



Department for
Business, Energy
& Industrial Strategy

Understanding the Reasons for Incorporation

Final Report – Technical Report

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1. Introduction

1.1 Background and context

In 2019 there were an estimated 5.9 million private sector businesses in the UK. The vast majority were small businesses - approximately 5.82 million have between 0 and 49 employees - with medium and large business with 50 or more employees accounting for just under 1% of the total number of businesses. Sole proprietorships (“sole traders”) represent the largest proportion of small businesses (59% of the total), followed by limited liability companies (LLCs) (34%), and ordinary partnerships (7%). In total – across the three types of legal status - approximately 76% of businesses (4.5 million) had no employees¹.

There has been rapid growth in the number of incorporated companies in the last decade. In 2018 – 2019 alone approximately 673,000 new companies were registered. This was an increase of 8.5% compared with the previous year². However, the reasons for the increase are not well understood. It is not known why a large proportion of business owners choose to incorporate as LLCs rather than operate as (registered) sole traders³.

In general, the Government has encouraged company incorporation by making the process for registering a LLC straightforward with minimal associated financial cost⁴. There are, though, ongoing associated costs such as the additional administrative requirements and loss of financial privacy. From a ‘rational choice’ perspective the interpretation is that business owners expect that the benefits of incorporation outweigh the potential costs. Nevertheless, what may represent the best choice for business owners may not necessarily lead to the best overall outcome for the economy and society.

For example, the current tax regime likely means that lower rates of tax are receipted from the smallest LLCs via corporation tax and dividend tax compared with equivalently sized sole traders (STs) via income tax and national insurance contributions. Whilst this simply represents a transfer from the public budget to owners of incorporated companies, there may also be an associated deadweight loss, due to the higher costs of setting up and maintaining incorporated businesses. Hence the greater the ‘over supply’ of incorporated companies, the greater the deadweight loss.

To fully examine policy reform options that may alter incentives for business owners to incorporate it is important to have a clearer understanding of this choice - to understand what the most important demand factors are, and measure and quantify their effect on the rate of incorporation.

¹ Figures in this paragraph are sourced from BEIS Statistical Release: Business Population Estimates (BPE) for the UK and the Regions 2019. Available from: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852919/Business_Population_Estimates_for_the_UK_and_regions_-_2019_Statistical_Release.pdf. The BPE estimates of numbers of companies differs from the count of companies at Companies House as the BPE aggregates companies that belong to a related economic unit.

² Companies register activities:2018 to 2019. Available at: <https://www.gov.uk/government/publications/companies-register-activities-statistical-release-2018-to-2019/companies-register-activities-2018-to-2019>

³ Incorporation means a company becomes its own legal entity. This requires registration as a limited company at Company House, the UK’s registrar of companies and an executive agency and trading fund of the Government.

⁴ <https://www.gov.uk/government/publications/incorporation-and-names/incorporation-and-names>

1.2 Purpose of the study

The aim of the study is to provide evidence on the reasons why business owners decide to incorporate their business or not, including the relative influence of different characteristics of business status (i.e. LLC or ST). The specific objectives are to:

- Design a robust stated preference (SP) survey to understand the choice of business owners to incorporate or not;
- Implement the survey with a representative sample of business owners;
- Analyse the factors that influence business owners' demand for incorporation; and,
- Estimate the value of incorporation to business owners in terms of their willingness to pay (WTP) for different aspects of business status.

The study also looks at whether there are significant differences in WTP for incorporation between business owners with different personal characteristics (e.g. gender and ethnicity).

The approach to the research interprets company incorporation as an *individual choice* made by a (small) business owner. Adopting this micro-level perspective focuses the analysis on the factors that influence the choice of a business owner to set up and run a business as either a LLC or a ST. The focus of the research is therefore the preferences of individual business owners and their perceptions and experiences of the advantages and disadvantages of company incorporation. This is a bottom-up view and complements economy-wide analyses of the structural and institutional influences on company formation that have been examined in previous research (see Section 1.3).

The research outcomes provide monetary valuation estimates for select aspects of business legal status that are provided by company incorporation, alongside wider evidence on the reasons why small business owners (<10 employees) decide to incorporate or not. Small business of this size make up the vast majority of total businesses and are most likely to be subject to individual business owner decisions on their legal status. The findings add to the available evidence base that informs policy-making, providing a rounded view of the context and drivers from which individual business owners make this decision.

1.3 Literature review and qualitative research

The project methodology report (Appendix 1) set the foundation from which the research with business owners was conducted. It focused on building the understanding of the factors that potentially influence a business owner's decision to incorporate their business or not. The scoping work included a literature review of existing research into institutional influences on incorporation rates and qualitative research into business owner's motivations for incorporation, conducted through a series of interviews with a small sample of current LLC and ST business owners.

The literature review found that previous studies have primarily examined the influence of institutional factors on company incorporation rates, including overall corporate tax rates and economic conditions. The qualitative interviews provided a more in-depth assessment of individual-level circumstances, both supporting the findings from the literature review, but also

developing a broader understanding of “non-economic” reasons for incorporation such as lifestyle motivations (Box 1.1).

Box 1.1: Summary of scoping phase findings

Literature review

The purpose of the literature review was to investigate current understanding on the institutional influences on company or partnership incorporation. The identified literature covered several topics that influence incorporation rates including strength of institutions, tax incentives, access to credit and limited liability.

The reviewed literature primarily investigated institutional influences on incorporation, including the relationship between tax regimes and incorporation rates, and other economic influences such as access to credit and limited liability. The evidence demonstrates that decisions to incorporate are multi-dimensional and several factors need to be considered, with a consensus on the importance of the differentials between income and corporate tax rates as a driver of incorporation (i.e. the higher the corporate tax, the lower the incorporation rates).

