was relatively consistent across different retained earnings levels.

Companies in manufacturing, finance & real estate, and primary & utilities were more likely than average to own premises (29%, 30% and 36% respectively compared to 21% overall). Those in manufacturing (92%), wholesale & retail, transport & hospitality (83%), and in professional, scientific & technical activities (83%) were more likely than average (76%) to own plant, machinery, fixtures and fittings.

Similarly to ownership of premises and plant, machinery, fixtures and fittings, larger companies with higher turnover and more staff were also more likely to rent these types of assets. For example, companies with turnover of between £100,000 and £500,000 (60%), £500,000 to £1 million (68%) and over £1 million (78%) were far more likely to rent premises than companies with lower turnover (35% of those with turnover between £25,000 and £100,000, and 21% of those with less than £25,000). As low turnover companies are also less likely to own business premises it is likely that they simply do not need to work from a fixed business base. A similar pattern holds by number of employees, as could be expected given that larger companies will require more space.

Those with retained earnings were more likely to rent premises (51% compared with 45% with no retained earnings) although they were no more or less likely to rent plant, machinery, fixtures and fittings. Like owning premises, renting premises was more common among those with higher levels of retained earnings, although the level at which this became significant was lower than that for property ownership, at around £30,000 of retained earnings or above. For example, 43% of companies with retained earnings of below £30,000 rented premises, compared with 62% of those with retained earnings of between £30,000 and £50,000, 58% of those who retained between £50,000 and £100,000, and 66% of those retaining more than £100,000.

Companies in the manufacturing and wholesale & retail, transport & hospitality sectors were particularly likely to rent premises (70% and 63% respectively compared with 48% of all companies). Those in construction were most likely to rent plant, machinery, fixtures and fittings (30% compared with 15% overall).

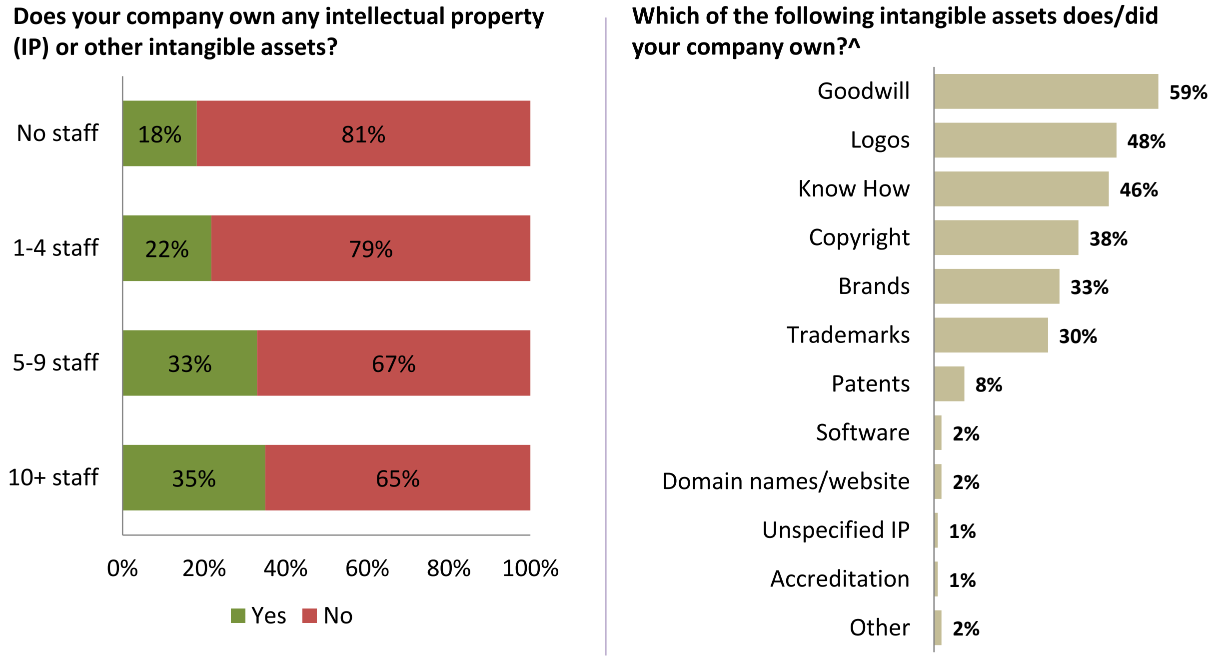
Of those with fixed assets, 5% had company cars or vehicles only. Having a company vehicle as the sole fixed asset was more common among companies with a turnover of zero (17%) or £1-£10,000 (11%), but in neither case was this statistically significant.

4.2.3 Intangible assets

Around a quarter of companies (24%) owned any intangible asset such as brands, patents or copyright. However, two in five (40%) of these had not made any investment in intangible assets over the past 12 months and 25% had invested less than £10,000. Again those who expected to grow were more likely to have intangible assets. Goodwill was the most common type of intangible asset, and 10% of companies with intangible assets had goodwill only.

Ownership of intangible assets was more common among companies with five or more staff (Figure 4.14), those with turnover of more than £100,000 (30%), and those with profits of more than £100,000 (40%). In line with this (as higher profit companies also tend to retain more earnings), those with over £100,000 in retained earnings were also more likely to own intangible assets (37%).

Figure 4.14 – Ownership of intangible assets



Base: All respondents (1,501); ^All with any intangible assets (370). Don't know/refused not shown (5%)

The companies with the highest turnover – of more than £1m – were most likely to own intellectual property (23% compared with 16% overall) and other intangible assets (23% compared with 14% overall). This was also true for companies with more staff (22% of those with 10 or more staff compared with 16% overall). Unlike with fixed assets however there is not a relationship by length of trading or indeed by having retained earnings.

