Ipsos MORI
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Research on Sources of Company Income

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The views in this report are the authors’ own and do not necessarily reflect those of HM Revenue & Customs.

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Glossary[1]

	Definition
Business clients	These excluded clients who were individuals or private households. This is the collective term used for clients who are: ▪ Organisational ▪ Mainly in the private sector ▪ Mainly in the public sector ▪ A mixture of the above
Business critical individuals	In the survey, business critical individuals were described as employees or directors who were 'critical to the continued existence of the business'. Further clarification was given as, 'any individual who is irreplaceable in the sense that if they left, the business would not be able to recruit a replacement and continue or resume its current operations'.
Connected parties	'Connected' parties are any employees, shareholders, or directors that are associated with any of the company shareholders in any of the following ways: ▪ A member of a shareholder's family (spouse, partner, child, stepchild or parent) ▪ A trustee of a trust able to give benefits to a shareholder ▪ A shareholder's business partner or the business partner of a person connected with a shareholder (as described earlier)
Financial assets	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'.
Fixed assets	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.
Incorporation	Incorporation is the formation or registering of a business as a legally-recognised company with Companies House.
One-person operations	Only the respondent works for the company currently, with no other employees, directors or shareholders
Remuneration	Remuneration is the total compensation package which may include salary, dividends, shares, pensions and other economic benefits.
Repeat business	By 'repeat business' it was meant business with a client that the company has worked for previously, on a separate project or contract.
Retained earnings	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.

[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

	The survey asked for the retained earnings for the last full accounting year, rather than the cumulative figure from more than one year.
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).
Turnover	This is the total amount received in respect of sales of goods and services

Key findings

Background and methodology

HMRC commissioned Ipsos MORI to conduct research to understand the characteristics of small companies with 0 to 4 employees, including firmographic details such as business composition, size and sector, company income, expenditure and assets, and particularly how they derive their income and work with clients.

The research took place between January and April 2016 and comprised a random probability telephone survey of 1,000 businesses and follow-up qualitative interviews with 30 businesses who had taken part in the survey.

Business size and composition

Three-quarters of businesses had one or two employees – 40% had one and 33% had two. A further 20% had three or four employees. Fewer than one in ten (8%) had no employees at all. Two in five of all businesses categorised themselves as one-person operations (41%) – indicating they were the sole person working in the business with no other directors or shareholders involved.

Discounting one-person operations, who by definition only have one shareholder and one director, the majority of other small businesses had one or two shareholders (83%) each, and six in ten of them (62%) had one or two directors each.

Overall, two in five small businesses (39%) contained connected employees, while around one in ten (11% and 9% respectively) contained non-employee directors or non-employee shareholders.

Company finances

Around two in five companies reported a turnover of up to £50,000 in the most recent year (37%), one in five had a turnover of between £50,000 and £100,000 (22%) and another two in five had a turnover of more than £100,000 (38%).

Nine in ten (88%) contained a 'business critical' individual whose work was crucial to the continued existence of the business – generally the owner-director.

Linked to this, most companies were dependent on a single employee for a large proportion of their income in the last 12 months – for three in five (58%) the highest contributing single employee was responsible for three-quarters or more of the company's income.

Three-quarters (75%) of companies made a profit in the last 12 months while 14% made a loss and 9% broke even. More than four in five profit-making companies (84%) retained at least some earnings in the last full accounting year. Two in five (42%) of these retained up to £10,000. Just over one in three profit-making companies (37%) had a retained earnings to profit ratio[2] of 0.7 or more, while a similar proportion (33%) retained a lower level of up to 0.3. Smaller business (in terms of both employee size and turnover) tended to retain a higher ratio of profits. Retained earnings were mainly used as financial security for the company, and as a source of finance for future investment or growth.

[2] This is where we analysed retained earnings as a ratio of profit in the last accounting year, to account for the size of the company's potential for retained earnings via the size of its profits.

Among the companies surveyed, investment in fixed assets was very low. One in three (32%) had no fixed assets at all and one in four (37%) companies had low value fixed assets worth up to £10,000. The mean level of fixed assets, among companies who had them, was £77,000. Smaller companies were less likely to have fixed assets, with 46% of companies with no employees and 41% of companies with one employee having no fixed assets at all. This compared with 21% of those with three or four employees.

Company remuneration

Salaries were more common for employees (72% with non-director employees used these as part of their remuneration strategy for employees); while directors were more likely to be paid in dividends (62% with directors used this), or a combination of dividends and salaries), due to tax efficiency. Companies were heavily reliant on accountants for advice on these issues.

There was little evidence among these businesses of connected employees who did no work for the company being paid a large proportion of the profits, something that companies might do to reduce tax liability. Among companies with director-shareholders, around half (47%) paid a quarter of their profits or less to director-shareholders in the last financial year, including 36% who paid out 10% or less of their profits.

Client base and relationships

Although companies tended to have multiple clients, half (49%) attributed three-quarters or more of their income to repeat business, with a further fifth (22%) attributing between half and three-quarters. For this reason, word of mouth was a key way to maintain and develop new business and doing a good job was key for retaining clients.

Companies with organisational clients[3] nevertheless tended to work independently from their clients on a day-to-day basis. Very few were reliant on using their clients' equipment all or most of the time (just 11% were) or took instruction mainly from the client's staff (10%).

Business identity and reasons for incorporation

The qualitative research found that business' sense of identity was influenced by a mixture of self-perception, technical status, and how they choose to present themselves to clients. Technically, some business owners said they were an employee of their own business (as they received a salary), but they *perceived* themselves as being self-employed, in as much as they were their own boss with control over what work they do, for whom and when.

Among the companies surveyed, around one in five incorporated because they had to as a 'client requirement'. This consisted of 8% of companies who cited this as the only reason for incorporating, and a further 13% who cited this as one of many reasons. Therefore, three in four companies' reasons for incorporating had nothing to do with client requirements (75%). The qualitative research found that a key reason for becoming incorporated was limited liability, a finding supported by previous research[4], and that accountant advice and/or tax efficiency also were prominent reasons.

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[3] These are clients that are not only individuals or private households.

[4] https://www.gov.uk/government/publications/reasons-behind-incorporation

Main findings

1 Introduction and methodology

1.1 Policy context

HMRC commissioned Ipsos MORI to conduct research among businesses with between zero and four employees, in order to improve its understanding of these very small companies and identify ways to better support them in the tax system. While there is a wealth of information available about public limited companies, it is more difficult to find out about small companies (which are predominantly unlisted) because their accounts contain less public information. Previous HMRC research has investigated small companies' reasons for incorporation and explored how and why unlisted companies distribute, invest or retain their profits, in relation to company growth plans and tax planning. This research builds on those studies. Its overarching aims are:

To understand the characteristics of small companies, including firmographic details such as business composition, size and sector, company income, expenditure and assets, and particularly how they derive their income and work with clients. In particular, there is a growing number of small companies who derive income mainly from the work of one or two people.

To estimate what these companies do with their income, including investment and tax-planning strategies, and how income is distributed between those involved with the company, including connected parties. A connected party may be a close relative, spouse or civil partner, or related to a spouse or civil partner.

1.2 Methodology

The research comprised two related strands of work:

A random probability telephone survey of 1,000 businesses to provide representative data for very small companies' business composition, company finances and remuneration, sources of income; and client base; and

Qualitative telephone interviews with 30 businesses that had agreed to be re-contacted from the survey, to provide more in-depth insight. These interviews discussed a number of issues including remuneration strategies, the use of retained earnings and how far these were influenced by tax considerations, and business' sense of identity and self-definition. The qualitative interviews also explored small business' attitudes towards incorporation.

1.3 Quantitative telephone survey

Questionnaire development for the survey was informed by a small-scale pilot. Fieldwork for the survey took place between 6 January and 16 February 2016. Interviews were conducted with the company owner or director, or a senior finance professional within the business. The average interview length was 20 minutes.

Businesses were selected from HMRC administrative data to be representative of the target sample group, which was defined as small companies with between zero and four employees. A breakdown of the sample used, response rates, and the weighted and unweighted profile figures, is provided in Appendix 3.

1.4 Qualitative follow-up interviews

Depth interviews were conducted in April 2016. Interviews were recorded with the permission of participants, and lasted around 40 minutes. The sample was structured to ensure coverage of a range of businesses and topics. The sample profile is outlined in Appendix 3.

The qualitative research was designed based in part on the findings of the quantitative survey. The aim of the qualitative interviews was to explore in greater depth topics of particular interest that emerged from the quantitative findings.

1.5 Interpretation of findings

When reading this report, it is important to note that all findings are based on self-reported data, from respondents. As such, they are the result of individuals' perceptions rather than objective facts, or official definitions. For instance, when asked how many employees their business had in total, some 'one-person operations' may say zero and some may say one, depending on whether they viewed themselves as an employee or not. They may not have been considering the official, legal definition of an employee in their answer (although guidance was provided for people to include themselves in their answer, if they considered themselves as an employee as well as a company director).

1.5.1 Quantitative data

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

Where figures don't add up to 100%, this will be down one or more of the following:

- Respondents were able to select multiple options when giving their answers;
- The exclusion of 'don't know' or 'refused' response codes from charts or text; or
- Computer rounding of percentages.

1.5.2 Qualitative data

The data was analysed using an inductive approach whereby interview recordings were transcribed, summarised under thematic headings and analysed for themes, patterns, differences and similarities. Qualitative research is used to map the range and diversity of different types of experiences rather than indicate the prevalence of any one particular experience.

2 Main findings

Business composition and structure

Throughout this report it should be noted that figures on the number of employees, directors and shareholders are self-reported and are not mutually exclusive. This means that one individual may fall into more than one category, if it applies.

2.1 Company size

Participants were asked about the number of employees at their company and were advised to include company directors who were also employees, but to exclude unpaid workers and freelancers. All the companies that took part in this research employed four or fewer staff (including directors who were also employees). [5] The most common situation was to have one (40%) or two (33%) employees, with one-fifth having three or four (20%). Eight per cent of companies reported having no employees. Two-thirds (69%) of company directors also defined themselves as an employee.

The distribution of employees was consistent across sectors, with the exception that companies in 'Wholesale and Retail; Transport and Hospitality' tended to be larger than average (28% employed three or four staff). Companies in 'Arts, Leisure and Other Services' were much more likely to have two employees than the average (45%, compared with 33% overall).

In total, 41% of all businesses categorised themselves as 'one-person operations', consisting of companies with one director-shareholder (who could also characterise themselves as an employee) and no other employees, shareholders or directors. Three in five of those with zero employees (58%) and 91% of those with one employee also identified as one-person operations. One-person operations were most prevalent in Professional, Scientific and Technical Activities and Information and Communications, where they comprised 54% and 53% of companies, respectively.

The qualitative research, found that one-person operations were a diverse group in terms of their reasons for being in business. Some were providing a professional service with a view to getting enough income to live on but not necessarily to grow it further. They liked the autonomy of working on their own and the flexibility of being able to work when they wanted, and tended to be younger professionals. Others were older and had taken the opportunity of redundancy to either re-train or go it alone doing subcontract work in industries where they already had connections. They similarly looked to be able to get enough income to live on.

> ***"My son is eight years old so I'm not looking to work full-time so for me being able to dip in and out works pretty well."*** - (Administrative & support services, 1 employee, one-person operation, 3-4 clients)

The qualitative research also identified a subgroup of one-person operations whose business was not their main source of income. They tended to be older, and to have alternative income streams through other businesses or pensions. These were most likely to have continued working because they were still interested in the work they had done prior to retirement, or had developed a new business through their 'hobby'.

[5] Note that in this study the numbers of employees, shareholders and directors, are all based on respondents' self-reporting in the survey, rather than a formal assessment of roles such as via PAYE or company records.

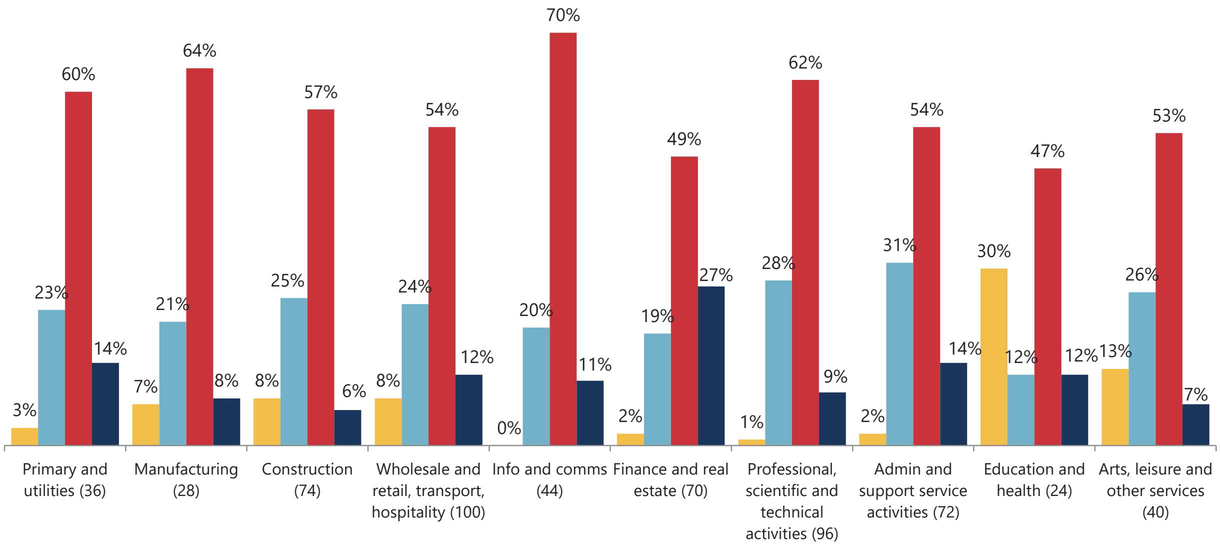
"I started it when I retired from my full time job in 2005, I didn't feel quite like stopping work completely and my role was acting as a consultant." - (Professional, scientific & technical activities, 1 employee, one-person operation, 3-4 clients)

2.2 The prevalence of shareholders and directors

The majority of small businesses had one or two shareholders[6]. Discounting one-person operations (who by definition have only one shareholder) 26% of other businesses had one shareholder and 57% had two. Five per cent of non-one-person operations (n=30) reported they had no shareholders[7] and 12% had three or more.

Figure 2.1 shows that the number of shareholders was broadly consistent across sectors. Finance and Real Estate companies were more likely than average to have three or more shareholders (indeed, at 27% they were more than twice as likely to have multiple shareholders)

Figure 2.1: The number of shareholders, by sector (excluding one-person operations)



Q: How many shareholders does this company currently have, including yourself?

Base: All non-one-person operations (584)

The number of directors[8] among businesses tended to rise with the number of employees (Figure 2.2). The majority of those with no employees or one employee had only one director (64% and 73% respectively). Those with two or more employees tended to have at least two directors (79% with two employees and 84% with three or four employees). Companies in the Professional, Scientific and Technical Activities sector were the most likely to have one director (54%

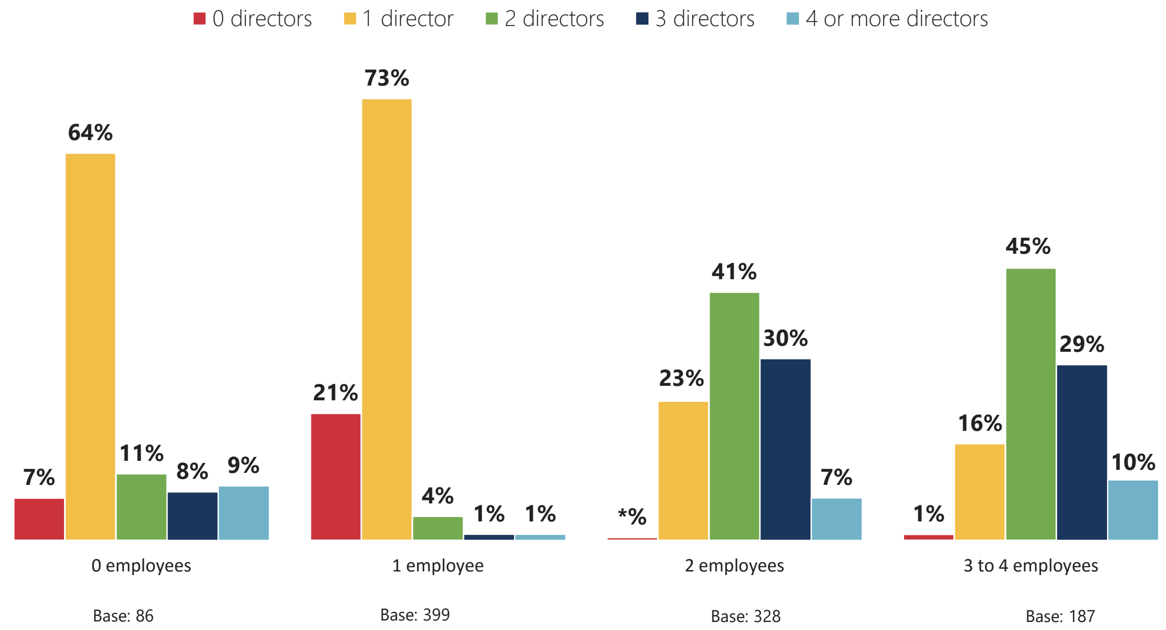
[6] Note as before that in this study these figures are based on self-reporting, rather than a formal assessment of roles/positions such as via company records.