While the findings from the literature review are useful in setting the context within which individuals make decisions, there is a lack of evidence on the factors which individual business owners consider in deciding on whether to incorporate a business, in particular around non-tax and non-economic reasons for incorporation. Such supplemental analysis would provide new insight on this topic and lead to better targeted policies.

Qualitative research

The purpose of the qualitative research was to gain an initial view on the factors that influence the choice of business owners to incorporate their business (or not). This provides a contrast to the insight from the literature review which mainly covers the relationship between institutional factors and incorporation rates.

A total of 20 tele-depth interviews were undertaken with business owners – ten with LLCs and ten with STs. The target sample was primarily aimed at small businesses with zero to four employees, across a range of sectors and different locations from across the UK. A mix of sectors were represented across the 20 interviews including retail, construction, health/beauty/hairdresser, hospitality and leisure, recruitment, entertainment and the motor trade.

The interviews were approximately 30 minutes in duration and followed a semi-structured discussion guide. Topics covered included: the nature of the interviewee’s business; the legal status; the reasons for their choice of legal status; the perceived benefits/disbenefits of alternatives; sources of advice sought; and wider aspects of business attitudes and experience.

Notably, the interviews indicated that business owners are not always particularly knowledgeable on the incorporation process, and what benefits and costs the business structure brings relative to being a ST. This is a factor which has been considered further in the survey design, to ensure to present enough information for respondents to make an informed and meaningful decision.

1.4 Structure of this report

The remainder of this report is structured as follows:

- Section 2 provides an overview of the approach, presents different stated preference methods and discusses the validity of stated preference research;
- Section 3 describes the survey design and testing, including the survey structure, cognitive testing, piloting, and sampling strategy;
- Section 4 contains the results, presenting the achieved sample, the respondent profile and perceptions, the choice model analysis, and segmentation;
- Section 5 presents the aggregation of results, with estimates of aggregate benefits and sample policy scenarios; and,
- Section 6 concludes with a discussion on the main findings of the study.

The report also contains Appendixes with supplemental information. These include:

- Appendix 1 – Methodology report
- Appendix 2 – Cognitive testing
- Appendix 3 – Survey questionnaire
- Appendix 4 – Onscreen layout
- Appendix 5 – Summary statistics
- Appendix 6 – Choice model analysis
- Appendix 7 – Peer review

2. Approach

There are two main approaches to elicit information on individual decision-making and behavioural preferences: revealed preference and stated preference. Revealed preference approaches require data on observed behaviours where a decision or activity has already occurred, whereas stated preference approaches rely on survey respondents making choices in a simulated choice setting. While revealed preference approaches examine data based on actual choices, the scope of their applicability is limited by the context within which the decision was made. By applying simulated scenarios, stated preference approaches are more flexible in application to non-observed behaviour, though must be carefully designed to produce reliable data.

Although this study relates to an observable behaviour (i.e. the decision to incorporate or not), the decision does not occur within a context whereby the full costs and benefits of that decision are borne by the decision-maker (e.g. the cost is nominal). Consequently, the value that the decision-maker places on incorporation is not readily apparent from available data. Furthermore, there is no scope for observing changes in behaviour due to alternate choice contexts (e.g. changes in the incorporation 'package' or its cost).

The current research objective requires both an understanding of the value that individual business owners place on incorporation, including individual attributes of incorporation such as limited liability, and how that value would differ if the incorporation package changed. As such there is limited insight that can be drawn from a revealed preference approach. In contrast a stated preference approach provides greater scope to address the research objectives.

2.1 Overview of stated preference methodology

Stated preference methods are survey-based approaches that present respondents with simulated choices to measure their preferences and valuations for particular goods, services or outcomes. These methods are often used to value the provision of non-priced or non-market outcomes. Company incorporation – including limited liability – for the most part represents a non-priced outcome, since only a nominal fee is charged for company registration and associated ongoing annual filings⁵. Therefore the fee is unlikely to reflect the value that LLC business owners derive from incorporation.

The central component of a stated preference survey is a 'choice task', or sequence of choice tasks, in which respondents are asked to make choices about the provision of the good/service/outcome of interest. The choice task(s) usually involves trade-offs between improved, maintained, or deteriorated levels of provision. The choices that respondents make reveal their priorities (demand) for the provision of the good, service or outcome, i.e., what they want and care about most. Where trade-offs with monetary amounts are included (e.g., a price for the good, service, or outcome) respondents' choices also reveal the value they derive from its provision. Most commonly, this value is measured in terms of the respondent's willingness to pay (WTP). This measures the benefit that individuals derive from improved or maintained (avoided deterioration) provision of good, in terms of the monetary amount they are prepared

⁵ For example, it costs £12 to register a company on-line and £13 to file a confirmation statement once a year.

to give up to secure that level of provision⁶. For example, a business owner's WTP for company incorporation – in terms of the maximum amount that would be paid for company registration – can provide a measure of the value of incorporation and the attributes that incorporation brings with it (e.g. limited liability).

2.2 Stated preference methods

A stated preference approach offers a particularly flexible research method in the context of this study. It provides a basis for examining the overall value of company incorporation to business owners and the contribution of individual characteristics of incorporation to the overall value (e.g., limited liability). The scope of stated preference methods, however, can be broadly defined and associated with a wide range of terminology which varies across applications in different sectors. Table 2.1 provides a summary of the main variants.