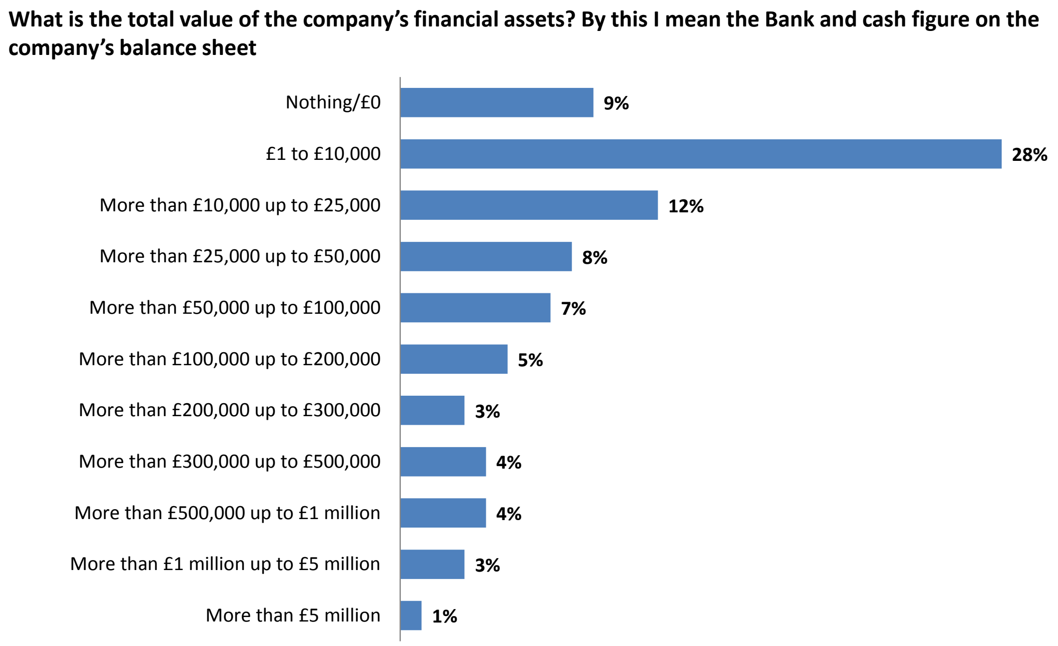
There were differences by sector. Companies in the Information and Communications sector were particularly likely to own intellectual property (39%) and other intangible assets (22%), as were those in professional, scientific & technical activities (23% and 21%). Intellectual property ownership was also relatively high among manufacturing companies (24%). Those in construction were especially unlikely to have these types of asset (4% and 5% having either respectively), as were those in finance & real estate (7% and 9%).

4.3.4 Financial assets

The median total value of companies' financial assets was £20,000, and many companies only held up to £10,000 (but not zero) (28%). Nine per cent did not have any financial assets at all while 15% did not know. Patterns in the value of companies' financial assets were similar to those discussed previously regarding fixed and intangible assets, in that larger companies with more staff, higher turnover and higher profits also had more financial assets. As could be expected, companies which had been trading for longer also had higher levels of financial assets. Almost half (46%) of those trading for five years or less had financial assets of £10,000 or below, compared with 37% overall. By contrast, companies that had been trading for 30 to 40 years and 40 years or more were significantly more likely than average to have financial assets of more than £500,000 (20% and 25% respectively, compared with 8% overall).

As before, companies that expected to grow tended to have higher financial assets. Their median financial assets amounted to £40,000, while for companies that expected to stay the same the median was £25,000 and for those that expected to decline it was £20,000.

Figure 4.15 – Financial assets



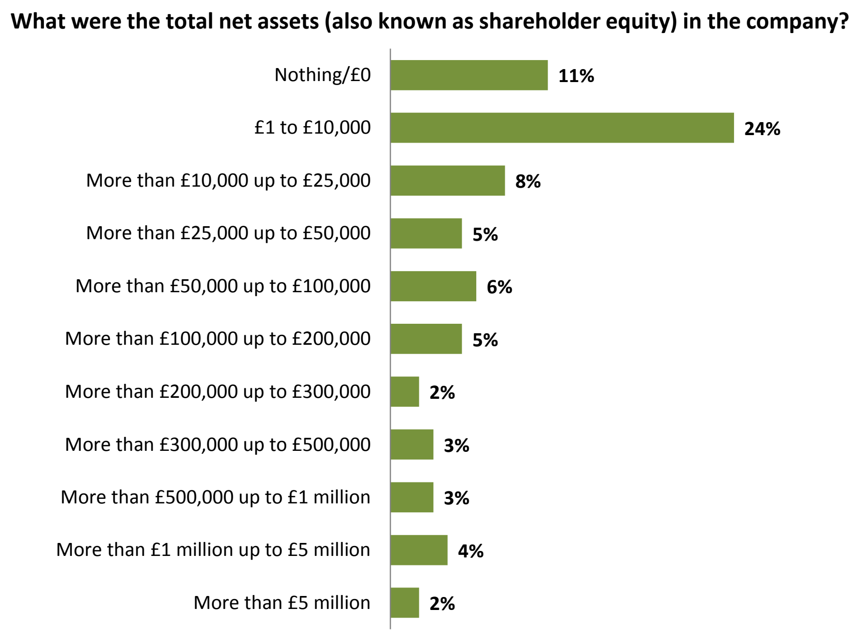
Base: All respondents (1,501). Don't know/refused not shown (17%)

4.3.5 Total net assets (shareholder equity)

Companies were asked about their net assets (also known as shareholders' equity), because this indicated how much they had invested in their company. Shareholders' equity comes from two main sources. The first source is the money that was originally invested in the company, and any additional direct investments made thereafter. The second comes from retained earnings which the company earns and accumulates over time through its operations.