[7] Note that this is not factually accurate, as incorporated companies must have at least one shareholder. All findings in this survey are based on self-reporting from respondents, so this inconsistency could be due to respondents answering incorrectly, or not understanding the terminology.

[8] Note as before that in this study such positions are all based on self-reporting rather than a formal assessment of roles/positions such as via company records.

compared to 45% overall) while those in Manufacturing, Education and Health and in Arts, Leisure and Other Services were particularly likely to have five or more directors (7%, 7% and 6% did respectively compared with 1% overall).

Figure 2.2: The number of directors by the number of employees



Q: How many directors does the company currently have?
Base: All businesses (1000), individuals bases shown

Two in five of the companies had one individual who was both a director and a shareholder – termed a 'director-shareholder' – (40%) and 74% had at least one employee who was also a director and a shareholder[9]. Companies who had one director-shareholder (regardless of the number of employees) were most common in Professional, Scientific and Technical Activities (49%).

2.3 The extent and nature of connected parties

Participants were asked about the extent of connected parties in their businesses, namely whether any employees, non-employee directors or non-employee shareholders were related or connected[10] to any of the company's shareholders. Overall, two in five companies (41%) had at least one connected party (either an employee, non-employee director or non-employee shareholder) and 57% contained no connected parties (the remaining 2% didn't know or refused at one of the questions on connected parties).

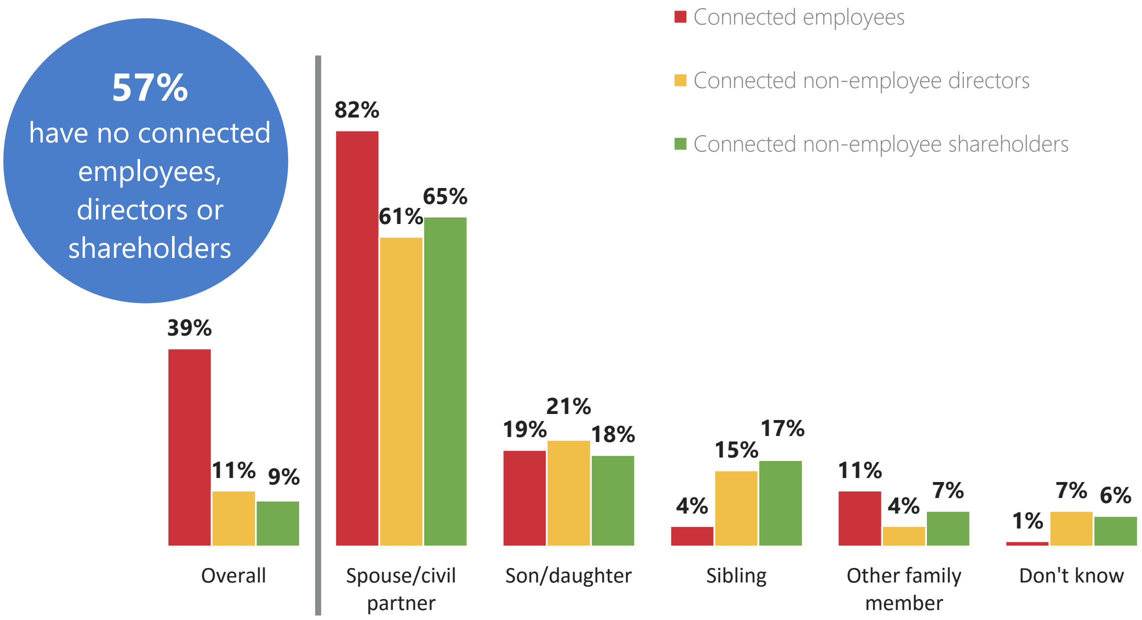
Figure 2.3 shows that the most common type of connection was to have an employee who was connected to a shareholder (found in 39% of companies). Of those, connected employees were most prevalent in Construction and Professional, Scientific and Technical Activities. In this sense, an 'employee' could also be a shareholder or a director (or both).

[9] Note that on these sorts of measures there will be a degree of overlap between categories, for example a director could also be a shareholder and define themselves as an employee if paid a salary. As before the findings are based on the self-reporting by the research participant.

[10] Please see Glossary on page 4 for a full definition, as used in the survey.

One in nine (11%) companies had at least one non-employee director who was connected to another company shareholder, and one in eleven (9%) of companies had at least one connected, non-employee shareholder. When combined with their role as employees, 35% of companies had at least one connected director and the same proportion had at least one connected shareholder.

Figure 2.3: Connected employees, non-employee directors, non-employee shareholders, and their connections



Q: Are you/they/Is the director who is not also an employee/Is the company shareholder who is not also an employee related to, or connected to, any of the other company shareholders? In what way are they related or connected?
Base: Overall (1000); All employees connected to shareholders (401); All non-employee directors connected to shareholders (115); All non-employee shareholders connected to other shareholders (90)

Figure 2.3 also shows how the connected parties were related. The vast majority of employee connections were between spouses or civil partners (82%). By contrast, one in five connected employees were related as children to parents (19%). The qualitative research interviewed several husband and wife partnerships. Among our interviewees, there were examples where the fee earner had previously been made redundant and decided to set up a company, with their spouse providing a more administrative or organisational role. In these cases, the fee earner was usually the 'majority' shareholder. These types of business aimed to provide an income – sometimes to supplement other sources such as pensions – rather than to expand and take on other employees. A couple of these husband and wife businesses mentioned how one of their children may get involved in the business in the longer-term, as they looked to wind down – potentially looking to grow the business then, or to change its direction.

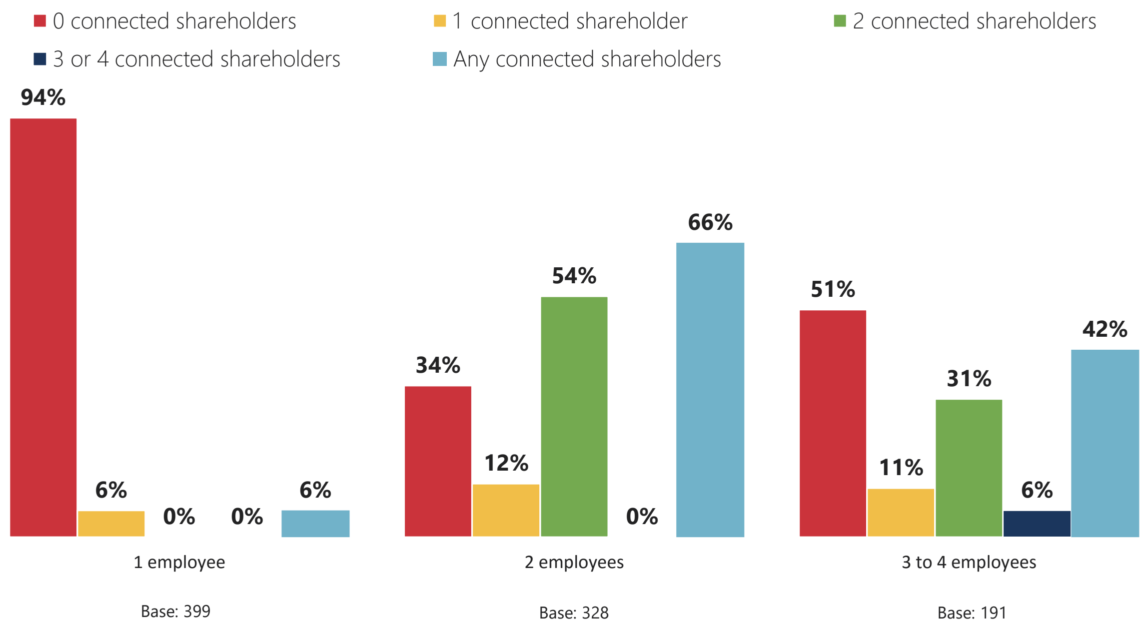
"I'm a quantity surveyor by profession…I became redundant and I decided… there were such minimal amounts of employee protection really that there was no point in being an employee any longer, and I decided to just go on my own. [My wife] She's a retired teacher. So she does the admin work for me." -
(Professional, scientific & technical activities, 2 employees, husband/wife team, 3-4 clients)

Among companies with both employees and shareholders, a quarter (26%) had no employees with any connections to shareholders. This was more common among larger businesses, with 32% of those with three or four employees exclusively employing people with no connections compared with 22% of those employing one or two staff.

In total 11% of companies had at least one non-employee director who was related or connected to a shareholder. This was most common among those with three or four employees (at 23%).

Almost all companies with employees who are shareholders, with connections to other shareholders, had two or more employees in the business (Figure 2.4). However, more companies with two employees had connected shareholders than did those with three or four employees (68% and 54% respectively).

Figure 2.4: Employees who are shareholders connected with other shareholders, by number of employees



Base: All businesses with at least one employee (914), individual bases shown

2.4 Business critical employees

Two thirds of companies (68%) identified one employee or director who was critical to the continued existence of the business – a 'business critical' individual.[11] Having one business critical individual was most prevalent in Information and Communications (83%) and Professional, Scientific and Technical Activities (82%) – the two sectors with the highest proportion of one-person operations. Manufacturing had the third highest instance of one business critical employee (74%), but the proportion of Manufacturing companies who classed themselves as one-person operations was not significantly different from the overall figure.

[11] The 'business critical' employee or employees is again based on the definition of the respondent in the survey, which in turn was defined in the questionnaire as 'any individual who is irreplaceable in the sense that if they left, the business would not be able to recruit a replacement and continue or resume its current operations'

One in five companies (21%) stated that they had more than one business critical individual, and this was most common in Wholesale and Retail; Transport and Hospitality (32%) and Primary and Utilities (31%).

Companies cited various reasons as to why they considered employees or directors to be 'business critical'. The most common are shown in Table 2.1.

Table 2.1: Reasons why employees or directors are considered to be business critical[12]

	%
Unique skills and knowledge	46%
Just them/only person at the business	41%
Quality of work done	20%
Volume of work done	19%
Bring new clients or sales, or clients have personal loyalty	19%
Does everything/sole employee/trader	5%
Contribute essential intangible assets/IP	5%
Contribute finance/invests in company	4%
Contribute essential fixed assets	3%
Founding member/director	2%
Main income/fee earner	1%
Partnership/dependent on each other/team work	1%
Other	1%
Don't know	*%

Q: Why would you say that employee is/those employees are business critical?
Base: All with business critical employees (883)

There were several sectoral differences in why companies cited having a business critical employee:

- Information and Communications and Arts, Leisure and Other Services businesses were the most likely to report having a business critical employee due to the unique skills and knowledge they brought to the company (62% and 63% respectively, compared with 46% overall).

- Bringing in new clients, or having clients with personal loyalty, was more likely than average to be cited by Finance and Real Estate companies (29%, compared with 19% overall) and these were also more likely than average to report that an employee was business critical due to the intangible assets or intellectual property they provided (15% compared with 5% overall). There is a degree of overlap here given that goodwill is a form of intangible asset, and this related to the personal loyalty of clients.

[12] Note that this was a multi-response question, in that a respondent could give more than one reason if they wished.

- Manufacturing companies were more likely than average to have an employee who was business critical due to the quality of their work (38%, compared with 20% overall) reflecting the production-based nature of that sector.

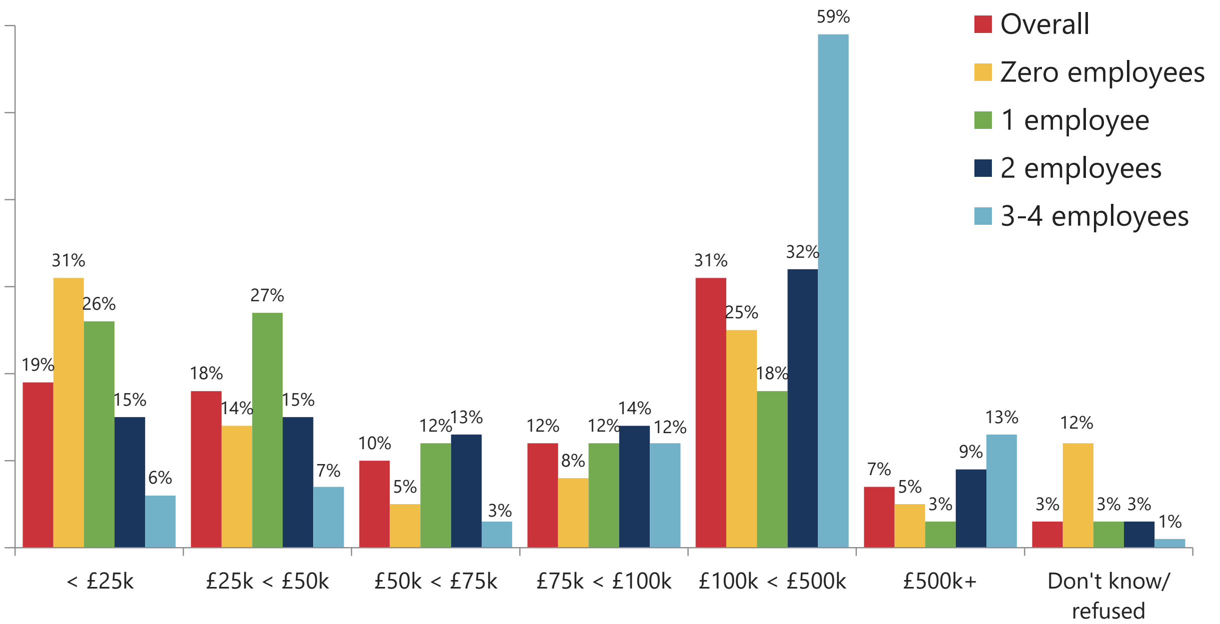
Company finances

2.5 Income and expenditure

2.5.1 Turnover

Around two in five companies reported a turnover of up to £50,000 in the most recent year (37%), one in five had a turnover of between £50,000 and £100,000 (22%) and another two in five had a turnover of more than £100,000 (38%). Turnover increased with company size: seven in ten businesses (72%) with three or four employees had a turnover above £100,000, compared with 30% of those with no employees and 21% of those with one (Figure 2.5).

Figure 2.5: Turnover by employee size in the last full accounting year



Q: What was your approximate turnover for the last full accounting year?

Base: All businesses overall (1,000); all with zero employees (86); all with 1 employee (399); all with 2 employees (328); all with 3-4 employees (187)

Turnover was highest in Wholesale and Retail, Transport and Hospitality, with 21% having a turnover of £500,000 or more compared with 7% overall. Manufacturing, and Education and Health companies were more likely than average to have very small turnovers of up to £10,000 (22% and 21% respectively) compared with 9% overall.