Table 2.1: Stated preference choice formats

Method/format	Description	Use for customer preferences research
Dichotomous choice contingent valuation (DCCV)	Single choice question Respondent selects preferred option from 2 alternatives	Valuing a discrete outcome (e.g., WTP for specified change in provision of a good or service)
Paired comparison	Repeated choice exercise Respondent asked to choose between two alternative options/scenarios Some applications combine respondent choice with a rating scale to gauge strength of preference	Quantifying priorities (e.g., preference weights) Valuing incremental changes in an outcome and its defining characteristics (e.g., WTP for maintaining/improving provision)
Discrete choice experiment (DCE)	Repeated choice exercise Respondent asked to choose preferred option/scenario from 2 or more alternatives	Quantifying priorities (e.g. preference weights) Valuing incremental changes in an outcome and its defining characteristics (e.g., WTP for maintaining/improving provision)
Contingent rating/ranking	Usually a repeated choice exercise Respondent asked to rank (1st, 2nd, etc.) or rate (e.g. Likert or	Quantifying priorities (e.g., preference weights)

⁶ Willingness to pay (WTP) is a measure of economic value. It applies (universally) to all types of goods and services, whether they are traded in competitive markets, provided in a regulated market setting (e.g. energy), or non-market (e.g. open-access public sector information).

	scale 1-10) their preference for a single or multiple options/scenarios	Usually not consistent with estimating WTP by itself
Best-worst scaling (BWS) (incl. max-diff)	Repeated choice exercise Respondent asked to select most (best) and least (worst) preferred aspects of a single option/scenario ('profile')	Quantifying priorities (e.g., preference weights) Usually not consistent with estimating WTP by itself
DCE – BWS hybrid	Repeated choice exercise Respondent asked to select most (best) and least (worst) preferred option/scenario from three or more alternatives	Quantifying priorities (e.g., preference weights) Valuing incremental changes in an outcome and its defining characteristics (e.g., WTP for maintaining/improving provision)

Table 2.1 also highlights that different stated preference approaches are suitable for eliciting different types of preference information. The discrete choice experiment (DCE) and dichotomous choice contingent valuation (DCCV) are the theoretically valid methods for estimating WTP values. These methods – if applied appropriately – meet certain criteria concerning the measurement of economic value⁷. The choices presented to respondents should: (a) include at least one feasible option (usually the 'baseline' or no change/status quo), where 'feasible' means within the respondent's budget constraint, and (b) not force respondents to make a costly choice when they would be happy with the baseline, or for any reason cannot afford to pay. Other methods such as rating, and scaling approaches can provide quantitative views on preferences (priorities) but are not consistent with underlying economic theory⁸.

2.3 Validity of stated preference research

Stated preference methods are adaptable and hence can be applied to a wide range of settings to produce economic valuations⁹. However, these methods require careful application to ensure that the results that are produced are both valid and robust. They are (questionnaire) survey-based approaches and consequently their reliability is dependent on respondent's understanding the topics of these surveys and providing responses and making choices that genuinely reflect their preferences for the good or service in question. Poorly designed and implemented surveys can be subject to a range of validity concerns that can be related to respondent understanding or design-induced biases (Table 2.2).

⁷ Johnston et al. (2017) 'Contemporary Guidance for Stated Preference Studies', Journal of the Association of Environmental and Resource Economists 2017 4:2, 319-405.

⁸ See for example: Louviere, J.L., Flynn, T.N. and Carson, R.T. (2010) Discrete choice experiments are not conjoint analysis. Journal of Choice Modelling 3(3), pp 57-72.

⁹ See for example previous stated preference work conducted for BEIS by eftec available at: <https://www.gov.uk/government/publications/companies-house-data-valuing-the-user-benefits>

Table 2.2: Stated preference methods – validity testing

Aspect of study	Key issues	
Content validity	Do respondents understand the survey purpose and explanatory material? Are the simulated market and choice tasks credible? Is the potential for biases in responses addressed and minimised?	Content validity is addressed in the survey design and testing phase and then tested for in the analysis phase
Construct validity	Do results align with reasonable expectations based on: Underlying economic theory Findings from similar studies using comparable methods	Construct validity is tested in the analysis phase.

Good practice guidance for applying stated preference methods emphasises the importance of the validity testing process, which is integral to the survey design and analysis phases¹⁰. A key area of focus is the complexity of survey and choice task(s) and respondent understanding in terms of: (i) the explanatory material describing the good/service/outcome, its characteristics ('attributes') and levels of provision; and (ii) the cognitive burden of the choice task exercise(s).

As described in Section 3 the survey design process for this study followed an iterative test-retest process consistent with good practice recommendations to test respondent understanding and balance the amount of information presented with the requirements of the choice tasks. The cognitive burden of a stated preference choice task is determined by a combination of survey design factors. This includes: (i) the number of attributes respondents are asked to consider; (ii) the levels of provision for these attributes and the range they cover; (iii) the number of alternative options respondents are asked to choose between; and (iv) the number of choices they are asked to make.

¹⁰ Bateman et al. (2002) *Economic Valuation with Stated Preference Techniques: A Manual*, Edward Elgar; Johnston et al. (2017) 'Contemporary Guidance for Stated Preference Studies', *Journal of the Association of Environmental and Resource Economists* 2017 4:2, 319-405

3. Survey design and testing

3.1 Overview

This section summarises the development of the stated preference survey questionnaire, including the structure and content and choice task format, along with the proposed sampling strategy.

The three main steps in the survey development process were:

- Draft survey: the survey structure and content were developed following good practice guidance. The main focus was on developing a range of warm-up and introductory questions to understand business owners' experience and motivations for incorporating their business (or not), along with refining the specification and definition of the choice attributes from an initial long-list (see Methodology Report in Appendix 1).
- Cognitive interviews: a total of 20 1-to-1 interviews were carried out with ST and LLC business owners in 4 waves to test the choice task and survey material.
- Pilot survey: the pilot survey was implemented online. This tested the survey and respondent recruitment approaches prior to the main survey implementation (see Section 3.4).