On average (as a median), total net assets were valued at £20,200, although as Figure 4.16 indicates, companies most commonly had less than £10,000 in total net assets excluding zero (24%). One in ten companies (11%) did not have any net assets and around a quarter (26%) did not know or refused.

Figure 4.16 – Distribution of total net assets



Base: All unlisted companies (1,501). Don't know/refused not shown (26%)

Companies that expected to grow in the next 12 months had higher levels of net assets. The median net asset for these companies was £56,000, while for those that expected to stay the same or decline it was £20,000 and £20,200 respectively.

Having net assets was more prevalent in companies that:

- Had been trading for longer – 72% of those trading for 30 or more years held net assets, compared with 65% of those trading for five years or less;
- Employed more staff – 82% of those employing 50 or more staff held net assets, compared with 62% of those with less than five staff;
- Had higher turnover (71% of those with turnover over £1 million held net assets compared with 62% of those with turnover of below £25,000);

- Made a profit in the last accounting year (66% compared with 58% of those who made a loss);
- Had retained earnings during the last accounting period (71% compared with 54% of those who had not retained earnings). Although the pattern in terms of level of retained earnings fluctuated somewhat, generally speaking, the higher the level of retained earnings, the more likely that the company held net assets: 76% of those who retained up to £10,000 had net assets, compared with 86% of those who retained £500,000 to £1 million and 96% of those who retained more than £1 million.

In nearly half of the companies (46%) net assets had remained unchanged in the past 12 months. Net assets had increased in 28% of companies but decreased in 19%. The latter were, unsurprisingly, disproportionately likely to be loss-making companies – 36% of those whose net assets had decreased made a loss in the last full accounting year, compared with 16% of companies overall who made a loss.

Those whose net assets increased were again distinguishable in their size and sector. They tended to have more staff – 27% of those with an increase in net assets had ten or more staff compared with 15% of those with a decrease.

Those who had increased their net assets were also more common in the manufacturing sector and in finance and real estate, at least compared with those with a decrease. While in the transport & storage sector it was relatively uncommon to have net assets.

4.4 Expectations and Aspirations for Future Growth

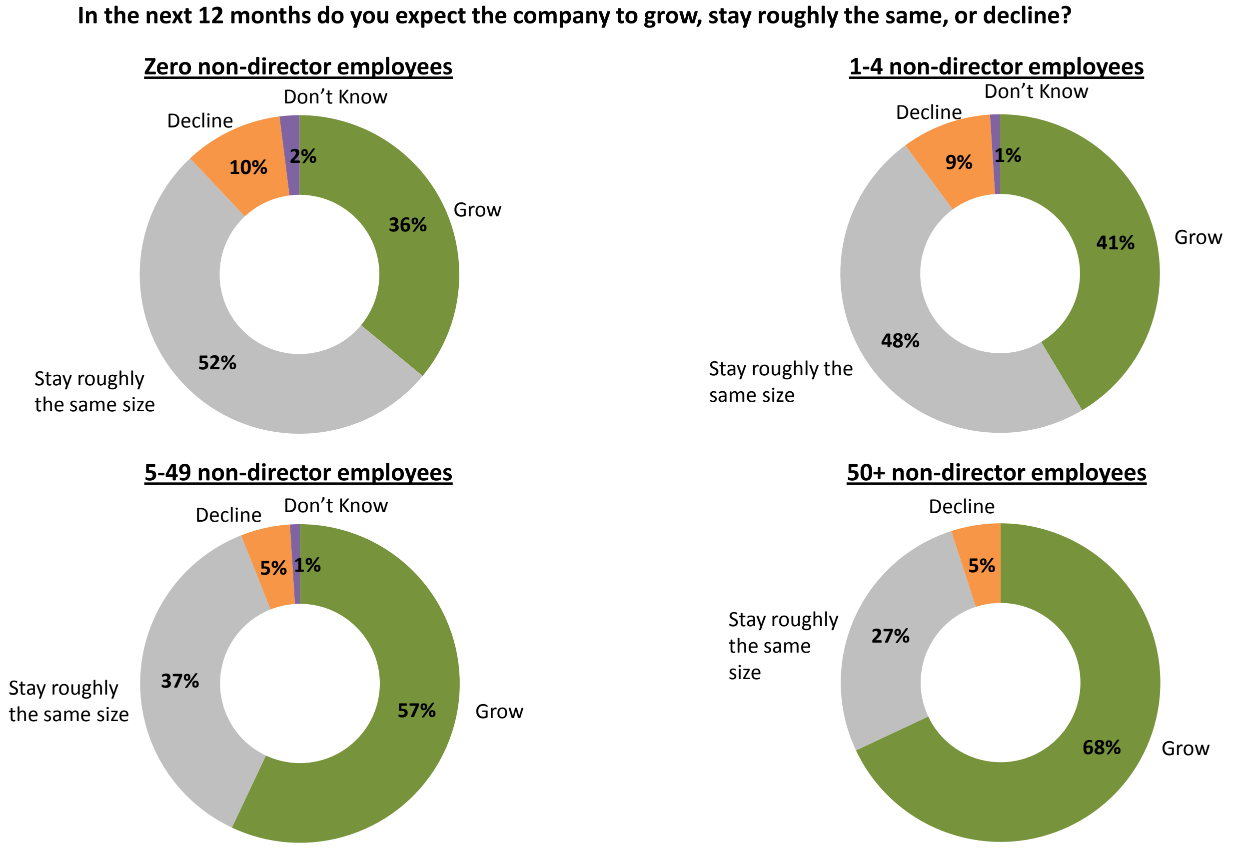
4.4.1 Expectations for future growth

The overwhelming majority of companies that were still trading expected their company to grow (44%) or stay the same size (46%) in the next twelve months; only 9 per cent expected to decline. Figure 4.17 (overleaf) shows how expectations for growth varied according to company size. The majority employing five or more staff expected growth, this being especially high among those with a workforce of 50 or more staff.