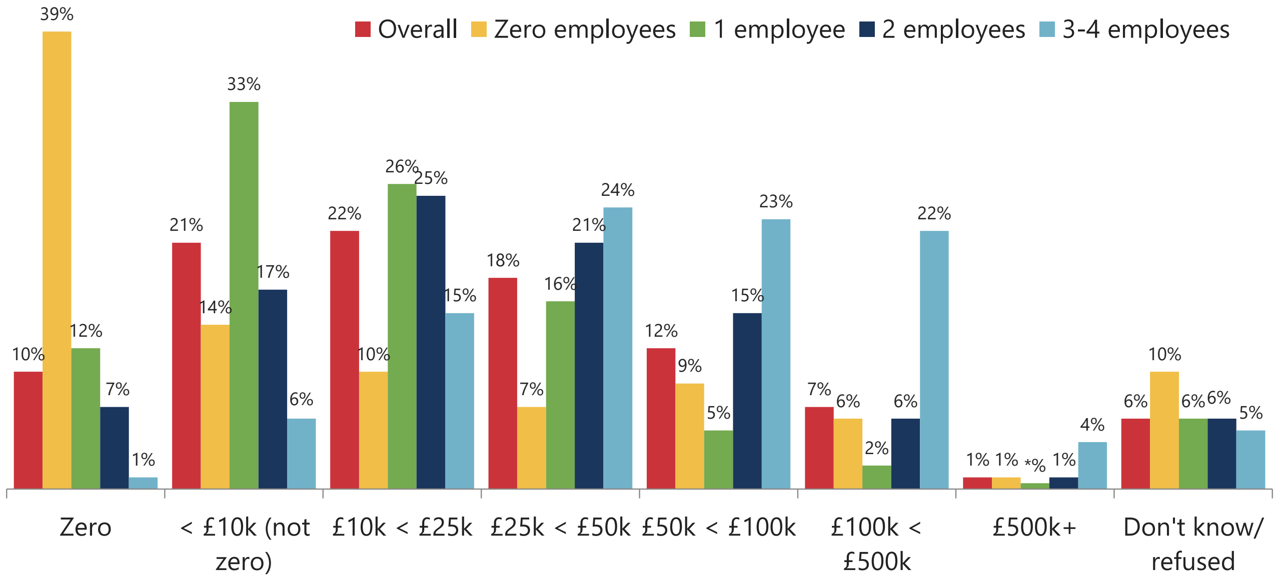
Those who made a loss in the last full accounting year were more likely to have a smaller turnover – 41% had a turnover of £25,000 or below compared with 19% overall.

Figure 2.4 also shows that almost a third of companies with zero employees (30%) had a turnover of more than £100,000. This possibly reflects companies that generate a lot of money from the work of one person who does not view themselves as an employee.[13]

2.5.2 Spending

Spending on wages and other direct costs in the last full accounting year varied considerably by the number of employees. Two in five (39%) with zero employees spent nothing on wages and direct costs, while 1% with three or four employees did the same. These larger companies were more likely than others to have spent larger sums on wages and direct costs, of £50,000 or more (Figure 2.6).

Figure 2.6: Expenditure on wages and other direct costs by employee size in the last full accounting year



Q: How much did the company spend on wages and other direct costs in the last full accounting year?

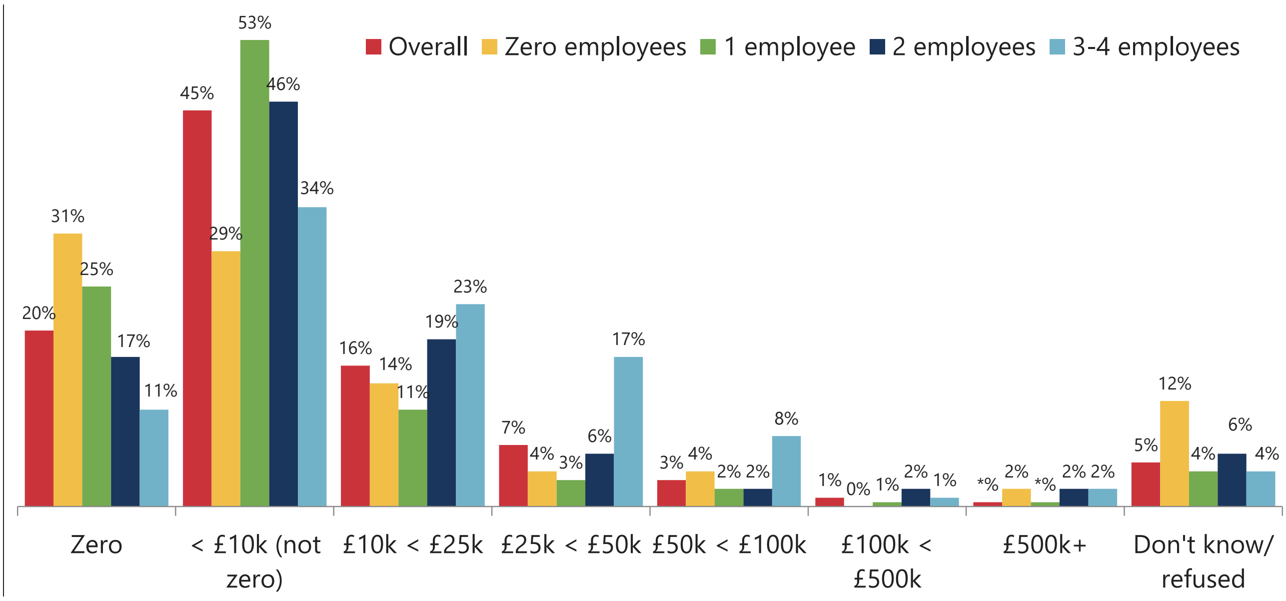
Base: All businesses overall (1,000); all with zero employees (86); all with 1 employee (399); all with 2 employees (328); all with 3-4 employees (187)

There also is a relationship with turnover – almost half (47%) of those with the smallest turnovers (of up to £10,000) did not spend anything on wages or direct costs (compared with 10% overall), while 44% of those with a turnover of £100,000 or more spent more than £50,000 (compared with 21% overall). Companies in the smallest turnover bracket were most likely to have no employees - 20% compared with 8%. Those who made a loss and those who did not have a business critical employee (both 19%) were also more likely to have spent nothing on wages and other direct costs.

Over the course of the last full accounting year, companies spent less on indirect costs such as rent and operating machinery than they did on direct costs. Two-thirds (65%) spent no more than £10,000 (indeed 20% spent nothing at all). Figure 2.7 shows that the pattern by number of employees is less pronounced, given the absence of wage costs, but still present.

[13] As previously noted all such definitions are based on self-reporting.

Figure 2.7: Expenditure on indirect costs in the last full accounting year



Q: How much did the company spend on rent, operating machinery and other indirect costs in the last full accounting year?

Base: All businesses overall (1,000); all with zero employees (86); all with 1 employee (399); all with 2 employees (328); all with 3-4 employees (187)

Similar to direct costs, businesses with larger turnovers were more likely to have spent more on indirect costs, with 47% of those with a turnover of £100,000 or more spending over £10,000, compared with 28% overall.

2.6 Income derived from the work of employees

Just under half of companies with employees and that were not one-person operations were dependent on the work of one single person for a large proportion of their income in the last 12 months – for 47% the highest contributing single employee was responsible for three-quarters or more of the company's income.

Table 2.2 shows that reliance on the work of the highest contributing person declines as the number of employees increases, with 31% of those with three or four employees deriving at least three-quarters of their income from the work of one person.

Table 2.2: Percentage of company income derived from employee whose work comprises the highest proportion of the company's work

	All with employees	1 employee	2 employees	3-4 employees
Base	(510)	(28*)	(308)	(174)
10% or under	2%	6%	2%	3%
11-25%	4%	0%	4%	5%
26-50%	20%	9%	16%	28%
51-75%	27%	15%	24%	33%
76%-100%	47%	70%	54%	31%

N.B. One-person operations excluded, as are Don't Know/Refused/other answers

*Small base, findings indicative only

Q: Would you be able to estimate the percentage of the company's income derived from your own work/the work of that employee over the last 12 months? Was it approximately...?

Businesses operating in Information and Communications or in Professional, Scientific and Technical Activities were most likely to have a single highest contributing employee providing at least three-quarters or more of their income – 64% and 61% respectively compared with 47% overall. Businesses in Wholesale and Retail, Transport and Hospitality were the least likely to be dependent on a single employee for income – 14% had their highest contributing employee provide no more than a quarter of the company's income, compared with 6% overall.

Those with at least one business critical employee also were more likely than average to have a single high-contributing employee (49% of them were reliant on their highest contributing employee for at least three-quarters of their income compared with 31% who did not have a business critical employee).

For most companies that were not one-person operations, the majority of their income was derived from the work of employees as opposed to other income sources (such as assets like property or other investments). Three in five (62%) estimated that three-quarters of more of their income came from employees' work.

Table 2.3: Percentage of company income derived from the work of employees as opposed to other sources

	Overall	Zero employees	1 employee	2 employee	3-4 employees
Base	(584)	(38*)	(31*)	(328)	(187)
10% or under	13%	52%	13%	10%	10%
11-25%	4%	0%	10%	3%	5%
26-50%	5%	4%	5%	3%	7%
51-75%	7%	5%	4%	6%	8%
76-100%	62%	24%	62%	69%	58%
Don't know/ Refused	10%	16%	6%	9%	11%

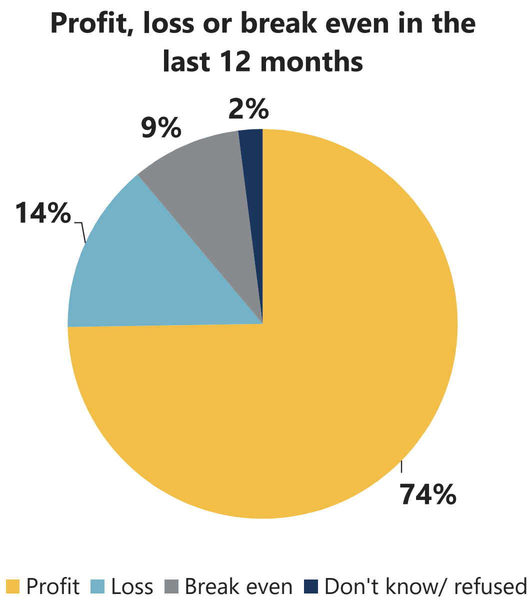
N.B. One-person operations excluded
*Small base, findings indicative only

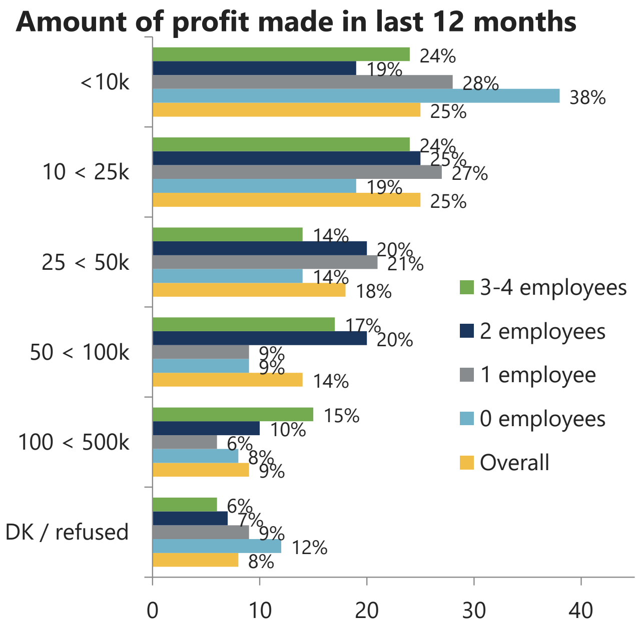
Q: Thinking about all employees, including directors and shareholders who are employees, would you be able to estimate the percentage of the company's income that is derived from your own personal work for the company/the work of employees, as opposed to any other income sources, over the last 12 months? Was it approximately?

2.7 Overall financial performance for the last full accounting year

Three-quarters of companies made a profit in the last 12 months while 14% made a loss and 9% broke even. Figure 2.8 also shows that profit levels varied widely, but half (50%) made a profit of under £25,000. Higher turnover companies were more likely to have made a profit – 84% with a turnover of £50,000 or more made a profit compared with 74% overall. Around one-third (35%) of those with a very small turnover of up to £10,000 made a loss, compared with 14% overall.

Figure 2.8: Profit or loss in the last 12 months and the amount of profit made





Q: Taking into account all sources of income in the last full accounting year, did the business generate a profit or loss before tax, or did you break even?

Base: All businesses that made a profit in the last 12 months (770); all with 0 employees (55); all with 1 employee (304); all with 2 employees (252); all with 3-4 employees (159)

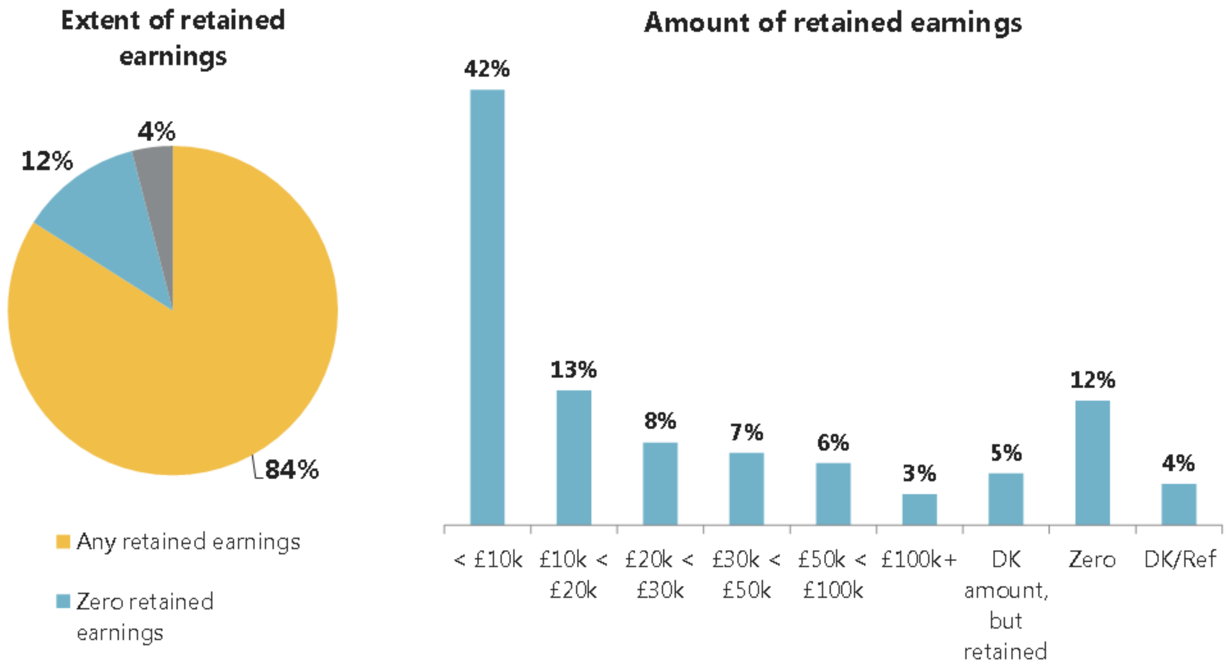
Companies in Professional, Scientific and Technical Activities and in Information and Communication were most likely to have made any profit – 86% and 85% respectively. However, companies in Finance and Real Estate made the largest profits – 22% of them made a profit of more than £100,000 compared with 10% overall.

Manufacturing companies were most likely to have made a loss – 34% compared with 14% overall. This may reflect that manufacturing companies tended to have low turnovers – 22% of them had a turnover of up to £10,000 compared with 9% overall – although they were not significantly more likely to have high direct or indirect costs.

2.8 Extent of and reasons for retained earnings

More than four in five profit-making companies (84%) retained at least some earnings in the last full accounting year. Just over four in 10 companies (42%) retained no more than £10,000.

Figure 2.9: How much of company profit in the last full accounting year was retained



Q: How much of your company's profit in the last full accounting year was retained within the company?

Base: All businesses that made a profit in the last 12 months and answered the question[14] (569)

Those with a turnover of £100,000 or more had higher levels of retained earnings, with the mean retained earnings among them being £33,000 compared with that of £20,000 for all businesses. There is a similar pattern by company size - those with 3 or 4 employees retained a mean of £27,000 compared with a mean of £16,000 among those with one employee. Those in Finance and Real Estate also had higher levels of retained earnings, with a mean of £47,000, reflecting their higher profit levels.

Companies with connected employees retained more – 46% with connected employees retained more than £10,000, compared with 34% who had no connected employees.