3.2 Survey design and structure

The stated preference survey questionnaire (main survey version) is provided in Appendix 3. It is structured as follows:

- A. Respondent screening and business profile – upfront questions to: (a) ensure the respondent profile is consistent with the sampling frame (business owner, LLC or ST, small business / between 0 – 9 employees); and (b) support an assessment of the wider representativeness of the business population (e.g. location, turnover);
- B. Business formation – ‘warm-up’ questions that introduce the respondent to the survey topic (business status and formation) and collect relevant contextual information on their business and decision to operate as either a LLC or ST (nature of the business, business age, legal status, advice received, etc);
- C. Choice task(s) – the stated preference choice questions that elicit respondent preferences and WTP for company incorporation;
- D. Follow-ups – a sequence of questions that probe respondents' motives and understanding of the choice tasks to assess the validity of their responses (e.g., testing for certain response biases) and other supplementary questions to collate supporting evidence (e.g., views on benefits/disbenefits of incorporation; impact of COVID-19 pandemic on business); and
- E. Respondent profile - a concluding set of questions to obtain additional profile information on the business owner (socio-economic and demographic characteristics) which support the data analysis for segmenting results and validity testing.

Overall, the target timescale for completing the survey was approximately 10 - 15 minutes. This is a reasonable timescale for a stated preference survey of this nature, in terms of maintaining respondents' attention and avoiding survey fatigue.

Attributes and levels

Table 3.3.1 summarises the final set of choice task attributes featured in the pilot survey. The definitions of the attributes and levels was developed from an initial long list of characteristics which potentially influence a business owner's decision to incorporate or not. These covered aspects of the legal status of a business, finance and taxation, commercial opportunities, ownership, and administrative burden.

Table 3.3.1 Choice task attributes and levels

Attribute	Description	Levels
Limited liability	Protection for the business owner(s) (i.e. shareholders), separating the business as a legal entity from their personal finances.	No limited liability Limited liability
Public record	Requirements to file annual accounts and other information about changes to the business each year, which are made publicly available by Companies House.	No public record requirements Annual filing of business ownership information and accounts required
Change in tax paid	The difference in tax liability for the business owner (depending on the legal status of the business, this will be a combination of income tax, national insurance contributions, corporation tax, tax on dividends, etc.). Note that the levels chosen are consistent with the range of differentials in tax paid between a sole trader and a LLC at varying income levels up to £100,000 (i.e., £0 to £3,000 difference in tax paid).	Decrease approx. £3,000 less per year Decrease approx. £2,000 less per year Decrease - approx. £1,000 less per year Decrease - approx. £500 less per year No change - Same as current amount paid per year Increase - approx. £500 more per year Increase - approx. £1,000 more per year Increase - approx. £2,000 more per year Increase - approx. 3,000 more per year
Company name registration	Registration means that a company cannot register a name which is the same as another company. This is a form of protection for a company name (it is not, though, a trademark, which is a different form of protection).	No protection of business name Business name protected

Annual fee for business registration	Annual fee charged – currently this is paid each year when submitting required filings to Companies House. The value £15 a year is broadly similar to the current fee charged by Companies House for on-line registration.	<p>N/A (no fee/registration) [ST Option C only]</p> <p>£0 per year</p> <p>£15 per year</p> <p>£50 per year</p> <p>£100 per year</p> <p>£250 per year</p> <p>£500 per year</p> <p>£1,000 per year</p> <p>£2,500 per year</p> <p>£5,000 per year</p>
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Choice task format

The simulated choice component of the stated preference survey used a discrete choice experiment (DCE) methodology. The choice of business type was represented by a set of attributes that describe the legal status of the business (e.g. liability, tax implications, protections, fees, etc.). Respondents answered a series of repeated choices with alternative options in each that offered varying combinations of the attribute levels (i.e., characteristics for business status). The combination of attribute levels shown in each choice option was determined by a statistical experimental design¹¹.

An example of the DCE choice task is shown in Figure 3.1. Respondents were asked to select their preferred option from three alternatives (A, B, or C). Options A and B present various alternative legal status scenarios for the respondent’s business, mixing characteristics of LLC and STs. The profiles shown vary across the repeated choices. In each choice, Option C presented the option to operate as a sole trader. For ST respondents this represented a status quo option (no change – no cost), with no change from the current situation for their business. For LLC respondents, Option C was a feasible option or baseline option.

A status quo option (no change from LLC legal status) for LLC respondents was not a viable alternative from the perspective of the design of the choice task since it is a dominant option – i.e. maximum level of provision for minimal cost. Hence its inclusion would limit the trade-off behaviour that would be revealed on the part of LLC business owners and significantly constrain the ability to assess WTP for company incorporation and limited liability.

¹¹ There are numerous ways in which the choice task attribute levels can be combined into alternative options for respondents to consider. The purpose of the experimental design task is to ensure that the effects of interest – i.e. business owners’ preferences for company incorporation - can be adequately and efficiently estimated from the available sample size. The experimental design specifies combinations of attribute levels for each choice task presented to a respondent; i.e. it determines which levels of attributes will be presented on a given choice card, with an objective to ‘optimise’ the amount of preference information that is generated by the choice task given the sample size.

Figure 3.1: Example DCE choice card (main survey)

	Option A	Option B	Option C (Sole trader)
Limited Liability	No limited liability <i>No separation of business and business owners' personal finances</i>	Limited liability <i>Business is a separate legal entity to business owner(s)</i>	No limited liability <i>No separation of business and business owners' personal finances</i>
Public record	Annual filing of business ownership information and accounts required	No public record requirements	No public record requirements
Tax paid by business owner - change from current amount paid	<i>Increase</i> approx. £1,000 more per year	<i>Decrease</i> approx. £1,000 less per year	<i>No change</i> Same as current amount paid per year
Business name protection	Business name protected	No protection of business name	No protection of business name
Annual fee for business registration	£250 per year	£100 per year	N/A (no fee/registration)
Which option do you prefer?	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

3.3 Cognitive testing

For the stated preference survey to produce reliable and robust information about business owners' preferences for company incorporation, respondents needed to: (a) understand the choices they are being asked to make; and (b) believe that their responses are consequential (i.e., that their views matter). Both elements were examined in the cognitive testing process that supported the development of the survey content. Satisfying the comprehension and credibility criteria are the basic requirements for avoiding hypothetical bias in the survey results (part of the content validity considerations). This is dependent on both the design of the choice task, and the content of the wider survey which provides the introduction and warm-up to the simulated choices.