Asides from higher numbers of employees, other characteristics of companies who expected to grow were high turnover (58% of companies with turnover of more than £1 million expected to grow) and those trading in the Wholesale & Retail, Transport & Hospitality sector (53%).

There was also some evidence that expected growth was related to the profit just made – 40% of those with profit of up to £10,000 expected to grow compared with 55% of those who made a profit of more than £100,000 (the pattern in the range of profit levels between this is not consistent). The pattern roughly holds by differing sizes of company, though is less pronounced with smaller companies with zero to four staff, as many in these groups still expected to stay the same size. Growth expectations were higher among profit-making companies which had over £50,000 in retained earnings (51% compared with 42% among those who retained below £50,000) and among companies with higher net assets (57% of those with net assets above £1 million, compared with 44% of those with net assets below this).

Figure 4.8 – Expectations for the next 12 months



Base: All companies still trading with no staff (427); All companies still trading with 1-4 staff (426); All companies still trading with 5-49 staff (352); All companies still trading with 50 or more staff (131)

Nearly half of all companies that expected to grow in the next twelve months were anticipating this to come from higher demand or volume of work (46%). Other reasons given for expected growth included the company actively looking to grow as part of their business plan (35%), investment in expansion (29%) and an improving economic climate (24%).

The majority of companies (53%) who expected to remain the same size during the next 12 months had no intention to grow the company, being content with the status quo. The characteristics of those companies which expected to stay the same were that:

- They were more likely to have a turnover of up to £500,000, this was the case for 48% of these companies compared with 37% of those with higher turnovers who expected to stay the same size;
- They also were more likely to have up to four staff (50% compared with 35% of those with more employees);
- They were most commonly found among finance & real estate (57%) and least likely to be found among those in wholesale & retail, transport & hospitality (36%);

- There is not a clear pattern by company size, though medium-sized companies were distinctly less likely than other companies to expect to stay the same size (29% compared with 46% overall).

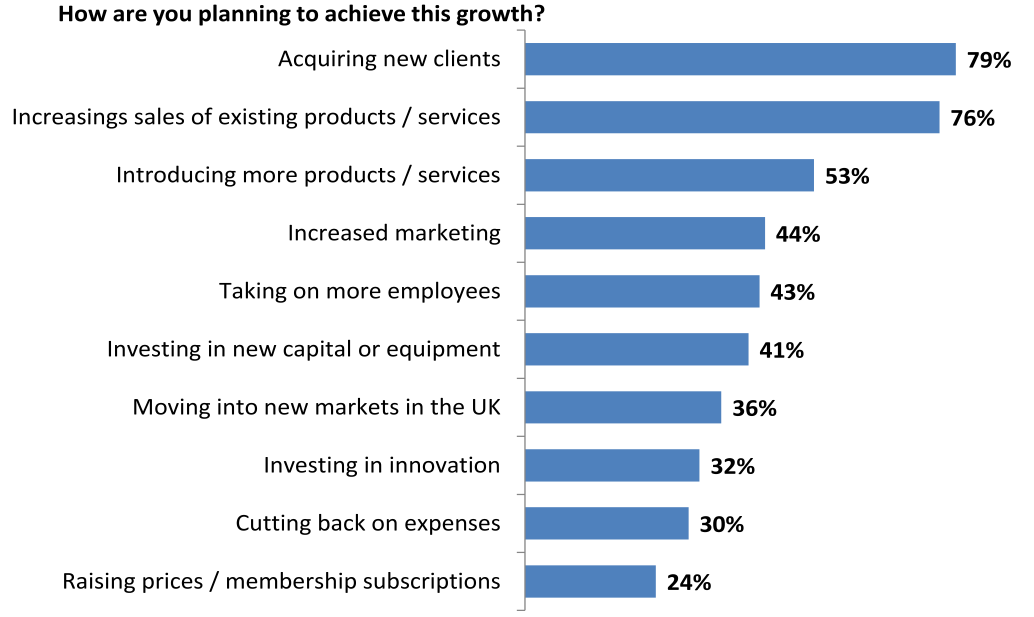
Where the company expected to decline, the main reasons were due to actively winding down the company (36%), more difficult business or economic climates generally (27%) or lower demand (23%). Personal circumstances such as age or planned retirement were also a key reason (14%) – all bar one of the companies who mentioned this were micro-companies (n = 16). Directors that were closer to retirement were more likely to expect their company to decline than younger directors (16% of those aged 65-74 compared to 6% of those aged below 50). There were few other significant differences.

4.4.2 Plans to achieve growth

Four in five companies who expected to grow (79%) were planning on achieving this by acquiring new clients. A similar proportion (76%) said they intended to increase sales of existing products or services, and just over half (53%) planned on introducing more products or services.