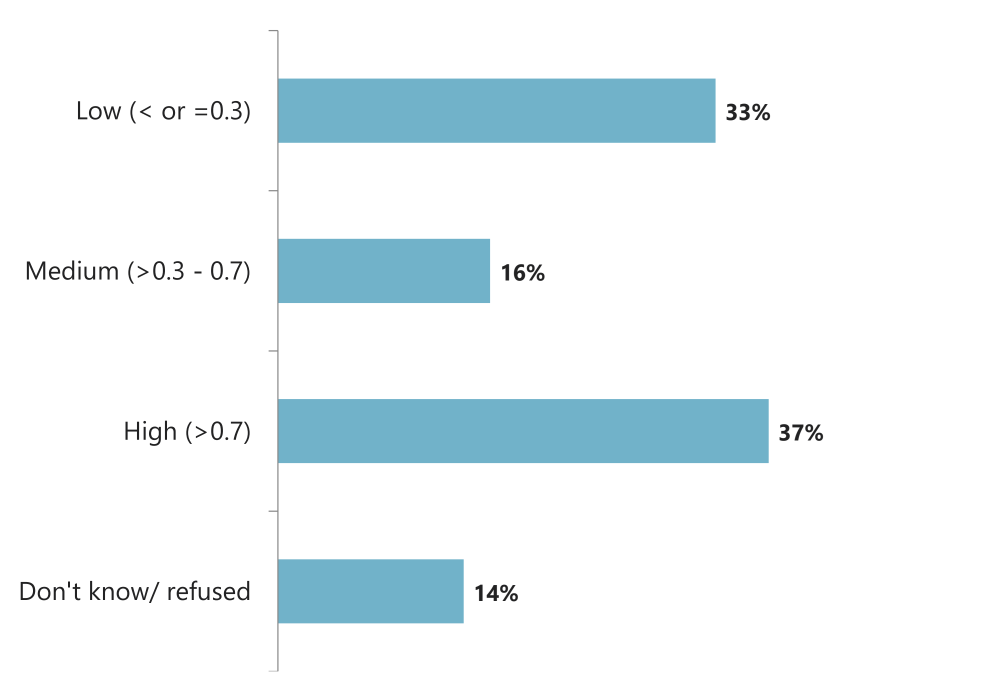
Among companies that made a profit, the level of retained earnings and level of fixed assets grew together – 61% of those with up to £10,000 in fixed assets also had up to £10,000 retained earnings, compared with 44% of those with higher levels of fixed assets, who tended to also have more retained earnings. For example, while 21% of those with up to £10,000 in fixed assets had more than £20,000 in retained earnings, this increased to 35% of those with fixed assets worth £10,000 or more.

Older participants were more likely to report higher levels of retained earnings. Almost half of those aged 65+ had retained earnings of £10,000 or more, which compares with 31% of those aged under-50. Similarly, 42% of those aged 65 or over had retained earnings of below £10,000 compared with 63% of under-50s. This reflects the qualitative research findings wherein older participants often had alternative sources of income and did not draw on the business for their main regular income, instead accumulating retained earnings which they could 'dip in to' for personal or other expenses should the need arise.

[14] Note that the question wording was revised part of the way through fieldwork, to specify retained earnings within the last full accounting year.

In order to control for differences in the amount of profits made, we also analysed retained earnings as a ratio of profit in the last accounting year. Just over one in three profit-making businesses (37%) retained a ratio of 0.7 of their profits or more. A similar proportion (33%) retained up to 0.3, and 16% retained a ratio of between 0.3 and 0.7 (Figure 2.10).

Figure 2.10: Ratio of retained earnings to profit



Base: All businesses that made a profit in the last 12 months and provided a figure for profit and retained earnings[15] (569)

In contrast to the overall levels of retained earnings, when controlling for the size of profits available to retain, the smallest businesses have the highest *ratio* of retained earnings to profits. Companies with zero employees had a median ratio of 0.76 and similarly those in the lowest turnover band, of up to £10,000, had a median ratio of 0.85, compared with a median ratio of 0.35 overall. Companies operating in 'Wholesale and Retail, Transport and Hospitality' had a significantly higher than average median ratio of retained earnings to profits, at 0.52.

Financial security was the main reason for companies to retain earnings (Figure 2.11) followed by keeping money within the business as a way of financing future growth or investment.

[15] Note that the question wording was revised part of the way through fieldwork, to specify retained earnings within the last full accounting year.

Figure 2.11: Reasons for retaining earnings

Q: Why did you retain earnings within the company?

Base: All businesses that confirmed they have retained earnings for the last accounting year (481)[16]

There were very few significant differences between those with and without connected employees in terms of their reasons for retaining earnings: the only one being that those with connected employees with more likely to retain earnings to maintain or increase working capital (11% compared with 4%).

Similar to the findings of Ipsos MORI's 2015 study on company income distribution and retention strategies for HMRC[17], there was little evidence of companies making concrete plans or strategies about what they would do with any retained earnings. For some it was simply the amount of money 'left in the account'. They would leave it there for no specific reason, often because it was a small amount, or because it was not their main income source and so they could let it accumulate, and draw on it periodically when needed.

> ***"I've already got significant pensions already from my earlier work because I've worked for a long time in big corporations with pension schemes so I don't always feel the need to dip into my earnings from the consultancy… I quite often forget to do it quite frankly…I should attend to it more. I should take it as a dividend and invest it, make it work…Anyway there are not huge sums involved so I'm not missing out on too much… I just tend to leave it piling up and take it out when I want it, which isn't very often."*** - (Professional, scientific & technical activities, 1 employee, one-person operation, 3-4 clients)

[16] Roughly one week into the mainstage fieldwork, based on further advice from HMRC's policy customers it was decided to revise the definition of retained earnings in the survey question, to ask for retained earnings for 'the last full accounting year' only. Before this, the survey defined retained earnings in terms of the 'cumulative figure specified at the bottom of the company's profit and loss account'. Those who answered the original question wording have not been included in any analysis about retained earnings.

[17] See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/458574/HMRC_Research_Report_390_-_Profit_Distribution_and_Investment_Patterns_of_Unlisted_Companies.pdf

The qualitative research supported the survey findings in that a major reason for retaining earnings was to provide a financial buffer or 'cash reserve' for any unexpected eventualities. The financial buffer came up in relation to both personal and business reasons: for one-person operations or husband and wife partnerships where there was one fee-earner, it was usually for personal reasons such as evening out fluctuations in their own earnings, as there were usually few external costs or investment needs involved (especially in certain sectors such as Administrative or Professional Services). For companies with employees/ more external costs, then having a buffer for business reasons was a more important consideration.

> ***"I guess it's just to have a small buffer of money… I think just to have a few thousand pounds just to give you that sense of security that you've got something there if an unexpected expense does come up."*** - (Administrative & support services, 1 employee, one-person operation, 3-4 clients)

Earnings were also retained for cash-flow reasons, to ensure businesses had enough money to pay themselves, their employees and their suppliers during quieter periods – one-person operations in particular noted the 'feast or famine' nature of their business.

> ***"I think it's for financial security of the business basically, that you've got something there and in case you go through a really quiet patch because it's not, it's never guaranteed that you're going to get work."*** - (Professional, scientific & technical activities, 1 employee, one-person operation, 2 clients)

Where businesses did have a plan to grow and want to re-invest in the business they aimed to use retained earnings to help them achieve this, for example by investing in stock or new equipment over the longer-term.

> ***"Essentially I just pay myself the bare minimum just to cover my bills and stuff…I would rather reinvest. Anything we make I'd reinvest it back into the business because…we're only xx years old and we have accelerated quite quickly and the way we've been able to do that is by always having what people need on the shelf which does involve quite a big stockholding. Our stockholding's something like a quarter of a million. That's quite a few years retained profit up till now reinvested straight back into stock on the shelf."*** - (Wholesale & retail, transport & hospitality, 2-4 employees, 5+ clients)

Some interpreted tax considerations for retaining earnings as having a 'buffer' in case their tax bill was higher than expected if, for instance, the tax rules or thresholds changed. As with other financial issues, businesses took advice from their accountant on what to do with retained earnings and, to this extent, there was an assumption that the accountants' advice would take tax into account.

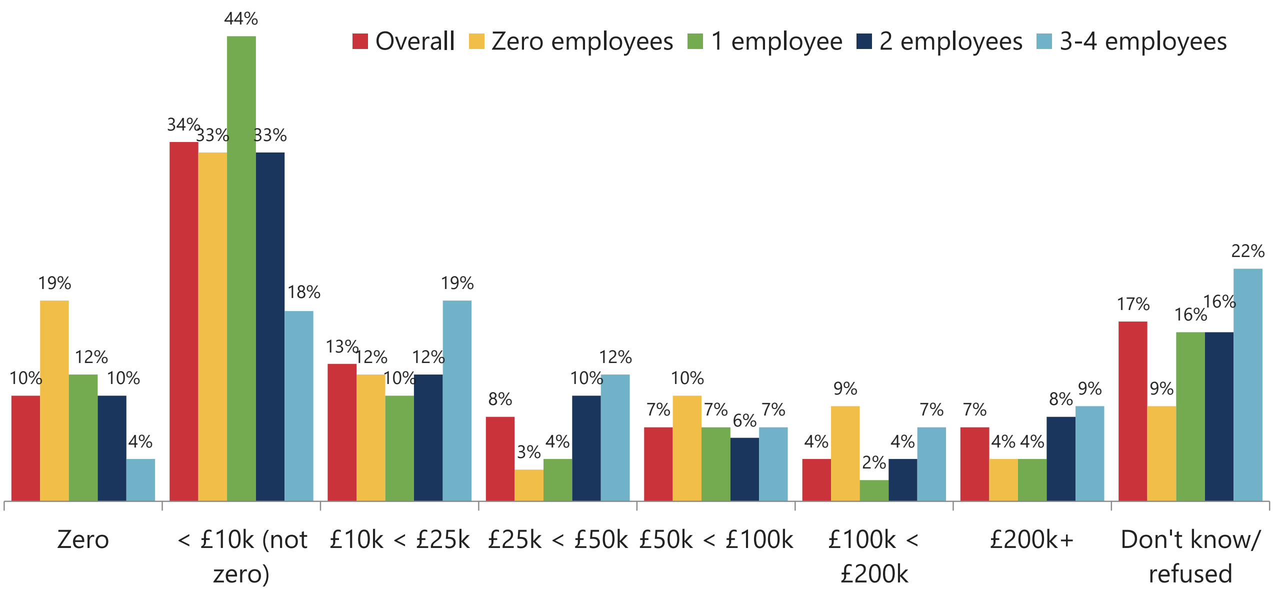
> ***"Well, we're not talking about huge sums of money anyway, but we use an accountant, listen to his advice and act accordingly… if it's a choice, well, if you do this, you'll pay X tax and if you do this then you won't pay X tax, I won't pay X tax."*** - (Professional, scientific & technical activities, 2-4 employees, husband/wife team, 3-4 clients)

2.9 Assets

2.9.1 Net assets

Companies had low levels of net assets (this is also known as Shareholder Equity). One in ten (10%) had no net assets while a further one in three (34%) had net assets worth no more than £10,000. The level of net assets is related to number of employees (Figure 2.12). Four per cent of the largest companies, with 3 or 4 employees, had no net assets (compared with 10% overall) and 18% had net assets worth no more than £10,000 (compared with 34% overall).

Figure 2.12: Level of net assets in the last full accounting period



Q: What were the total net assets (known as shareholder equity) in the company in the last full accounting period?

Base : All businesses overall (1,000); all with zero employees (86); all with 1 employee (399); all with 2 employees (328); all with 3-4 employees (187)

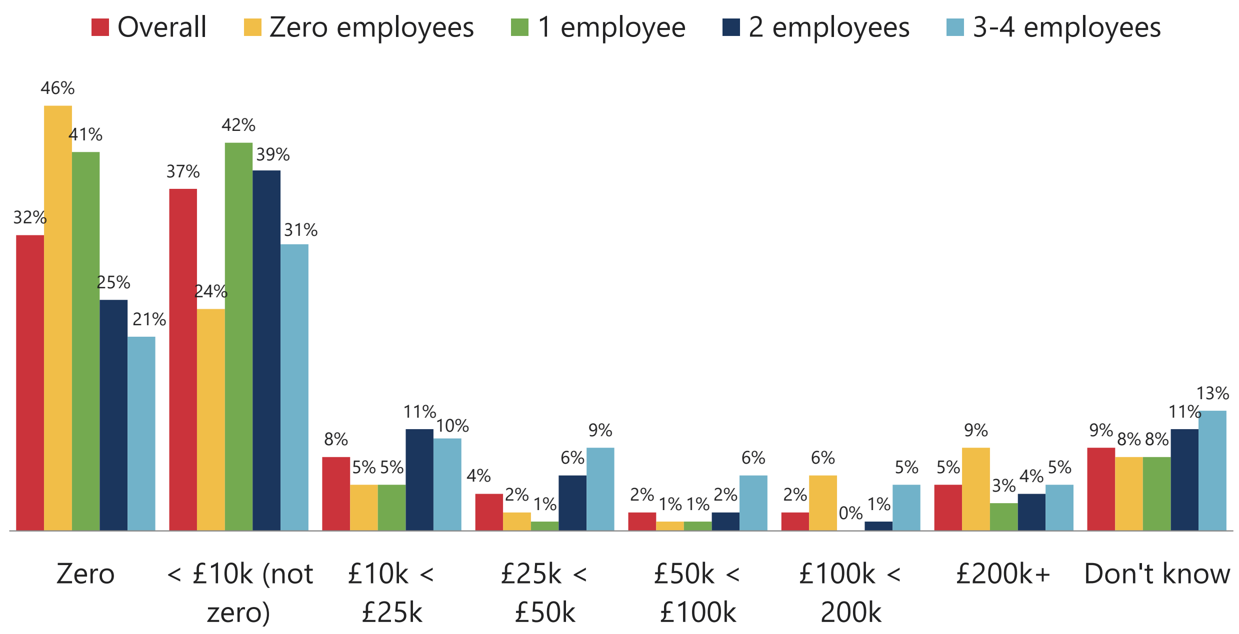
Those with higher turnovers, of £100,000 or more, also had high net assets, with the mean net asset value among them being £215,000 compared with a mean of £100,000 for all businesses. Those in Finance and Real Estate (with a mean of £434,000) and Primary and Utilities (a mean of £346,000) also had higher than average net asset levels. This potentially reflects the capital-intensive nature of those sectors, where businesses are more likely to own property or land, or hold investments. Those in Arts, Leisure and Other Services and in Professional, Scientific and Technical Activities were most likely to have low value net assets – 52% and 43% respectively had net assets of up to £10,000 (compared with 34% overall)) – reflecting that these sectors are more knowledge intensive.

2.9.2 Fixed assets

Compared with net assets, more companies had no fixed assets (such as buildings, plant and machinery and vehicles) or only fixed assets of a low value (Figure 2.13). One in three (32%) had no fixed assets at all while slightly more (37%) had low value fixed assets worth up to £10,000. The mean level of fixed assets among companies who had them was £77,000. Along with their higher than average value of net assets, Finance and Real Estate businesses reported a much higher value of fixed assets than average – with a mean of £466,000 (this is likely to be due to the comparatively high value of property as a fixed asset).

Smaller companies in terms of employee size were more likely to have no fixed assets at all – 46% with no employees and 41% with one employee had no fixed assets, compared with 21% of those with three or four employees. High- turnover companies (£100,000 or more) were also more likely to have higher value fixed assets – 34% had fixed assets worth more than £10,000 compared with 21% overall.

Figure 2.13: Investment in fixed assets



Q: What was the business' total investment in fixed assets (such as buildings, plant and machinery, and vehicles) on the balance sheet?

Base: All businesses (1,000)

Plant, machinery, fixtures and fittings were the most common type held by businesses that had any fixed assets (88%), followed by company vehicles (26%) and property or land (15%).

Two in five (40%) companies with fixed assets reported that this generated income for the business. Those in Finance and Real Estate were more likely than average to use fixed assets to generate income (57%) as were those in Arts, Leisure and Other Service (63%). Those in Finance and Real Estate were particularly likely to have buildings as fixed assets (51%) which they were likely to be renting out or using as an investment to generate income. As a whole, businesses who included buildings among their fixed assets were especially likely to use these to generate income (62%).

2.10 Investment from external parties and use of tax reliefs

Three per cent of businesses had received investment from an external party in the past five years. Of these 26 businesses, six had received investment via the Seed Enterprise Scheme, Enterprise Investment Scheme or similar.

The qualitative interviews found there was a general awareness of tax reliefs amongst businesses in as much as they knew that various items could be offset against tax on their tax return. Most commonly there was awareness of capital allowances. Amongst the small number who were aware their business had made use of capital allowances, this was not perceived to have enabled additional investment, simply because it was not large enough, the financial benefit is delayed or because investment decisions are based on need only.

> ***"We use Capital Allowances yes…we certainly make use of them for our capital goods…I don't think it has made any difference [to our investment]. We will invest in capital items that we need rather than saying that it's a good tax wheeze, we buy stuff because the business needs it and for no other reason really."*** - (Wholesale & retail, transport & hospitality, 2-4 employees, 5+ clients)

Though there was an assumption that accountants would be privy to any tax reliefs they could make use of, there was a view that it would be useful to know more. Some businesses noted how they found out about tax relief they were entitled to by chance. One business said he had found out about capital allowance via the question mark dialogue boxes on his annual tax return. A second business was taking advantage of NI small business relief but, again, did not know this was on offer and found out about it by chance using the basic PAYE software provided by HMRC, when he got a notification. Businesses felt that there should be better information on reliefs, and what small businesses were entitled to, and that any information should be in layman terms - not in terms only understood by accountants.