The cognitive testing interviews were carried out in September and October 2020. A total of 20 interviews were conducted in four waves, with iterative updates and revisions to survey content (the questionnaire, showcards and choice tasks) in-between. All respondents were business owners, operating as either a ST or LLC. Interviews were equally spread across both legal status types. The sample of respondents featured businesses operating in construction, motor trade, retail, leisure, and health and beauty sectors. An overview of the findings from the cognitive interviews is presented in Table 3.2. A full summary of the testing process and results is provided in Appendix 2.

Table 3.2: Overview of findings from cognitive testing interviews

Aspect of the survey	Key findings
Survey understanding	Overall, respondents understood what the survey was about and what they were being asked to do in completing it.
Ease of survey completion	Generally, respondents found the survey fairly easy to understand and straightforward to complete. A small number were challenged by the choice tasks, taking their time to understand them and if necessary, re-reading instructions to ensure they had understood them correctly.
Legal status options for business formation	Overall, there were mixed levels of awareness regarding the different types of legal status. Most people had heard of STs and LLCs, although the extent to which each was understood was much more variable.
Terminology – “incorporation”	“Incorporation” was a term that was not very well understood, regardless of legal status of the respondent’s business. A small number of respondents had a clear idea of what incorporation meant, but in the main, there was little to no understanding of what it meant especially amongst sole traders.
Choice task attributes	Descriptions of the choice task attributes were revised through the iterations with interviews, with the purpose of ensuring there was no ambiguity in respondent interpretation. Whilst there were some issues in initial sets of attributes and descriptions, all the final attributes and definitions were found to be clear and comprehensive, enabling respondents to have enough information to evaluate trade-offs and choose between the options presented.
Choice tasks - discrete choice experiment (DCE) format	The cognitive interviews showed that respondents were comfortable with the concept of choosing between the different options and feedback indicated that it was found to be an intuitive basis for weighing pros and cons (trade-offs) between alternative profiles for the legal status of a business.
COVID–19	Despite the impact of the COVID-19 pandemic on respondent’s businesses, the majority indicated that they were taking a longer-term view; only a small number of respondents stated that their responses were directly influenced in this regard.

Generally, the feedback from the cognitive interviews was that the survey was straightforward to complete. However, initially the term “incorporation” was not very well understood, and as a result specific explanatory material (a showcard) was included in subsequent iterations of the testing to explain the term. This was also accompanied by explanatory material that described the main differences between ST and LLC legal status – rather than relying on respondents own prior knowledge. Notwithstanding these clarifications, the findings from the cognitive interviews suggested that respondents had a good grasp of the survey topic and overall perceived it to be a credible exercise, including the purpose, the relevance of the questions and the requirements of the choice task.

3.4 Pilot test

The pilot survey was implemented online in November 2020. The purpose was to: (a) provide an online field test of survey questionnaire and choice task with a wider sample of business owners; and (b) practically test the respondent recruitment from the available panels to gauge the likely response rate and breakdown of the sample in terms of STs and LLCs.

Business owner respondents for the pilot survey were recruited from two panels (see below): (i) the CH user panel; and (ii) an online business to business (B2B) panel, comprised of business owners and representatives from a sample of UK-based businesses.

A total of 75 invites were sent to members of the CH panel with follow-up reminders for non-responders. The overall response rate was lower than expected (12%), with just 9 completed survey responses from the 75 invites. A further 60 completed survey responses were achieved from the online business panel (vs. a target of 60 completes).

The (mean) average survey completion time was approximately 15 minutes (i.e. as hoped for), with a median of approximately 12 minutes. The combined sample of 69 business owners comprised of 47 STs and 22 LLCs, with the following breakdown by business size:

- 0 employees: 18 respondents
- 1 employee: 18 respondents
- 2-4 employees: 18 respondents
- 5-9 employees: 15 respondents

The sample profile featured businesses operating in professional, scientific and technical activities (22%), wholesale and retail trade (13%), construction (12%), education (7%), arts (7%), real estate activities (7%) and information and communication (6%). Most of the businesses in the sample had an annual turnover of less than £85,000 per year (68%).

Overall, the survey results from the pilot survey were encouraging, with the expected patterns of responses observed across all parts of the stated preference survey, including the choice task component. Feedback elicited from respondents was also positive and indicated that they were engaged by the survey topic and gave considered responses. Given this and the pilot results for the choice task, no significant concerns were identified with respect to the validity of the survey, either in terms of respondent understanding or the robustness of the survey data.

Data from the pilot was used to update the experimental design for the choice task, with the purpose of improving the efficiency of the design in terms of the precision of WTP estimates

from the main survey data (i.e., smaller confidence intervals for a given sample size). Some minor updates were made to the cost attribute (annual fee) to help maximise the information available to estimate the demand curve for incorporation / limited liability.

3.5 Sampling strategy

The purpose of the sampling strategy is to define the target population, sampling method, survey mode and sample size for the implementation of the stated preference survey.

Target population

There were several potential sources from which to identify the target population for the survey, but the Business Population Estimates (BPE), national statistics produced by BEIS, was chosen as the preferred source since it is the one containing both companies and sole traders and can also be broken down by business size. The target population for the survey was small business owners. These are the individuals that face the choice of whether to incorporate their business and operate as a LLC or to set-up as a sole trader. Table 3.3 summarises the profile of the target population (2020 BPE).

Table 3.3 Target population

Size (no. employees)	No. businesses (% total)	No. sole traders (% total)	No. companies (% total)
Total	5,980,520	3,539,875	2,027,070
0	76%	94%	47%
1	2%	3%	0 (-)
2-4	13%	2%	31%
5-9	4%	1%	11%
10-19	2%	<1%	6%
20-49	1%	<1%	3%
50-99	<1%	<1%	1%
100+	<1%	<1%	1%

Source: Business Population Estimates for the UK and Regions 2020, 8th October 2020 (UK private sector).