Other common ways companies expected to grow included taking on more staff (43%) or investing in new capital or equipment (41%). Small companies and those with a turnover of more than £500,000 were most likely to anticipate recruiting new employees or increasing capital investment. Among those expecting to grow, companies with 10 to 49 or 50 to 249 staff were planning to achieve this by investing in new capital or equipment (53% and 56% respectively) as well as taking on more staff (63% and 61% respectively). Companies with between five and nine staff were also more likely than average to be planning recruitment (63%) in order to grow. Company sector influenced how companies planned to achieve growth – for example, half (50%) of those in the Information & Communications sector planned to invest in innovation (compared to 32% overall).

Figure 4.9 – Perceived enablers to growth



Base: All respondents who expect their company to grow in the next 12 months(602). Top answers shown only.

4.4.4 Attitudes towards growth

The quantitative and qualitative research together painted a picture of three distinct ‘growth mindsets’:

- Companies that want and expect to grow;
- Companies that want to grow but perceive barriers to their growth; and
- Companies that do not want to grow.

Companies that want and expect to grow

To many companies growth was a *raison d’etre* that they pursued.

It’s (growth is) very important. Because that’s the way we can ensure survival and prosperity in the future.

Large company, family company

Sustainable growth is so important to us, it's our driving vision.

Micro company, non-family company

Companies that want to grow but perceive barriers

Among companies who expected to grow, lack of working capital was perceived as the biggest barrier (16%). In terms of external factors that are outside of the companies’ control, in the quantitative research the most common unprompted obstacles among companies expecting to grow were strong competition (14%), poor general economic conditions (13%) and lack of available, skilled employees (13%).

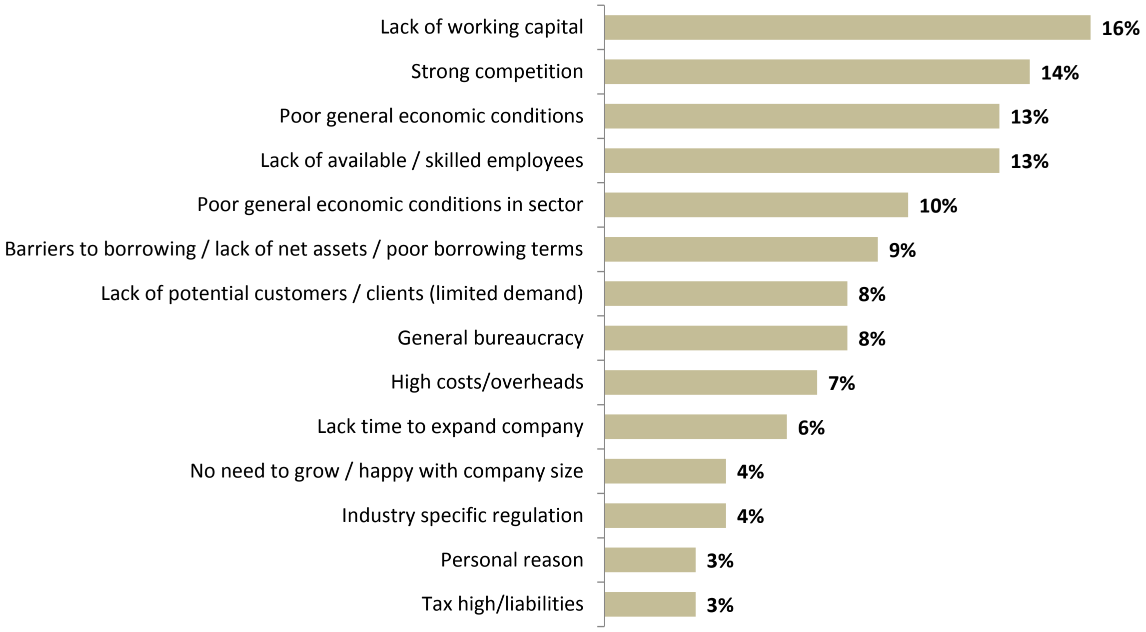
Among companies expecting to grow, perceptions of barriers to this growth differed by sector. Companies in arts, leisure & other services were most likely to identify limited demand as an issue (20%), whilst companies in the wholesale & retail, transport & hospitality sector were most likely to identify strong competition (24%). Companies in the manufacturing & professional and scientific & technical activities sectors were most likely to identify a lack of available and/or skilled employees as a barrier to growth (23% and 24% respectively).

There was no clear relationship between company size and perceived barriers to growth.

A small minority of those that expected to grow (9%) felt barriers to borrowing impeded their ability to grow, and an even smaller proportion (4%) felt that industry specific regulations and high tax liabilities (3%) were barriers. Small companies, in particular, felt industry specific regulations were barriers to growth - 10% said industry specific regulations were a barrier. There was no strong relationship between company sector and this barrier. There also was no significant relationship between having retained earnings and perceptions of barriers to growth.

Figure 4.10 – Perceived barriers to growth

Thinking generally, what would you say are the biggest barriers to this company growing over the next 12 months?



Base: All respondents who expect their company to grow over the next 12 months (602). Top answers shown only.

Qualitative results expanded on these findings; several of those who aspired to grow explained that they were pessimistic about the prospect of doing so because of market conditions. Furthermore, some companies described constraints to their future growth (e.g. limited director time for professional services firms or capacity in the case of leisure/hospitality companies, and difficulties in accessing finance). Some of these companies were seeking or were open to ways to overcome these constraints (e.g. through acquisition of other firms).

The banks don't lend money for anything at the moment, so the only way we can grow is organically through keeping the profits in the business.