> ***"A lot of people start their own business…they might be great at making cakes or arranging flowers, but they might not know anything about accounts or finance and it's probably quite hard to find out about some of these things and, even when you do find out about them, I think a lot of people don't understand the language and they're just scared of it and so they just don't do it."*** - (Wholesale & retail, transport & hospitality, 2-4 employees, 5+ clients)

Remuneration

2.11 Employee remuneration

The income paid out to employees was generally low (Figure 2.14) and relatively few were paid more than £32,000 in the last year.[18] Smaller companies paid their employees less - 56% with zero employees and 82% with turnover of up to £25,000 paid no more than £10,000 to their highest paid employee compared with 32% overall. Loss-making companies also tended to pay less - 63% of them paid up to £10,000 to their highest paid employee compared with 25% of those making a profit.

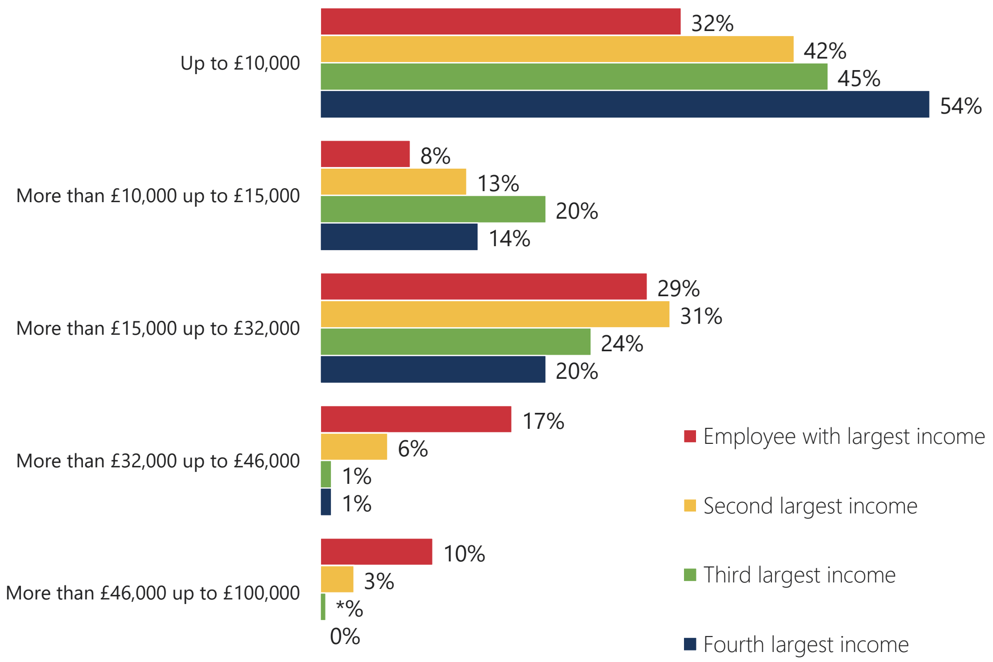
Information and Communications companies paid their employees higher personal incomes than average - 50% paid £32,000 or more to their largest employee, compared with 27% overall.

The qualitative research found that where family members worked for the business – either full-time or casually – they tended to be viewed as employees, and remunerated in the same way as un-connected employees.

> ***"They were on salary [two children]. It wasn't a lot, but on the whole they earned what they got. It wasn't a case of, oh, give me some money. So I don't let [them] get away with that. I want something in return please… We tend to treat them equally."*** - (Professional, scientific & technical activities, 2 employees, husband/wife team, 3-4 clients)

[18] For the employee income level respondents were asked to include in the total 'any salary, dividends and any payment of new shares during the year'.

Figure 2.14: Employees' personal income from the business in the last financial year



Q: Approximately what was your/this employee's personal income from the company in the last financial year? This would include any salary, dividends and any payment of new shares during the year.

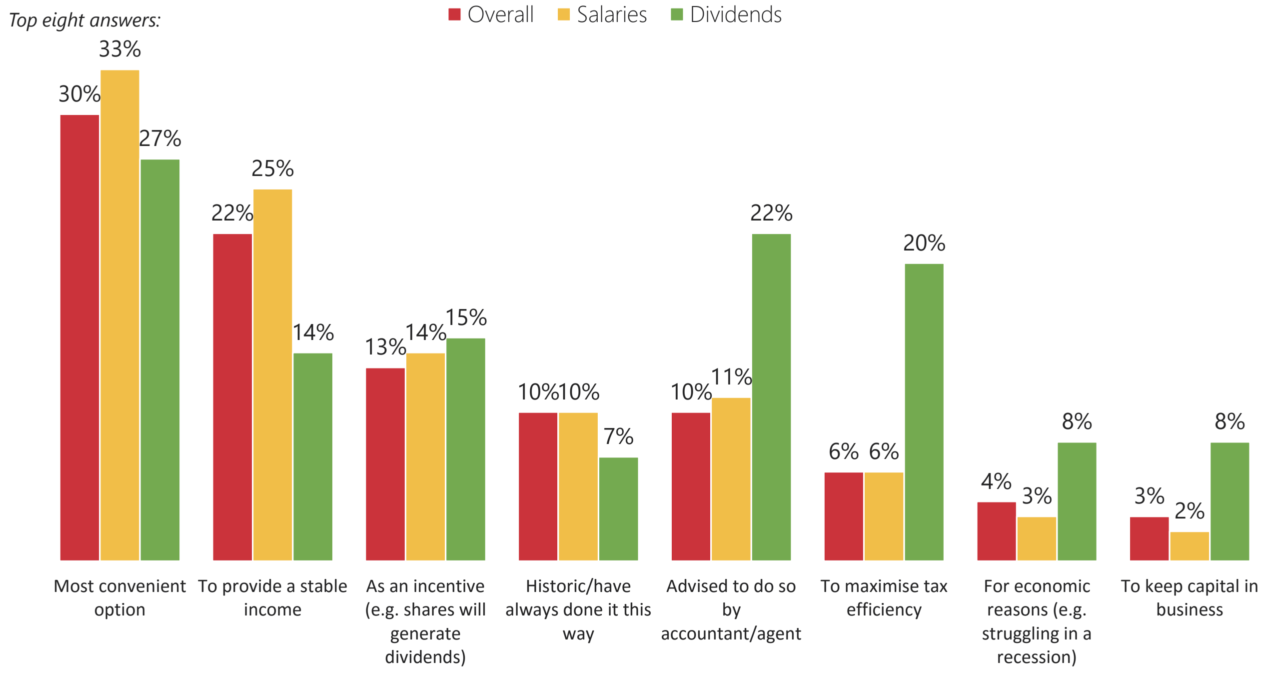
Base: All with employees or is a one-person operation (962); All with at least two employees (515); All with at least three employees (187); All with at least four employees (72)

For non-director employees, salaries were the dominant form of remuneration (72%), followed by dividends (23%). Twelve per cent of the businesses covered in this study reported that they paid into employer pensions. This is in line with the proportion of employers across Great Britain with 1-4 employees found to be offering a workplace pension in the *2015 Employer Pension Provision* survey[19].

The most common reasons determining decisions about employee remuneration were convenience and stability (Figure 2.15). Different types of remuneration were driven by different considerations – salary was offered for stability, and dividends more commonly on the basis of accountant advice or tax-related reasons.

[19] DWP (2015) Employers' Pensions Provision Survey, https://www.gov.uk/government/publications/employers-pension-provision-survey-2015

Figure 2.15: Reasons behind remuneration strategies for employees



Q: Why did the company choose to reward its employees this way?

Base: All with remunerated non-director employees (271)

2.12 Director remuneration

2.12.1 Types of director remuneration

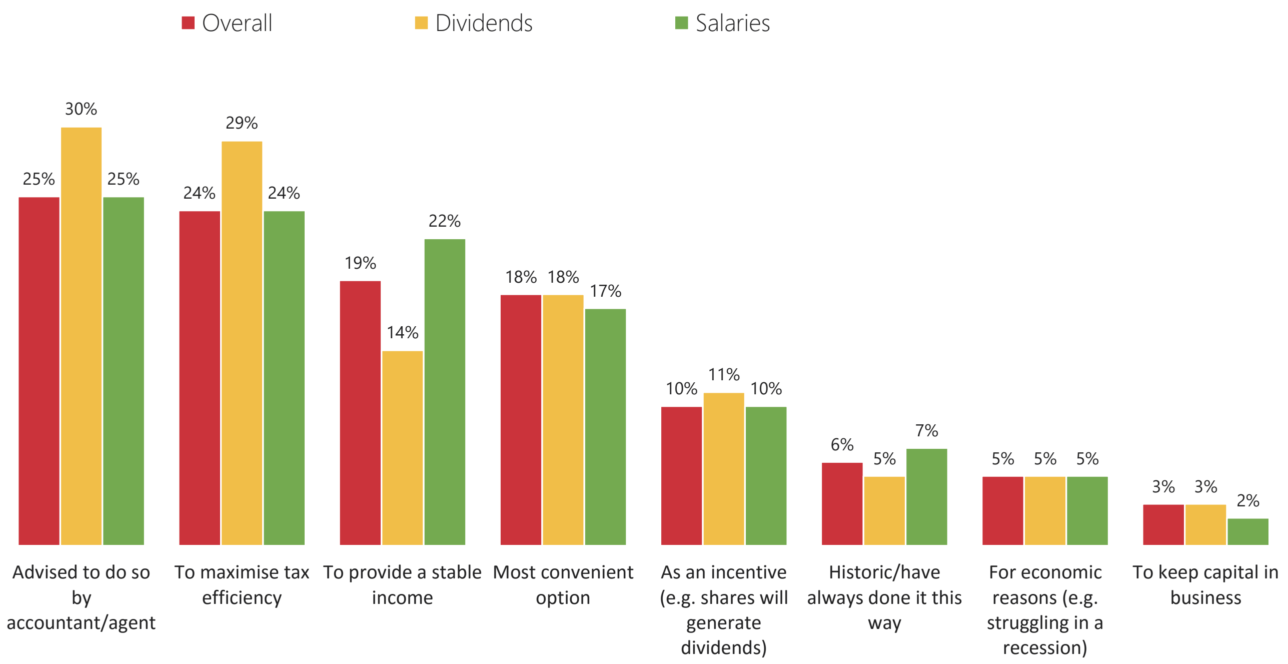
Among directors, dividends were much more common than for employees. Around three in five companies used dividends to pay their directors (62%) and a similar proportion (60%) used salaries. The next most common form of remuneration was employer pensions (13%).

Just under one in five companies (18%) with directors did not remunerate them at all. Smaller companies were more likely to pay nothing to directors - 48% with zero employees and 40% with turnover of up to £25,000 paid no director remuneration. Those with no business critical employees were also more likely to pay nothing to directors (31%).

Companies that made a profit were more likely to pay director dividends (72%), although 30% of those who made a loss also did so. Looking at those businesses who paid dividends despite making a loss, the majority operated in Administrative and Support Services or in Wholesale and Retail, Transport and Hospitality. They were no more likely to have family connections among employees, directors or shareholders.

While convenience and stability were the most common reasons driving employee remuneration, tax efficiency and accountant advice were the most common reasons underpinning business' director remuneration strategies (Figure 2.16). Those who made a loss were less likely than average to decide director remuneration to maximise tax efficiency or on the advice of an accountant (the respective figures are 9% and 7%). Those in Information and Communication were particularly likely to base their decisions on accountant advice (40% compared with 25% overall) while those in Finance and Real Estate were more likely to say they had always remunerated that way (17% compared with 6% overall).

Figure 2.16: Reasons behind remuneration strategies for directors



Q: Why did the company choose to reward its directors this way?

Base: All with remunerated directors (735); All who pay dividends to directors (576); All who pay salaries to directors (530)

As is the case for employee remuneration, paying dividends was most commonly driven by accountant/agent advice and tax efficiency, while providing a stable income was a more important consideration for offering salaries than dividends. Offering employer pensions was also more commonly associated with tax efficiency than is the case overall.

In the qualitative research, businesses were aware that remuneration packages could be more or less tax efficient, and assumed that their accountant would advise them of the most appropriate strategy. Typically the advice given was that directors/shareholders are paid salaries and dividends, or just dividends, and other employees paid salaries. Awareness and knowledge of how accountants decide on the most tax efficient packages varied. Some businesses were happy to fully take their accountant's advice without knowing any more, leaving it the accountant to guide them as the 'expert' on such issues.

> ***"They say to me what to do, what's the best thing to do and if they advise me, I'm guided by them. I'm a carpenter, I'm not a financial person at the end of the day, that's why I employ them. Provided they do everything that's legal and it's legit, as far as I'm concerned I'm quite happy."*** - (Construction, 1 employee, one-person operation, 1 client)

Other businesses were more aware of the 'tax efficiencies' they were benefitting from, most commonly the use of salary tax thresholds, topping up with dividends, or payment by dividends only.

> ***"I'm always asking, what about the comparative rate, if I took it as a salary... I'd be paying at the top rate of tax, 40% right, because I'm already in that tax bracket. But the dividend rate is less isn't it? It's less than 40% anyway so I will***

> ***take the money as a dividend. I'm savvy enough to do that and that's perfectly all right to do that so I do it."*** - (Professional, scientific & technical activities, 1 employee, one-person operation, 3-4 clients)

The qualitative research found that husband and wife partnerships or family businesses in particular had more knowledge on how to 'work' tax thresholds most efficiently, since ultimately income through salaries and dividends is joint and thereby shared. There was some awareness of changes to dividend tax from April 2016, and the implications of this.

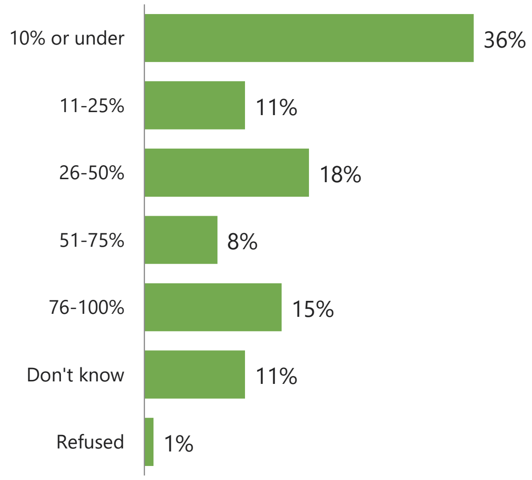
> ***"We've got an accountant and he's advising us that I should take a salary now as well [as my wife] because the rules on dividend tax have changed and it would then become more beneficial for us to do it that way... At the moment I earn £5,500 a year [from a separate job] so I'm substantially under that threshold. So we could top that up [with a salary], earn more money, take a smaller dividend and pay less tax on the dividend basically."*** - (Administrative & support services, 2-4 employees, hisband/wife team, 5+ clients)

2.12.2 How much profit is taken out of the company by director shareholders?

Figure 2.17 shows that among companies with director-shareholders[20], around half (47%) paid a quarter of their profits or less to director-shareholders in the last financial year, including 36% who paid out 10% or less of their profits.

[20] Note that 'director-shareholders' are directors who are also shareholders – it is possible that these people will hold other roles in the business too, such as employees. The categories are self-reported and are not mutually exclusive.

Figure 2.17: Overall percentage of the company's profits that was drawn by director shareholders



Q: Would you be able to estimate the percentage of the company's profits that was drawn by director shareholders from the company in the last financial year? Was it approximately...?

Base: All with directors who are also shareholders (582)

This varies for different types of business. Smaller businesses tended to have had a lower proportion of their profit go to director shareholders - 62% with zero employees and 69% with turnover of up to £10,000 had 10% or under of their profit go to a director shareholder, compared with the overall figure of 36%. There is a similar pattern for those who received low levels (25% or under) of their income from repeat business – 49% of them had 10% or under of profit go to a director shareholder.

Among those who made a profit, companies with no retained earnings were more likely to give a larger proportion of profit to director shareholders than those with retained earnings. Among those who made a profit and had zero retained earnings, one in five (18%) awarded 10% or less while at the other end of the scale one in three (34%) awarded 76-100% of their profit to director shareholders. Among those with retained earnings the respective figures are 29% and 14%.

There also are differences by sector. Those in the Wholesale and Retail, Transport and Hospitality sector were more likely to have paid 10% or less of their profit to director shareholders (57% compared with 36% overall), while those in Construction were more likely to have paid higher proportions of profit to director shareholders (24% paid 76% or more to a director shareholder compared with 15% overall).