The BPE highlights that approximately 91% of UK businesses fall within the 0-4 employee business size range. For sole traders this increases to approximately 99%. Around 78% of LLCs are sized 0-4 employees, with a further 11% in the range 5-9 employees and 6% in the range 10-19 employees – representing approximately 95% of all companies. According to the BPE data, the estimated number of business owners across these sizes is over 4 million.

Sample frame

The sample frame population is the source from which the stated preference survey sample is drawn. A combination of panels were used to construct the sample as no single source provided the required coverage of the target population at sufficient size for the sampling requirements:

- Companies House User Panel - for sampling (mainly) LLC owners;
- An online business to business (B2B) panel;
- A online consumer panel for self-employed business owners; and,
- Telephone recruitment of business owners to the online survey.

Sampling method

A stratified sampling approach was adopted as summarised in Table 3.4. Five distinct sub-populations (strata or segments) were defined based on company size. The main rationale for a stratification based on company size is that the choice on the part of a business owner to opt for LLC status may in part be driven by a business planning strategy that envisages growth of the company and increased number of employees. Hence the materiality of factors related to – for example - transfer of ownership or recruitment may differ across segments; a sub-sample approach therefore provides the basis for testing for such effects (e.g., vs LLCs with zero employees).

Table 3.4 Proposed sample stratification

Segment	Representation
Sole trader; 0 employees	Approx. 94% of all sole traders
Sole trader; 1-4 employees	Approx. 6% of all sole traders
Company; 0 employees	Approx. 46% of all LLCs
Company; 1-4 employees	Approx. 32% of all LLCs
Company; 5-9 employees	Approx. 11% of all LLCs

A random sampling approach was applied to the target population, with the intention that the segments would naturally fall out of the sample and approximately align with the population characteristics. The analysis of the choice task data treated each segment as an independent sample, meaning separate study results are provided for each sub-population. Aggregate results (overall business population) are estimated by weighting by the relative shares of each segment (see Section 5.2).

Randomised sampling of the target population would typically ensure a reasonable representation across industry sections within each segment, although as noted above the exact profile of businesses by legal status is unknown. The approach therefore was to monitor the sample composition to ensure that each sub-population had a good mix of respondents by industry section.

Sample size

Based the design of the DCE component on the stated preference survey, a minimum of 250 respondents per sampling strata would be expected to give reliable estimates in terms of the precision of results (e.g., WTP estimates). This factors in the potential for heterogeneity in business owner preferences within segments (strata) and the requirement to use appropriate choice model estimations to test for these effects. The ideal minimum for the overall target sample size was therefore 1,250. The precision of the estimation results would, though, be improved if larger samples were achieved for each segment.

4. Results

4.1 Achieved sample

The overall sample of approximately 1,500 business owners, is nearly evenly split with 47% LLCs vs. 53% STs. The largest proportion of LLC respondents were sourced from the Companies House panel (45%). Most ST respondents were sourced from commercial panel providers (96%). The breakdown of respondent numbers by legal status and business size by source is presented in Table 4.1.

Table 4.1 Respondent numbers by source (n = 1,530)

	Online panels		Company House panel ¹²		Telephone recruitment		Total	
	ST	LLC	ST	LLC	ST	LLC	ST	LLC
0 Employees	337	19	20	67	0	115	357	201
1 Employee	275	41	11	94	0	0	286	135
2-4 Employees	107	69	7	140	0	0	114	209
5-9 Employees	63	32	0	27	0	106	63	165
Total	782	161	38	327	0	221	817	713
	943		365		221		1,530	

4.2 Respondent profile and perceptions

Respondent profile

The demographic composition of the sampled business owners are detailed below, focusing on gender, age, ethnicity and education respectively in Figure 4.1, Figure 4.2, Figure 4.3 and Figure 4.4. In the sample, twice as many LLCs are owned by males than females¹³, while STs business owners are evenly split between males and females. ST ownership skews younger (18 to 44) than LLC ownership. The proportion of White British / Irish and other ethnicity business owner is the same between LLCs and STs. In general, STs ownership is more heavily weighted towards education attainment up to first degree, while LLC ownership is more heavily weighted towards those with a higher degree or professional qualification.

¹² Note that 6 of the LLC – 0 employee respondents were recruited through Company House social media accounts.

¹³ BEIS analysis of company directors recorded on FAME also suggests that the male to female ratio is 2:1, thus our sample is consistent with the general population.

Figure 4.1 Respondent gender (n = 1,530)

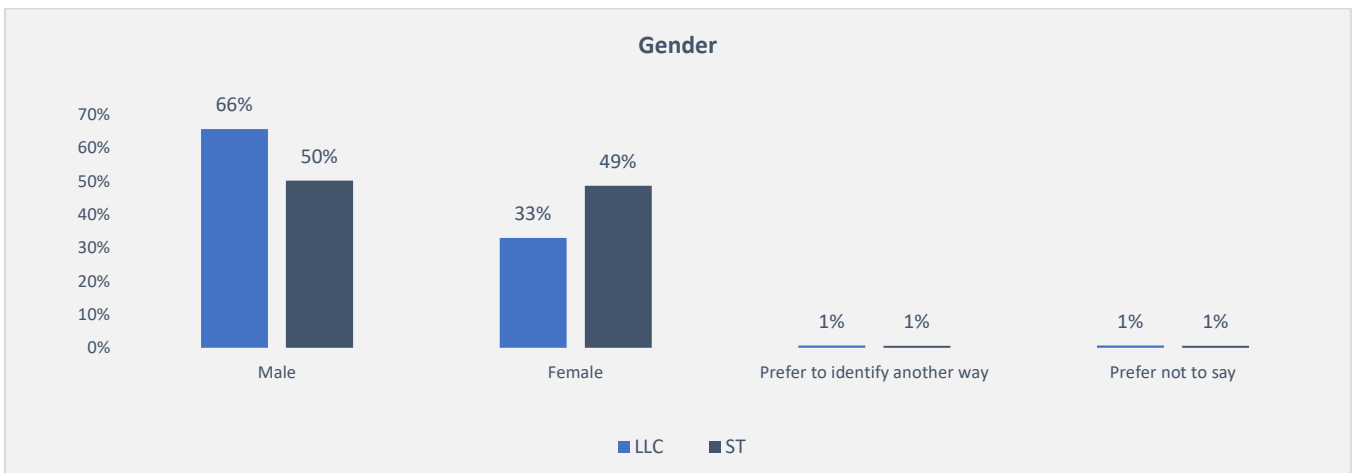


Figure 4.2 Respondent age (n = 1,530)