Medium-sized, family company

Companies that do not want to grow

Some companies, particularly smaller companies with few or no staff, were content to stay at roughly the same size. When asked about barriers to growth, around one in six companies (16%) overall were content with their current size or felt there was no reason to grow. Companies with no staff were more likely than average to be content with the current size of the company and see no need to grow (25%).

This attitude was also particularly common among companies with low turnover (for example, 25% of companies who had a turnover of less than £25,000) and also companies which did not identify themselves as close companies (26%).

The qualitative research found that in many circumstances this was a lifestyle choice, such as being above retirement age and happy to do some extra work to get some additional income or wanting to maintain their current work/life balance.

I'm limited by the fact that there's only me actually working. So if I take too much work on I just become overloaded so I can only do so much. So that's really what limits my growth potential. I mean if I wanted to grow I would obviously take other people on and become more of a business but since I'm 62 now I'm not really looking to start a new business off.

Micro company, family company

4.5 The influence of tax on decisions about company profits distribution

Both the survey and qualitative research identified that tax considerations had a greater impact on decisions around director remuneration than they did on other uses of company profits, with most of the companies participating in the research paying a mixture of salary and dividends for reasons of tax efficiency.

In the survey, tax/ high tax liability was not identified as a major barrier to growth (only 3% of companies cited this) and the qualitative research found that the tax regime did not commonly determine growth and investment decisions because wider economic, business and even personal considerations were more important. Tax instead was viewed primarily as something to be complied with. Tax consistency (i.e. tax regimes not changing regularly) plus the simplicity of the administration of tax were cited by some participants as their priorities for the tax system.

To be fair I don't see the tax system as a big issue.

Micro company, family company

I don't mind paying taxes, but make them simple… 20% on VAT, on everything, 20% on Capital Gains, 20% on Profits Tax, flat, flat, flat.

Small company, family company

VAT has its own challenge…a major cash flow implication once a quarter, where we have to find the money and give it back to the Revenue… which takes a lot of administration, as does the PAYE and National Insurance. That also takes a great amount of administration and it's unnecessarily complex.

Micro company, non-family company

Where tax did play a role in investment decisions, it was cited mainly in relation to the perceived tax and administrative burden of recruiting someone. A handful of companies (in particular those actively seeking to grow) suggested improvements, such as better incentives for investing in new products, higher capital allowances or more support through the tax system for recruiting apprentices. However none mentioned their awareness and use of currently available tax reliefs[10].

[10] Some examples of current tax reliefs include Annual Investment Allowance (AIA) - https://www.gov.uk/capital-allowances/annual-investment-allowance, Research and Development Relief for Corporation Tax -

A small number of companies cited Corporation Tax in particular as a charge they view as unfair as it is a tax that rises with the size of profits. One argued for a system wherein the tax can be relieved if the company re-invests the money instead, while one said that the lack of flexibility to pay taxes such as Corporation Tax in instalments is a disincentive to invest (a larger number of companies mentioned that they 'store money away' in anticipation of their Corporation Tax bill).

I think the biggest problem for small companies is Corporation Tax. I might be naïve, but I've never really understood why companies are penalised for making a profit. I think it would be a better way of doing it if you were to say you can retain that Corporation Tax liability if you're prepared to invest it in a new product.

Micro company, family company

https://www.gov.uk/corporation-tax-research-and-development-rd-relief and the abolition of employer contributions to National Insurance for apprentices under 25 - https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385150/TIIN_2143.pdf

Appendix 1: Sample outcomes

The table below breaks down the sample of 7,062 companies used in this research, as well as various response rates. It can be seen that a large proportion of the sample was unusable due to bad telephone numbers. From known eligible cases, around half the companies took part in an interview (the co-operation rate).

Table A.1 – Breakdown of sample used and response rates

	Number of sample
Complete interviews	1,501
Refusals[11]	1,572
Unknown eligibility, non-interviews[12]	1,512
Not eligible[13]	2,477
Grand total of sample used	7,062
Known eligible cases	3,073
Eligible cases with eligibility assumption applied to unknown cases[14]	3,910
Unadjusted response rate (proportion of interviews from total sample used)	*21%*
Co-operation rate (proportion of interviews from known eligible cases contacted)	*49%*
Adjusted response rate (proportion of interviews from eligible cases contacted with eligibility assumption applied to unknown cases)	*38%*
Refusal rate (proportion of refusals from eligible cases contacted with eligibility assumption applied to unknown cases)	*40%*

[11] These are made up of refusals from eligible sample.
[12] These are cases wherein eligibility could not be established, such as appointments not converted to interviews, answer machines, reaching the maximum number of tries without an interview and similar.
[13] These are cases established as ineligible, and are made up of unusable numbers such as wrong numbers, disconnected numbers and fax machines.
[14] This is where we take the proportion of those eligible in known cases (i.e. from the total of interviews, refusals and cases established not eligible) and assume the same proportion of cases with unknown eligibility would have been eligible, had we been able to contact them.