Businesses where none of the directors were connected to any shareholders were *more* likely to have paid a high proportion of their profit to director-shareholders – 21% paid out three-quarters or more of their profit compared with 15% overall.

2.13 Whether any income goes to those who do not work for the business

A very small number of companies (4%) paid any income to those who did no work for them in the last financial year. Among those companies that did pay income to individuals who did no work for the company, it was a low proportion of their profit – 44% of them paid 10% of profit or below.

There were few significant variations in the likelihood of paying income to those doing no work, other than among companies with three or more shareholders (among whom 10% paid a share of profit to someone who did no work for the business).

The qualitative research found an example of a 'family' business where four family members were listed as shareholders – husband, wife and two children. The husband was the 'fee earner', though this was not his sole income, and the children were listed as shareholders so that their parents could give them an income via dividends, although they did no work for the business.

> ***"They're [son and daughter] on really quite low income jobs. So we shovel a bit of money their way every so often to… help keep them afloat and this way, because … it's corporation tax paid, their dividend, they don't earn enough to actually pay any tax on that… If I give it to them out of my pocket then there's potentially inheritance tax to pay if I pop my clogs in the next couple of years and there isn't if they get a dividend."*** - (Information & Communications, 1 employee, 1 client)

Client base and relationships

2.14 The nature and extent of business' client base

2.14.1 Number of clients

Table 2.5 shows that two in three companies worked for five or more clients in the past 12 months (66%). This varied considerably by sector; For example, Wholesale and Retail; Transport and Hospitality companies were more than twice as likely to have five or more clients than those in the Information and Communications sector (85% compared to 38%).

Companies in the Information and Communications sector, in particular, were highly reliant on just one client and their continued business, as well as one employee's skills and client relationships. These companies were more than twice as likely as average to have just one client (22% compared to 10%). In addition, they were more likely to identify as one-person operations (53%) and to have one business critical individual (83%) due to unique skills or knowledge and the ability to attract and retain clients. One-person operations were much more reliant on one or two clients (25%) than companies in general (17%). Just over half (56%) had five or more clients, compared with 66% overall. Client numbers per sector are shown in Table 2.4, overleaf.

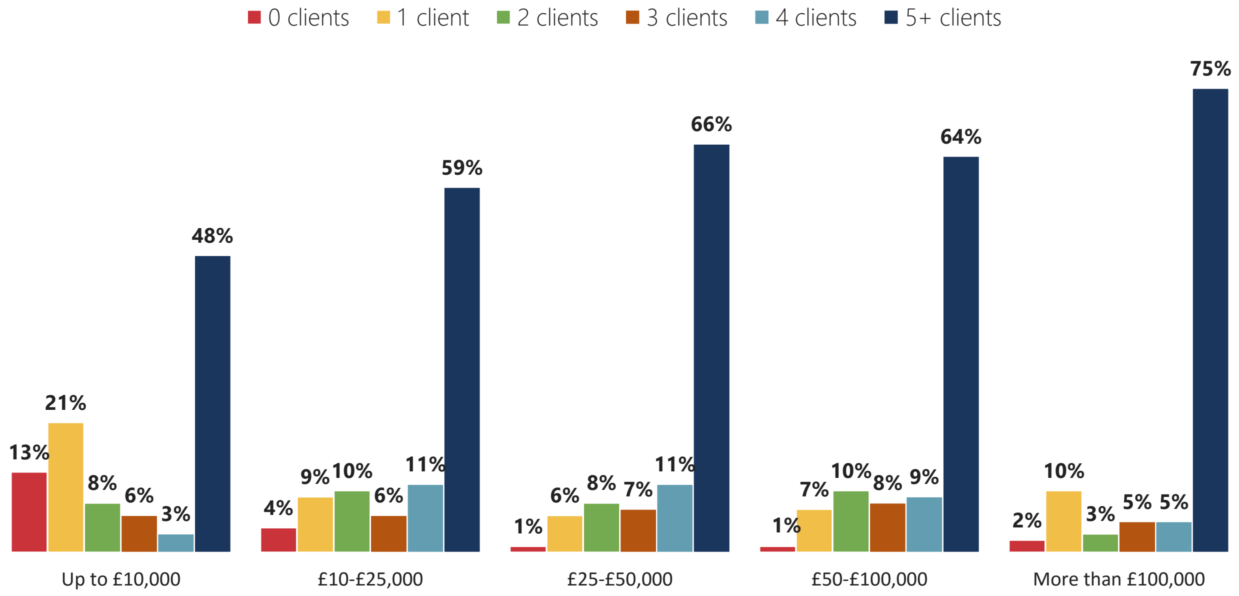
Table 2.4: Number of clients by sector

	Base	0 clients	1 client	2 clients	3 clients	4 clients	5 or more clients
Overall	(1,000)	3%	10%	7%	6%	7%	66%
Wholesale and Retail; Transport, Hospitality	(157)	3%	6%	**2%**	**2%**	**1%**	**85%**
Manufacturing	(43)	-	2%	-	2%	11%	**84%**
Arts, Leisure and Other Services	(63)	2%	7%	3%	6%	6%	74%
Education and Health	(41)	7%	4%	7%	6%	2%	71%
Construction	(116)	4%	10%	7%	5%	3%	69%
Admin and Support Service Activities	(119)	1%	9%	7%	3%	12%	67%
Finance and Real Estate	(113)	**7%**	9%	8%	5%	6%	64%
Primary and Utilities	(55)	7%	15%	4%	9%	5%	57%
Professional, Scientific and Technical Activities	(202)	*	11%	**13%**	**10%**	9%	**56%**
Info and Comms	(91)	6%	**22%**	9%	**17%**	8%	**38%**

N.B.: Significant differences by sector, compared with the relevant overall figure for that number of clients, are denoted in bold text.

The number of clients was also linked to turnover – companies with higher turnover over £100,000 per year were more likely to have had five or more clients in the past 12 months (Figure 2.18).

Figure 2.18: Overall number of clients in the last 12 months, by turnover in the last full accounting year



Q: How many separate clients has the company had in total in the last 12 months?

Base: All businesses (1,000)

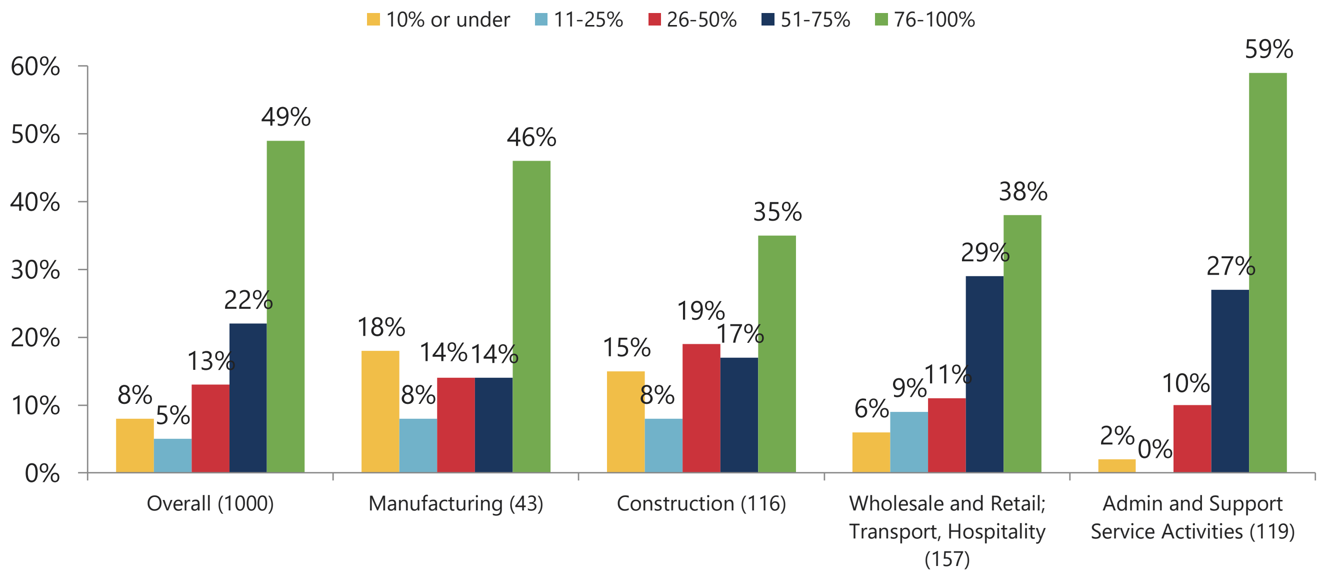
Of those with clients, 8% dealt mainly with the public sector – most dealt mainly with the private sector (46%), individuals or private households (18%) or a mixture of the two (27%). Companies in the Education and Health sector were much more likely to work mainly with public sector clients (31%), whilst Finance and Real Estate, and Arts, Leisure and Other Services were more likely to deal with private individuals (42% and 34%, respectively).

2.14.2 Reliance on repeat business

Half of companies attributed 76-100% of their income to repeat business (49%), with a further fifth attributing 51-75% (22%). This varied by client type. For instance, of those who had mainly private sector clients, three in five (60%) stated they relied on repeat business for 76-100% of their work. This fell for those who served mainly individuals or mainly public sector bodies (39% and 47%, respectively).

The distribution of income attributed to repeat business was broadly consistent across the sectors, with some notable differences. Companies in the Construction, and Wholesale and Retail; Transport and Hospitality sectors were the least likely to attribute the highest proportion of their income to repeat business (35% and 38%, respectively). Those in Wholesale and Retail; Transport and Hospitality were also less likely to find or retain clients by virtue of doing a good job or word of mouth than companies overall (67% compared to 76%).

Figure 2.19: The proportion of company income brought in by repeat business, in selected sectors



Q: Would you be able to estimate the percentage of the company's income currently that is derived from repeat business? Is it approximately…?

Base: All businesses (1000); Individuals bases shown.

2.15 The nature of company-client relationships

Overall, 14% of companies only had one or two clients that were mainly business clients. Table 2.5 shows companies with one or two business clients and the length of their relationship with their largest and second largest clients.

Table 2.5: Length of time working for largest and second largest client

	Biggest client	Second biggest client
Base (All with one or two business clients)	(137)	(55)
Up to 1 year	15%	41%
More than 1 year up to 3 years	26%	17%
More than 3 years up to 10 years	40%	23%
More than 10 years	15%	7%

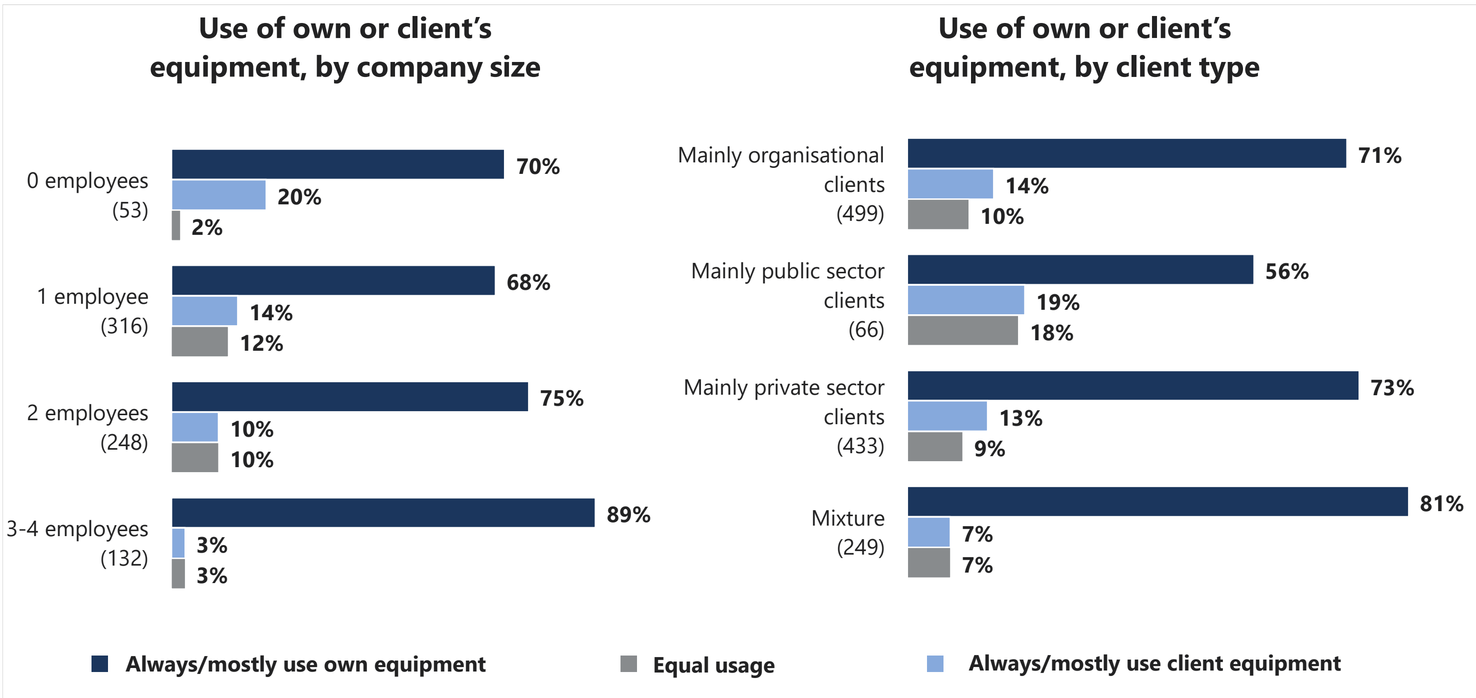
Q: Thinking about the biggest/second biggest business client, how long has your company been working for them?

Half the companies with only one or two business clients had employees who worked on those client's premises for the full duration of the contract (comprising 7% of companies overall). This was a more common practice among one-person operations, where three in five companies with only one or two business clients had this arrangement for their biggest client (59%). This arrangement was most prevalent amongst companies in the Professional, Scientific and Technical Activities sector, where 68% of companies with one or two business clients had employees working on the client's site.

Three in four companies with mainly business clients (74%) either always or mostly used their own equipment, rather than the client's. Eleven per cent of companies used their client's equipment for all or the majority of time.

Companies with fewer employees were more likely to use client equipment (Figure 2.20). For instance, 20% of those with zero employees and 14% of those with one employee mainly or wholly used client equipment, compared to 11% overall.

Figure 2.20: Companies with mainly business clients who use their own equipment, by size and client type



Q: Which of the following best describes how the company works for clients that are other companies or organisations?

Base: All with business clients; Individual bases shown

There was also sector variation. Nine in ten companies in the Primary and Utilities, and Construction sectors used their own equipment rather than their client's (88% and 87%, respectively). Education and Health, and Information and Communications companies were the least likely to use their own equipment (57% and 50%, respectively). Whilst companies in the Professional, Scientific and Technical Activities sector had a higher than average proportion of employees working on their clients' sites (68% compared to 50%), their use of their own equipment was in line with the overall figure (74%).

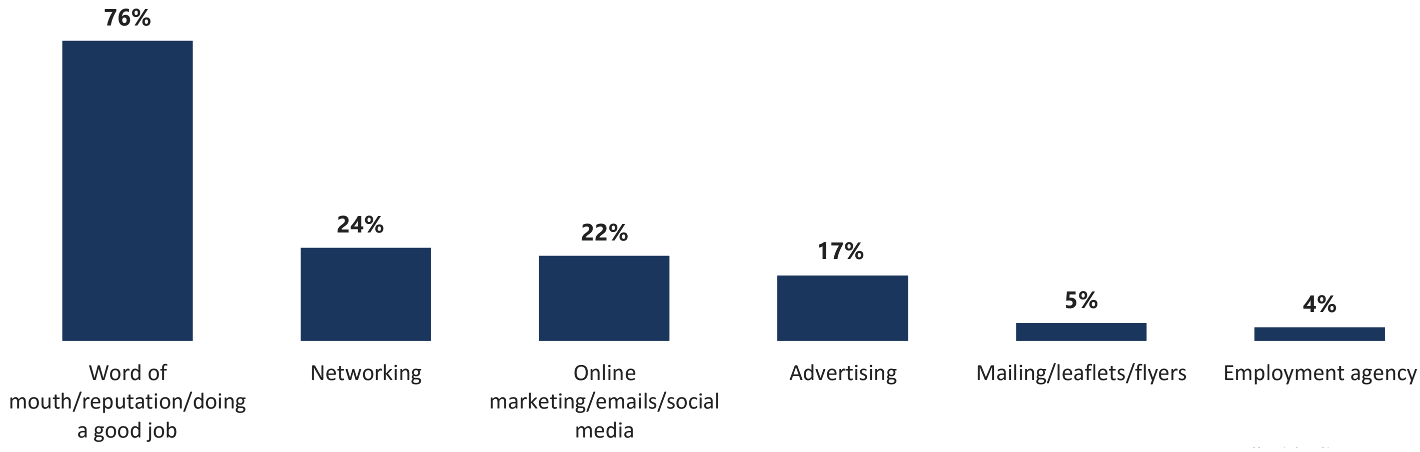
Respondents were asked to what extent clients organised the work done by the company's staff. Three in four companies with employees and mainly business clients organised their own work without input or with only occasional input from clients (73%). Ten per cent of companies with employees and mainly business clients had their work organised always or mostly by their clients. As with use of their own equipment, companies who dealt mainly with the public sector were less likely to organise their own work than average (62% compared to 73%).