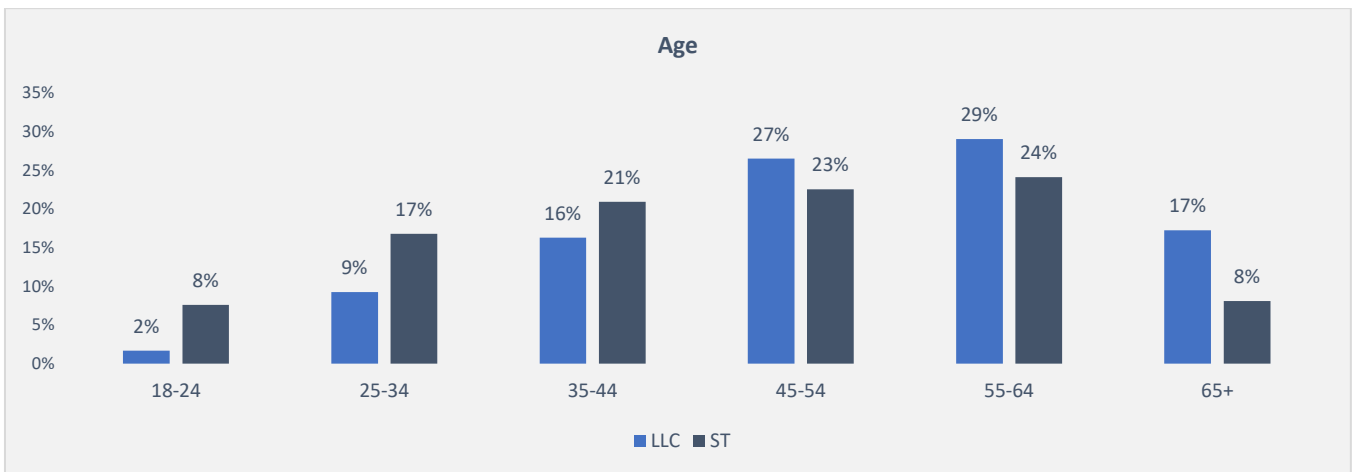


Figure 4.3 Respondent ethnicity (n = 1,530)

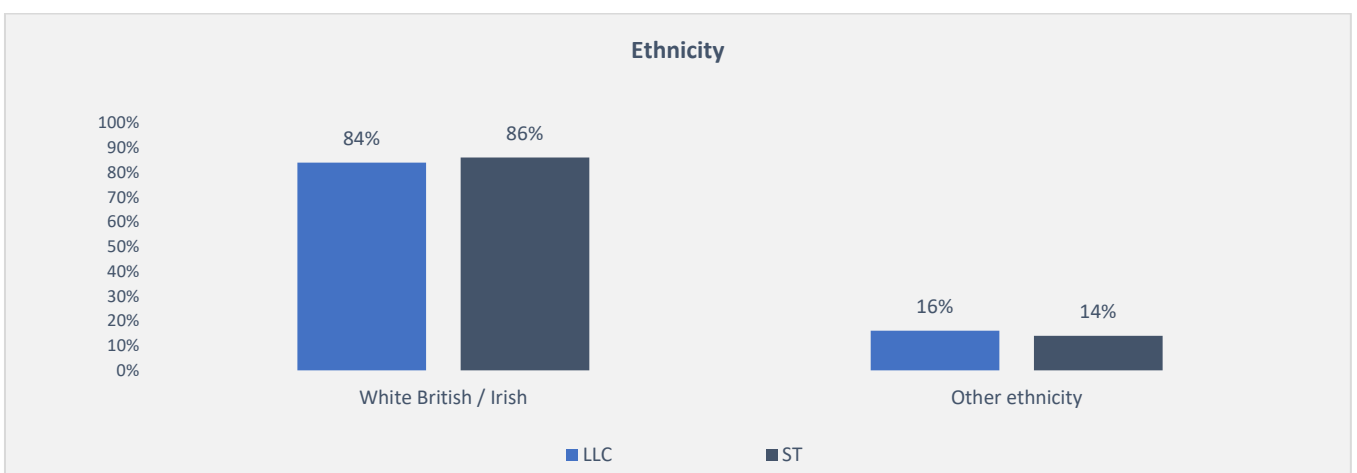
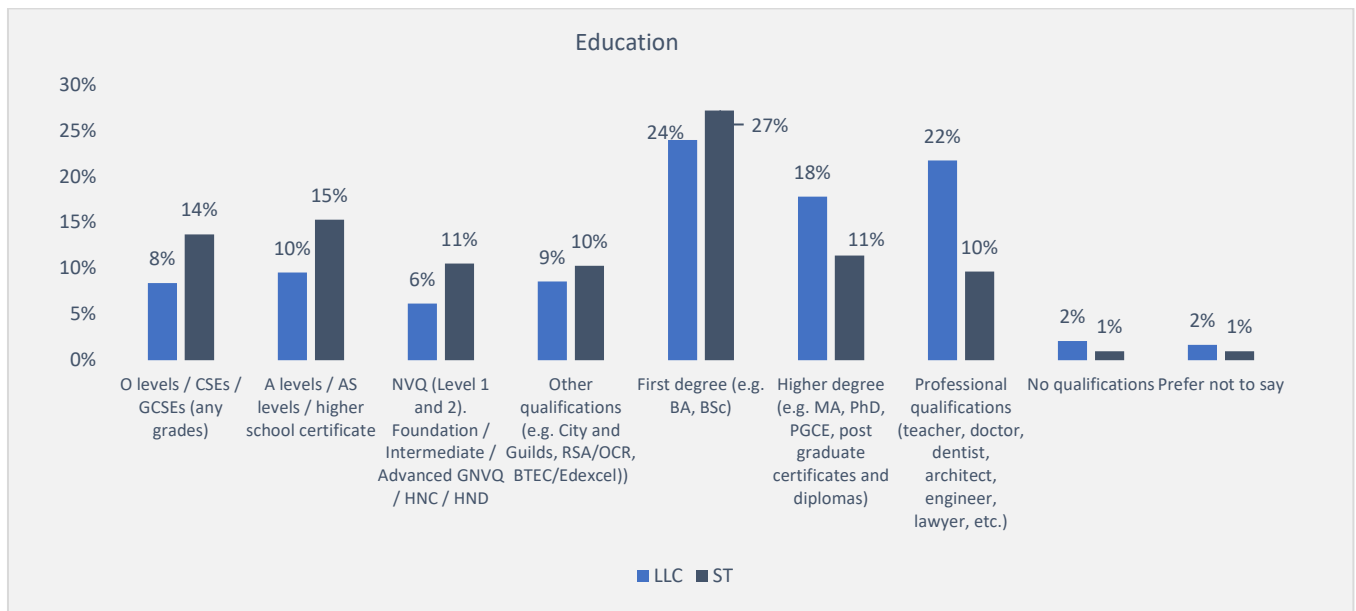