Appendix 2: Achieved sample profiles

Table A.2 – Profile of the quantitative achieved sample

	Weighted total	Unweighted total
North East/Yorks	120	127
North West	150	146
Midlands	210	216
East England	150	149
London	345	271
South West	120	137
South East	255	259
Wales/Scotland/NI	150	196
Micro	970	928
Small	152	208
Medium	45	117
Large	61	113
Unknown	273	135
Family business	820	835
Not family business	681	666
Trading up to 5 years	297	242
More than 5 years up to 10	382	372
More than 10 years up to 15	207	217
More than 15 years up to 20	131	147
More than 20 years up to 30	127	144
More than 30 years up to 40	67	83
More than 40 years	93	122

Base: All quantitative respondents (1,501)

Table A.3 – Asset profile of the quantitative achieved sample

	Weighted total	Unweighted total
Retained earnings	759	803
No retained earnings	742	698
Zero net assets	173	146
Net assets up to £10,000 (not zero)	363	315
Net assets more than £10,000 up to £100,00	288	270
Net assets more than £100,000	288	386
Don't know/Refused/Negative figure	389	384
Zero fixed assets	461	399
Fixed assets up to £10,000 (not zero)	420	383
Fixed assets more than £10,000 up to £100,00	260	283
Fixed assets more than £100,000	181	251
Don't know/Refused	178	185
Zero financial assets	135	124
Financial assets up to £10,000 (not zero)	416	366
Financial assets more than £10,000 up to £100,00	399	380
Financial assets more than £100,000	298	377
Don't know/Refused	252	254
Own premises	311	354
Rent premises	718	773
Own plant, machinery fixtures and fittings	1,135	1,179
Rent plant, machinery fixtures and fittings	232	257
Own intellectual property	248	257
Own other intangible assets	211	215

Base: All quantitative respondents (1,501)

Table A.4 – Profile of the qualitative participants

	Number
Family business	18
Not family business	9
Family business:	
Looking to grow	9
Remain stable/decline	10
Not family business:	
Looking to grow	5
Remain stable/decline	3
Micro	14
Small	6
Medium	4
Large	2
Unknown	1
No retained earnings	4
Up to £30,000 retained earnings	9
More than £30,000 up to £150,000 retained earnings	7
More than £150,000 retained earnings	7
No staff	6
1-10 staff	10
More than 10 staff	11

Base: All qualitative respondents (27)

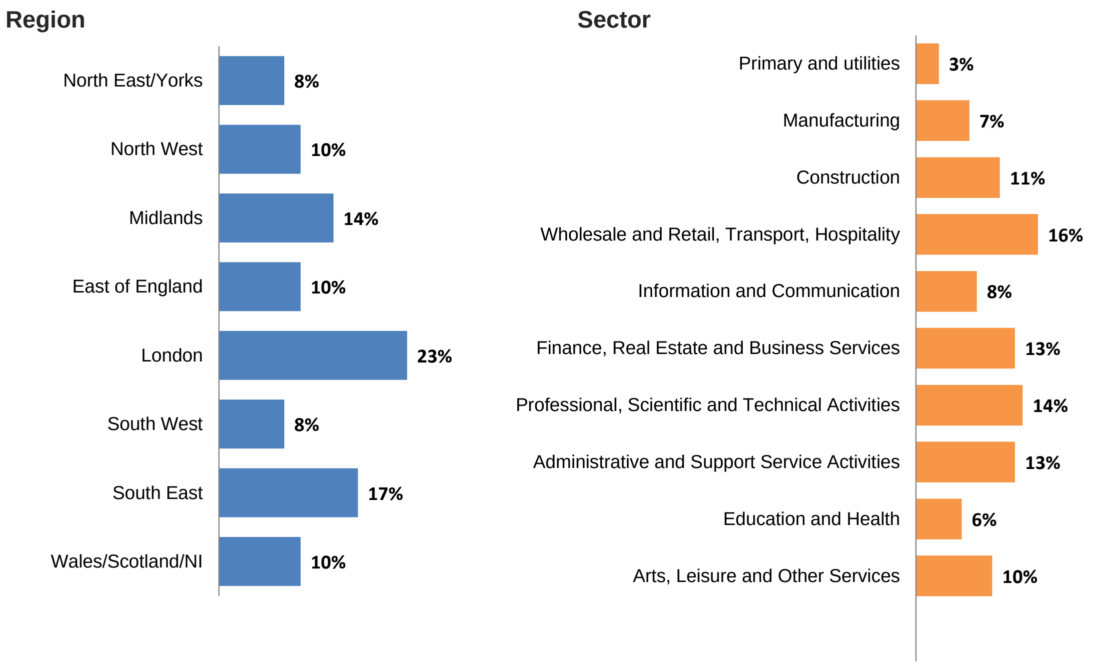
Appendix 3: The nature of unlisted companies

Who, what and where are they?

The vast majority of businesses interviewed classified themselves as close companies (92%) and just over half (55%) contained at least two members of the same family, either as shareholders or as a mix of shareholders and employees.

The most common sector, wholesale & retail, transport & hospitality, accounted for 16% of companies, followed by professional, scientific & technical activities (14%).

Figure A.1 – Regional and sector distribution of unlisted companies



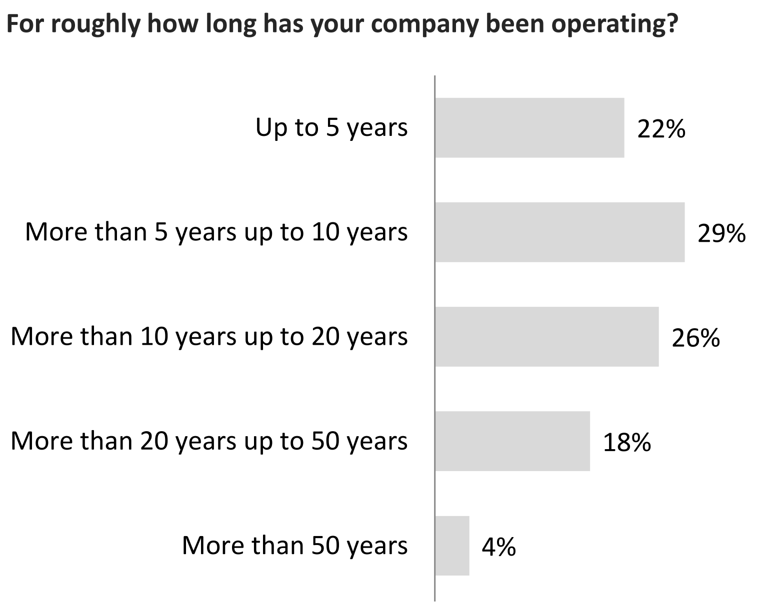
Base: All respondents (1,501)

At the time of the survey, around nine in ten of the companies interviewed (88%) were trading, 11% had either ceased trading or been liquidated and 1% had been sold or passed on[15].