There was also notable variation in terms of client input in the organisation of the companies' staff by sector. Around nine in ten companies in both the 'Primary and Utilities and Wholesale and Retail' and 'Transport and Hospitality' sectors who had employees and mainly business clients always or mostly organised their own work (87% and 85% respectively). Conversely, twice as many companies than average in the Education and Health, and Information and Communications sectors had their work mostly or always organised by clients (23% and 19%, respectively, compared with 10% overall). Whether or not companies organised their own work also varied by company size and turnover. Larger companies were more likely to organise their own work – 80% of those with three or four employees did so, compared with 73% of companies overall.

2.16 Finding and retaining clients

Small businesses used a range of techniques to find and retain clients, but the vast majority (76%) relied on word of mouth. One per cent of companies did nothing to attract new business. Figure 2.21 shows the most commonly used marketing strategies.

Figure 2.21: Channels used for finding, attracting or retaining clients



Q: What ways does the company use to find, attract or retain its clients?
Base: All with clients (960). Only top six answers shown.

Business development strategies varied by company size and turnover. Those with zero employees were twice as likely to attract new clients by networking (33%) and using leaflets or flyers (8%) than those with three to four employees (17% and 4%, respectively). Meanwhile, those with three to four employees were more likely to use word of mouth (80%) and online marketing strategies (25%) than those with zero employees (57% and 15%, respectively).

Companies with the lowest turnover (up to £10,000) were more likely than average to rely on networking (35% compared to 24%). However, they were less likely to use online marketing strategies (18%, compared with 28% of companies with a turnover above £100,000).

There was also variation by sector. Word of mouth was more common than average in the Construction sector (86%), while Manufacturing companies were the most likely to use online methods (38%).

These differences relate to a combination of factors identified in the qualitative research:

- the nature of business' clients and their orientation towards growth or maintaining their 'status quo'. Networking was more important for those with mainly business clients; whereas word of mouth was more important for those who provided services to individual consumers; The qualitative research found that word of mouth and networking were especially important for the continuity of businesses, in terms of maintaining rather than growing the company.

> ***"We've subscribed to a couple of information providers and so on and so we use those. But also it's, part of it is the old pals act it must be said…We run on our reputation a bit as well."*** - (Wholesale & retail, transport & hospitality, 2-4 employees, 5+ clients)

- the size of the business and the resources and expertise they have to invest in business development. Smaller companies and those with low turnovers found advertising costs prohibitive, especially for website development.
- the preferences and capacity of the company owner / director. Some businesses are 'cruising' – not looking for more clients because they are sufficiently busy, or because they are gradually winding down the business as they approach retirement. Others are restricted by lack of time or opportunity to find new clients.

> ***"Primarily I've been with this main contractor for over 30 years…As my age is getting on, I don't really want too much hassle so I'm quite happy to just work for them, and I move from job to job… wherever they want me… I just stick with one person who I know, he's been good to me and the money is good there every other week and I'm quite happy with that."*** - (Construction, 1 employee, one-person operation, 1 client)

Four per cent of companies with clients used an employment agency to find new business. This was most common in the Information and Communications sector. When companies used an employment agency, half were paid directly by the agency, one in five (22%) were not, and for the remaining one in ten (10%), it varied from case to case[21].

Business identity

Business identity was explored in the qualitative interviews, with participants prompted to discuss how they thought of themselves in relation to their business. Business' sense of identity was influenced by a mixture of self-perception, technical status, and how they choose to present themselves to clients. Technically, some business owners said they were an employee of their own business (as they received a salary), but they *perceived* themselves as being self-employed, in as much as they were their own boss with control over what work they do, for whom and when. In this respect, they saw themselves as being different to an employee – employees were considered to have fixed contracts, work a certain number of hours and lack control over their work.

> ***"I think of myself as self-employed…I think because I have the control over the work that I do and don't do…if I don't want to do something, or it interferes with school holidays, I'm in a position where I can say no."*** - (Administrative & support services, 1 employee, one-person operation, 3-4 clients)

[21] Note that we have not included percentages here due to the small base size.

One-person operations sometimes referred to themselves as sole traders – they saw themselves as such even though they knew that this is not 'technically' correct. This was often associated with certain sectors such as construction, where terms like sole trader or sub-contractor were part of the industry discourse.

> ***"I am a sole trader as such and I'm the only one that's running the business."*** - (Construction, 1 employee, 1 person operation, 1 client)

Those who did not describe themselves as being either self-employed or employed, were more likely to describe themselves as simply running a business, or as a company director.

> ***"It's not something I really think about, we're directors of the business, it's our business. Are we employees? We don't think of ourselves as employees, but I'm not sure we think of ourselves as anything else either. It's just our baby."*** - (Wholesale & retail, transport & hospitality, no employees, husband/wife team, 5+ clients)

How businesses wanted to present themselves to clients or potential clients also played a role in determining their sense of identity, and this often depended on the sector and whether the business was dealing with individual consumers or with other businesses. For example, presenting yourself as a company director was deemed to bring status and credibility in certain sectors such as professional services, but if business owners were dealing with members of the public, they tended to describe themselves in more 'down to earth' terms, even if they had several employees:

> ***"Technically I'm the company director, but when I'm out there with customers and people I never play on that, I just pretend I'm just an employee who comes round. I just go in there as a regular guy and set up a rapport with the customer like we're all on the same level. I don't like to go in there and lord it up over people… You get a better dialogue going that way."*** - (Wholesale & retail, transport & hospitality, 2-4 employees, 5+ clients)

Incorporation

2.17 Reasons for incorporation

The qualitative research also found that a key reason for becoming incorporated was limited liability, a finding supported by previous research'[22]. Many of the businesses had awareness or experience of the financial consequences which could be suffered by sole traders, and so become incorporated to have the protection of the business being a 'separate legal entity' from themselves with separate finances. With a limited company status, it was also perceived as easier to chase unpaid invoices and to leverage creditors.

[22] https://www.gov.uk/government/publications/reasons-behind-incorporation

> ***"If anything does go pear shaped I quite like to see my liability limited and so that is an important consideration. And I think it is, in our industry, I think it is the most understood and accepted method of having a business as well so I think it works with trying to make sure that one gets the credit rating that one should and that sort of thing, because people understand limited liability businesses."*** - (Wholesale & retail, transport & hospitality, 2-4 employees, 5+ clients)

The other main reason for incorporation cited in the qualitative research was that accountants had often advised that being incorporated was the best option for the business, and the most tax-efficient. As with remuneration, many took this as read without knowing exactly how they may benefit, but others were more knowledgeable.

> ***"Yes [there were tax considerations to becoming incorporated]… because of this issue of leaving money in the company and not drawing it out. But if you're self-employed you pay tax on what you're earning, and you might have a good year one year and pay a lot of tax, and a bad year another time and pay very little…. whereas with a company, incorporation, you can even things out, you're more in control of it."*** - (Construction, 2-4 employees, family business, 5+ clients)

Despite businesses becoming incorporated because they expected a tax benefit, some of the businesses which had previously been operating as a sole trader said they had not noticed this, and some went as far to say that the gap between the tax benefit of being a limited company as opposed to a sole trader had lessened (one company wanted to revert to being a sole trader for this reason).

> ***"I think you could say, over the years, the difference in the financial benefits have narrowed somewhat between being a sole trader and being a limited company. So I don't know if there's that much financial benefit now of being a limited company."*** - (Administrative & support services, 1 employee, one-person operation, 5+ clients)

Some businesses incorporated because, in the longer-term, they were looking to sell the business and were using this to fund or part-fund their retirement. In particular one business owner noted how it would be easier to transfer ownership of any patents he had if they were 'owned' by a limited company rather than him as an individual.

> ***"And that way if one day for whatever reason somebody came along and offered me £1,000,000 or something to buy it off me it's easily doable then, isn't it? It's just, OK, you are buying my share of the company, here you go."*** - (Wholesale & retail, transport & hospitality, 2-4 employees, 5+ clients)

A couple of businesses in the qualitative research noted the importance of becoming a limited company to differentiate themselves from competitors and avoid question marks about their employment status.

> ***"The business, it actually morphed out of a consultancy business that I ran, and it made complete sense for that consultancy business, in order for me to be able to avoid being, any, any hint of a possibility of being classified as an employee, various sort of constructions and contracts had to be created, one of which was the fact that a limited company was required."*** - (Wholesale and Retail, Transport and Hospitality, zero employees, 5+ clients)

Whilst the benefits of becoming incorporated were clear, there were some perceived drawbacks: namely additional paperwork and accountants' fees. Some felt that tax for limited companies was unnecessarily complicated and that an accountant was needed to support small businesses in doing their return. Company tax returns were deemed more complicated than self-assessment.

> ***"The biggest difference I've seen through being a sole trader and being a limited company is unfortunately my accountancy fees are higher… because obviously there's a lot more involvement from an accounting side of being a limited company, because they have to prepare a more thorough set of accounts, they have to do payroll for me being an employee…and I still have to do a self-assessment because I'm a director."*** - (Administrative & support services, 1 employee, one-person operation, 5+ clients)

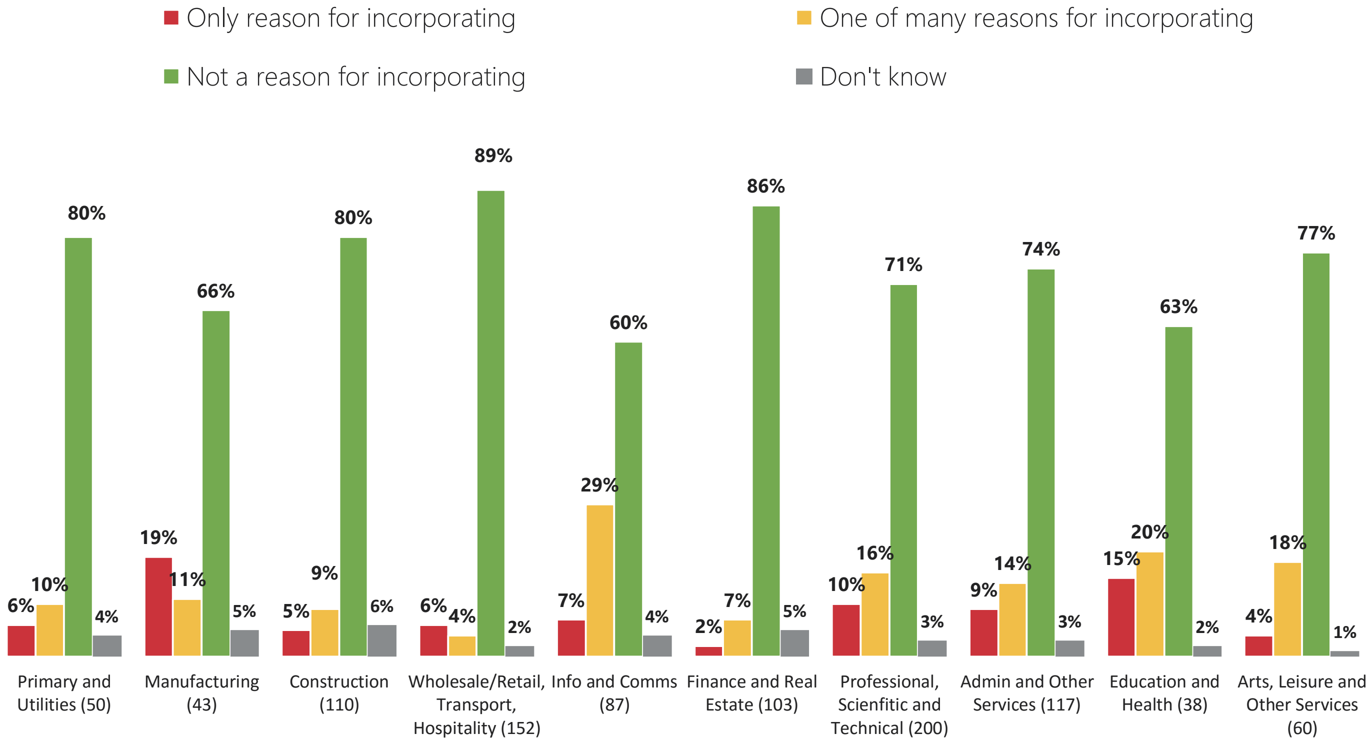
2.18 Becoming incorporated as a client requirement

The survey findings showed that three in four companies' reasons for incorporating had nothing to do with client requirements (75%) while 21% said this was either the sole factor in their decision, or one of several reasons. Overall, client requirement was the only reason for incorporating for 8% of companies with clients and one of many reasons for a further 13%.

Figure 2.22 shows incorporation as a client requirement, by sector. Companies in Information and Communications technology (36%) and, Education and Health (35%) were more likely than average to have incorporated at least in some part because of client requirements. This is likely to be because these companies tend to deal more with other businesses, and because of legal and regulatory frameworks in place within certain sectors, which are often embedded within procurement guidelines.

Likeliness to incorporate as a client requirement decreased as turnover increased. One-quarter (26%) of companies with turnovers of up to £10,000 and more than £10,000 up to £25,000 had incorporated due to client requirements. However, 17% of companies with turnovers greater than £100,000 cited this as a reason why they incorporated. This is because for larger companies, the benefits of incorporating of their own accord, such as limited liability, are likely to have been much clearer.

Figure 2.22: Whether incorporation was influenced by client requirements, by sector



Q: Thinking back to when your company incorporated, was this required by a client before being able to work for them? Would you say this was the only reason for incorporating or one of a number of reasons for incorporating?

Base: All with clients (960)

Thirteen per cent of companies who dealt mainly with individuals had been required to incorporate, compared to 21% of companies overall. Public sector clients were more likely to require incorporation – with 38% of companies who dealt mainly with the public sector incorporating for this reason, compared to 23% of companies who dealt with the private sector.

Size did not appear to relate to likeliness to have been required to incorporate – the same proportion of companies with zero employees and three to four employees had been required – 16%.

The qualitative research among businesses who had to become incorporated in order to work for their only or main client found that they generally accepted this as reasonable. There was one business who was 'very unhappy' at being forced to become incorporated after her one main client changed their rules on working with sole traders. She noted the financial implications of becoming incorporated.

> ***"I was forced to set up a company… I was quite annoyed. I had quite happily been a sole trader for nearly 20 years and I did my accounts myself. It was nice and easy, and suddenly I had to get a bookkeeper, pay somebody else to do my accounts, set up the company. I don't earn a huge amount of money, so paying somebody [to book-keep] is a significant chunk of that. Having to pay corporation tax on everything the company makes at 21%…And, oh yeah, the National Insurance…now I have to pay voluntary, which is significantly more."***
> - (Administrative & support services, 1 employee, one-person operation, 3-4 clients)

3 Conclusions

This population of very small businesses encompasses one-person operations, husband and wife partnerships, growing start-up businesses and family businesses – with differing motivations and mindsets regarding income sources and how that income is used. As well as the consistent differences by size and sector identified in the survey research, the qualitative research also revealed that lifestage of the business owner / director is an important influence on these issues.