Of those currently trading the total years they had operated varied; just over a quarter had operated for more than five up to ten years (29%) and more than ten up to twenty years (26%), whilst one in five (22%) were still in their first five years. The median number of years trading was 12.

[15] Although this proportion is representative of the sample, it should be noted that the sample was based on a snapshot of data, and the 'true' proportion that have ceased trading is likely to be higher, given that an unknown number will have closed between the time the sample was collated, and the survey fieldwork.

Figure A.2 – Duration of trading



Base: All respondents still trading at the time of the survey (1,340). Don’t know/refused not shown (1%)

In contrast, among those companies that had closed or been sold on, a sizeable minority (44%) had done so within their first five years, with another 30% who had traded for five to ten years. The median number of years trading among closed or sold on companies was 7.

Two in five unlisted companies were located in London (23%) or the South East (17%). The rest were distributed fairly evenly across the remaining English regions and the devolved administrations. London had a higher than average proportion of Administrative & Support Service companies (19% compared with 13% overall) while the North East and the Midlands both had higher concentrations of Manufacturing firms than average (12% and 14% respectively, compared with 7% overall).

Appendix 4: Illustrative Examples: Reasons for Retained Earnings

Case study 1: events company, medium-sized company, non-family company, over £150,000 of retained earnings

The participant is the main director and shareholder of an events company. There are two other directors/shareholders, none of whom are related to each other. Although there is some scope to increase bookings in quieter periods, the company's ability to grow is constrained by capacity factors. To significantly increase turnover, they would have to invest in new premises or acquire another events company.

They aim to retain a cash surplus of at least £250,000 in the bank, although are currently holding double that. The figure of £250,000 (which the participant describes as a "safety buffer") was chosen because if they lost 30% of their business, this would give them enough money to pay all their staff and the three directors for a year.

The sense of security this provides the company is greatly valued by the participant. It contributes to a sense of stability among staff and therefore helps the company retain staff. The participant also prefers to avoid borrowing money if possible.

Directors are paid a mixture of salary and dividends. They start with what the director with the least amount of shares needs and work backwards from there in deciding levels of salary and dividends, taking into account tax thresholds.

"I know that from an entrepreneurial point of view it's bad to have money in the bank, but we like it from a security point of view."

Case study 2: stationary company, medium-sized company, non-family company, over £150,000 of retained earnings

The participant is the director of a stationary company, along with his business partner. The sole shareholder is a holding company, the directors and shareholders of which are the participant, his business partner and his business partner's wife.

The company operates in a very competitive and cost driven market, with customers squeezing them on costs, while suppliers keep raising prices.

Cash flow drives decision making in the company ("cash flow is king"). Their retained earnings are working capital. The company relies on invoice factoring ("it is the only way we can operate") because their clients are not quick payers. They also have an overdraft. Dividends are paid as and when cash flow allows. There is very little scope to invest in the company.

"If our turnover improved, profitability improved, then, yes, we probably would take on more people, do more product development, and try to launch more products. Obviously, under the current circumstances, where we are, that is not possible."

Case study 3: Food importing company, small company, family company, zero retained earnings

The participant is a director of a company that imports food ingredients, such as dehydrated potato and dehydrated milk proteins, and the company has been trading for 30 years. The company is looking to grow "but not to such an extent that you lose that customer service".

The company had zero retained earnings as their profit was lower than expected last year, partly due to losing some contracts but also due to the impact of some debts. The respondent stated that it was the nature of the agriculture-based sector for profits to fluctuate: *"it does depend on what price we can offer and how much material (we have)",* which makes planning difficult. All of the profits went on dividends. He usually likes to retain some profits though, around £30,000 or more, as it gives customers and suppliers confidence that the company is achieving steady growth.

"It's what's left over after everything has been sorted out and spent to be quite honest. I think that, at the moment we don't have a hard and fast, 'This is how much has to be retained'; it's a case of how much have we got left over, is there any, for instance, pensions, bits and pieces like, once the money's gone into that then whatever is left over is left over."

Case study 4: IT company, medium-sized business, non-family company, over £150,000 of retained earnings

The participant is the managing director of an IT services company, one of two (unrelated) directors. The company has grown over the past few years, with the participant commenting that *"sustainable growth is so important to us, it's our driving vision."*

The business currently has around £300,000 of retained earnings. Typically at least half, if not more, of profits are reinvested back in the business. The business is currently buying new business premises, 50% of which will be funded from retained earnings and 50% from bank borrowing. Levels of retained earnings play an important role in investment decisions, for instance hiring new staff, refurbishing or buying new business premises or acquiring other IT companies.

Corporation Tax is seen to negatively impact on cash flow and therefore influences the timings of investment decisions.

"The biggest thing that impacts on investment is cash flow. When you're looking towards the end of one tax year, then you've suddenly got to find something great, in our case, a £60,000 Corporation Tax bill. That's a vast amount of money to find in one time, so therefore, you're not inclined to perhaps replace company cars, or renovate your building."

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