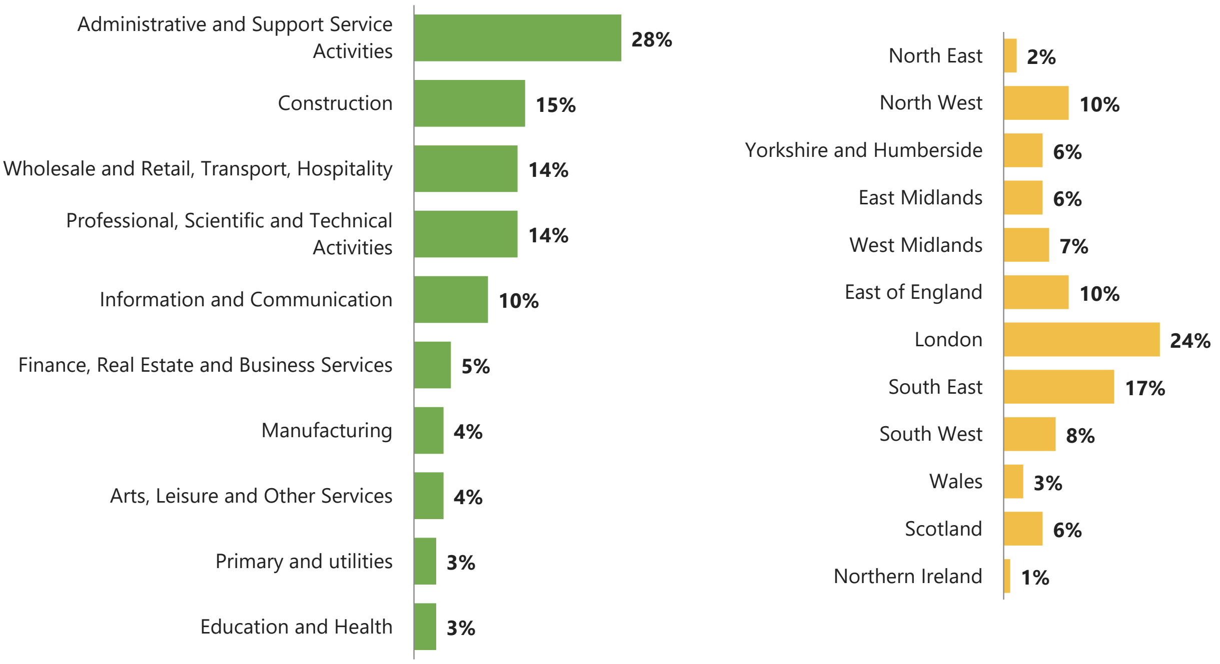
The majority of these companies are heavily dependent on the work of one or two people for the continued existence of the business. While a significant minority contain connected family members, there was little evidence of connected family members who did no work for the company receiving a large proportion of the profits.

Tax underpins director remuneration decisions more than employee salary levels – a finding similar to previous Ipsos MORI research for HMRC on company income distribution. Again, similar to that study, the main drivers of retained earnings are business and personal factors – tax is reported as a relatively minor consideration. In theory, retaining money within a business rather than transferring it to a personal account, may have tax advantages. However, this was not widely raised as an explicit reason for retaining earnings either in the survey or the qualitative research.

Appendix A: Company profiles by sector and region

All companies interviewed were still trading – companies who had ceased trading, been liquidated or had been sold or passed on were ineligible for this research. The most common sector, Administrative and Support Service Activities, accounted for 28% of companies (Figure A.1). Two in five companies were located in London (24%) or the South East (17%), with the rest distributed more evenly across the remaining English regions and the devolved administrations. The lowest concentrations of companies were in the North East, Wales, and Northern Ireland.

Figure A.1 – Regional and sector distribution of listed companies with 0-4 employees



Base: All businesses (1,000)

Appendix B: Company case studies

One-person operation, Professional and Technical Activities

This one-person business has operated for over ten years, providing consultancy to larger companies. The sole director-shareholder is in his late 60s and set it up on retirement from his previous job. He is considering stopping work soon as he doesn't need the money and wants to concentrate fully on enjoying the rest of his retirement.

"When I retired from my full time job with that main employer I thought I'd do a bit of freelance consulting. You're always working with a fresh set of problems so it's really interesting. The second thing is I quite like working outside of the corporate structure for a change."

He incorporated on advice from his accountant, but is not aware of any wider advantages. He initially got work though his extensive network of contacts, but over time he has concentrated on working with his more longstanding client companies and has had two clients in the past year. He does not want to expand the business any further and is content with this arrangement.

"In the beginning it was a question of who I knew and people who knew other people so it was connections and networking. Later on and more recently I've been concentrating my efforts largely on one company."

He was aware of the line between self-employed and employee, describing himself as a self-employed consultant.

"You have to be careful with that for tax reasons because then I think under certain circumstances you can be seen to be an employee of that company and I wanted to avoid that… make it quite clear to people that you are a consultant, you're not on their team as a member of the staff but rather as an outside help."

He pays himself a small amount in dividends, once or twice per year, using the money to fund holidays. He doesn't pay himself a salary because he is aware that the tax rate on dividends is lower than that on salaries. As he is already in the 40% tax bracket due to his income level, this is the better option for him.

"I'm always asking about the comparative rate if I took it out as salary. [The tax rate on dividends] is less than 40% anyway so I will take the money as a dividend. I'm savvy enough to do that and that's perfectly all right to do that so I do it."

The business retained earnings in the last financial year, mainly because he has little need to draw on the money, having an alternative source of income via his corporate pension scheme. In recent years he has taken advice from his accountant and put a small amount of income from the business into a pension fund (SIPP).

"I've already got significant pensions already from my earlier work because I've worked for a long time in big corporations with pension schemes so I don't always feel the need to dip into my earnings from the consultancy. I just tend to leave it piling up and take it out when I want it which isn't very often."

Small family-based company, comprising a father and two children: one is an employee-shareholder, the other two are employee-director-shareholders. Construction

This family business mainly comprises a father (who is an accountant), a son who does construction work, and another son who is a freelance marketing consultant. Both the sons are salaried employees. All three are company shareholders, but only the father and son who works in construction are company directors, as the other son has only recently started working under the umbrella of the company. Occasionally there is a daughter-in-law who puts work through the business in his freelance capacity. The work they do is unrelated to each other - the father set up the business expressly so that various members of the family could use it while they were self-employed.

"It's two people who are, who in other circumstances might both be self-employed. As it happens, they're both part of one unit, just only because they're brothers. They're completely different businesses and there's no crossover between the two of them at all."

He believes himself to be business critical given that his children don't know much about the legal or accountancy frameworks involved in running a company. He no longer takes any income from the business, running it purely for his children.

"I take no income out of it at all. As far as I'm concerned, I'm a shareholder because that's the way we set it up. I have worked for the company and invoiced from the company in the past, but my role now is just to run this for the sake of my children."

His sons are paid salaries at the minimum level required to meet their needs, with the remainder left in the business account to see them through periods when there is less work. Tax brackets are also taken into account when salary levels are decided.

"Their salary is not fixed in any way at all, and it's not based necessarily on what they're earning, it's based on their needs - trying to give them as little as possible so that there's as much as possible left for anything that might be needed in future in terms of emergencies or hard times, and because they are effectively both self-employed, work could dry up at any time."

Retaining these funds within the company is viewed as a tax advantage as well as a safety buffer, as they don't pay any tax on that money until they draw it out.

"The company will pay tax on it but the individuals won't, and the tax on the company is a lot less than the company on the individuals, so we're taking advantage of the corporate structure. I told them the money is there, if you need it you can draw it out, but you're going to have to pay the tax on it then. It's better off left in the company, that's the best way to save it."

The company was incorporated from the start, for a number of reasons around limited liability and because it was considered to provide greater credibility for the business among clients and credit providers. Tax considerations did play a role too, in terms of enabling them to 'even out' their finances from year to year.

"If you're dealing with a limited company, I think it does give people a bit more confidence, plus there's also the legal implications. So if you want a credit rating that's one of the things that your creditors would look at. And because of this issue of leaving money in the company and not drawing it out, if you're self-employed you pay tax on what you're earning, and you might have a good year one year and pay a lot of tax, and a bad year another time and pay very little, but you can't carry one forward to the other, whereas with a company, incorporation, you can even things out, you're more in control of it."

Small company, three employee-director-shareholders and four employees, Retail and Wholesale, no family connections

This company sells construction supplies across the South of England and comprises of three director-shareholders and four members of staff. All the director-shareholders have equal shares in the business, and are un-related. They like having three shareholders as it means there will always be a majority view, in the case of any disagreements about the future direction of the company.

"I think three is a very good number actually because basically if any of us disagree there's always going to be a majority and so I think it's a good number… I've been in businesses where it was a 50/50 and that can cause issues because no one has the casting vote."

They bring different skills and attributes to the business – one invested a considerable sum of money to set it up, another also invested, but with less money, and the third invested nothing financially, but has all the specialist industry knowledge and connections they need to function as a business in that sector.

"I think that the three directors I think are fairly critical to the business because we all bring different skills to the party."

The business has a large number of clients, with a core of around 25 small businesses who are 'regulars' and the rest of their business coming from sole traders who buy over the counter. Most of their business comes from word of mouth, but they do subscribe to some industry information providers who advertise their services.

"Everything from keeping ones ear close to the ground to using some of the information providers, we've subscribed to a couple of information providers and so on and so we use those. But also it's, part of it is the old pals act it must be said."

The business retained earnings last year with the main reason being to re-invest it to grow the company. All three directors are now aged over 60 and in the near future they are considering selling it on, so retaining money within the business makes it more attractive to potential buyers.

"We are trying to grow the business so rather than sucking money out of it we're leaving money in it so that we can grow the business because otherwise it won't grow, we won't be able to finance it. I would say that we're looking at the business with a view to a possible sale, we're all over 60 so there comes a point where we would like to take the money and run and so it's a matter of keeping the balance sheet as positive as possible and make it as attractive as possible to a buyer."

All the company directors are involved with other businesses as well, and all pay themselves via service company arrangements. The main method is through dividends. This arrangement was advised by an accountant as the most tax-efficient method of remuneration. The employees are all paid a salary through PAYE, with the two customer-facing ones also eligible for a company bonus.

The main perceived advantage of being incorporated is limited liability, with the added bonus that it makes it easier to qualify for credit.

"Limited liability is an important consideration it just, if anything does go pear shaped I quite like to see my liability limited. In our industry it is the most understood and accepted method of having a business as well so it works with trying to make sure that one gets the credit rating that one should and that sort of thing."

Husband and wife business (one is the fee earner and one provides administrative support), both are director-shareholders, Information and Communication Technology

This company consists of two director-shareholders and is a husband and wife partnership. The man works as an IT consultant, mainly for one large company, effectively on an 'on call' basis. Although he does do work for other companies, this is on an occasional basis – while he has an ongoing contract with his major client that has lasted for approximately five years. His wife provides occasional administrative support. He is very clear that he operates independently of his major client.

"I am an external contractor, I don't work on their site. I don't have access to their site or their email. … I'm not part of their organisation, I provide my own business equipment, I have my own professional indemnity insurance and all that kind of thing."

He incorporated because he was required to do so by his major client. He didn't have any choice in this if he wanted to accept the contract. While he perceives advantages and disadvantages, on the whole the former outweigh the latter.

"[The client] insisted that I was a limited company as opposed to a sole trader… because the general issue of being seen as an employee as opposed to not an employee, which I am not, and that was just their stance on the matter. So I had no choice, either I had the contract and set up the company, or I had neither."

He used to pay himself a pension from the company but has stopped doing this for tax reasons, as he was paying tax on it at 55 per cent. Instead, he now takes a small annual salary and a larger dividend. His wife also receives a small salary and a dividend, but her dividend is substantially lower than his, as she only does a small amount of work for the company.

"I'm the majority shareholder, so that my income ends up much larger than hers. But that is fair in a sense in the fact that I do most of the company's work."

The company has £10,000-£20,000 in retained earnings from the most recent financial year, and more in terms of accumulated retained earnings in the business account as a whole. He is gradually reclaiming this as income, but being careful to avoid exceeding the relevant tax thresholds, so that he does not pay more tax than is necessary. He also has alternative sources of income and can afford to let the money 'sit' in the account. He is in his early 60s and plans to take phase retirement, closing down the business in five or six years.

"I don't need this job, I've got plenty of savings and money in the family myself, or, and my wife, and so what am I going to do? I'm going to take it out, stick it in the bank, and earn 1% interest on it. And it's probably easier to set it up as the company and then maybe gradually reclaim it. I reclaimed last year more than was retained."

Appendix C: Technical information

3.1 The pilot survey

Between 14 and 17 December 2015, a short pilot survey was conducted with 19 small businesses to check the quality and eligibility of the sample, assess willingness to participate, and test the questionnaire for comprehension, usefulness and relevance. For the pilot sample, 250 leads were provided by HMRC, of which 38 had telephone numbers. After Ipsos MORI conducted automated telephone number matching for business telephone numbers, and then (if unsuccessful) residential numbers (as many owners of businesses this size may operate from home), and after the opt-out exercise, 111 leads were available to call for the pilot. This was slightly lower than the 140 leads predicted initially.

The pilot did not identify major problems with the questionnaire or with of the willingness of businesses to take part in the research. A short report of pilot outcomes was delivered to HMRC. Small changes were made to the questionnaire in advance of the mainstage, as a result of the pilot: mainly incorporating additional definitions, and changes to the routing to improve the flow of the interview for one-person operations.

3.2 The main stage survey

A stratified random sample of 22,498 leads was drawn by HMRC from Companies House and HMRC administrative records. HMRC provided this to Ipsos MORI to conduct an advance opt-out mailing prior to fieldwork. Around ten per cent (2,485) of the records contained a telephone number, so Ipsos MORI conducted tele-matching using publicly available data provided by UK Changes. This provided an additional 8,220 leads with phone numbers. These 10,705 businesses were sent an advance letter two weeks before fieldwork began, asking if they wished to opt out of being contacted in relation to the study. Following this (with an opt-out rate of 13%), 9,268 sample leads with phone numbers were available for interviewing. Table A.1 provides a breakdown of the sample used and the response rates achieved.

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

	All issued sample		Known valid sample	
	N	%	N	%
Complete interviews	1,000	12	1,000	37
Refusals (including abandoned interviews)	1,502	18	1,502	56
Screened out (companies that had ceased trading/been liquidated/sold on or those with more than five employees)	661	8	-	-
Live sample, still trying to establish contact	2,295	28	-	-
Not available in fieldwork period	330	4	198	7
Bad numbers	3,480	42	-	-
Total sample	**9,268**		**2,700**	
Total sample with a known call outcome	**6,973**			
Ineligible (screen-out and bad numbers) as a proportion of known call outcomes		42%		
Unadjusted response rate (complete/all sample)		**12%**		
Adjusted response rate (complete/ known valid sample)				**37%**
Co-operation rate (complete/(complete + refusal))				**40%**

Table A.2 – Unweighted and weighted profile of interviews achieved in the survey

		Unweighted total	Weighted total
Number of employees	0	86	82
	1	399	399
	2	328	328
	3 to 4	187	191
Region	A North East	27	21
	B North West	110	99
	C Yorkshire & Humberside	69	61
	D East Midlands	64	55
	E West Midlands	71	74
	F East of England	118	99
	G London	130	244
	H South East	179	171
	I South West	114	78
	J Wales	35	27
	K Scotland	72	57
	L Northern Ireland	11	12
Sector	Primary and Utilities	55	30
	Manufacturing	43	40
	Construction	116	150
	Wholesale and Retail; Transport and Hospitality	157	140
	Information and Communications	91	100
	Financial/Insurance Activities and Real Estate	113	50
	Professional, Scientific and Technical Activities	202	140
	Administrative and Support Service Activities	119	280
	Education and Health	41	30
	Arts, Leisure and Other Services	63	40
Turnover	Up to £10,000	90	89
	More than £10,000 up to £25,000	112	102
	More than £25,000 up to £50,000	179	182
	More than £50,000 up to £100,000	243	221
	More than £100,000	352	376

Table A.3 – Profile of the qualitative participants

		Total
Number of employees	0	6
	1	12
	2 to 4	12
Region[23]	North	5
	Midlands	10
	South	8
	London	7
Sector	Manufacturing	3
	Construction	4
	Wholesale and Retail; Transport and Hospitality	6
	Information and Communications	3
	Professional, Scientific and Technical Activities	7
	Administrative and Support Service Activities	7
Number of shareholders (minimum quota set)	More than one	10
Number of directors (minimum quota set)	More than one	8
Director remuneration strategy	Salaries	9
	Dividends or additional shares	10
	Employee benefits (pension, company car, health cover)	5
	No directors receive any remuneration currently	6
Retained earnings	Didn't make a profit	6
	Made a profit, but didn't retain earnings	4
	Up to £10,000	11
	More than £10,000 up to £50,000	5
	More than £50,000	4
Number of clients	0	2
	1	2
	2	4
	3 to 4	5
	5 or more	17

[23] Companies from Scotland, N. Ireland and Wales were not interviewed due to purdah restrictions during the fieldwork period

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