Figure 4.4 Respondent education (n = 1,530)



Respondent perceptions

Business owners can also be influenced by their prior experiences and perceptions when making decisions around their business legal status. The survey collected information which provides useful context for understanding respondents and interpreting their decisions.

Figure 4.5 and Figure 4.6 present the different sources of advice sought by LLC and ST business owners and the topics of advice sought. Most LLCs and STs did seek advice when setting up their business. Accountants are the most common source of advice for both LLC and ST business owners, although to a greater degree for those who decided to incorporate. STs more commonly sought advice from family and other people in their sector than LLCs, although LLC business owners also consulted these sources. The most common topics consulted on are tax liability, limited liability, and administrative requirements across both STs and LLCs, although limited liability advice was more frequently sought by LLC respondents.

Figure 4.5 Source of advice on business legal status (n = 1,530)

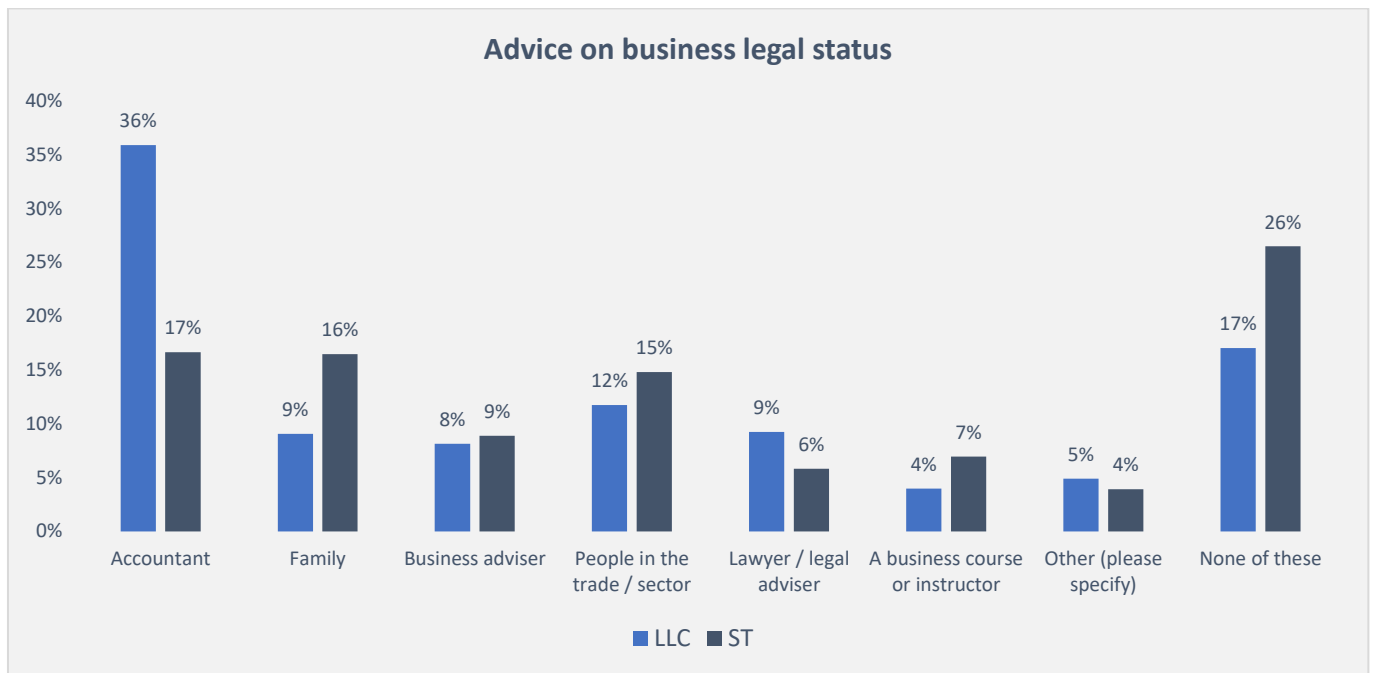
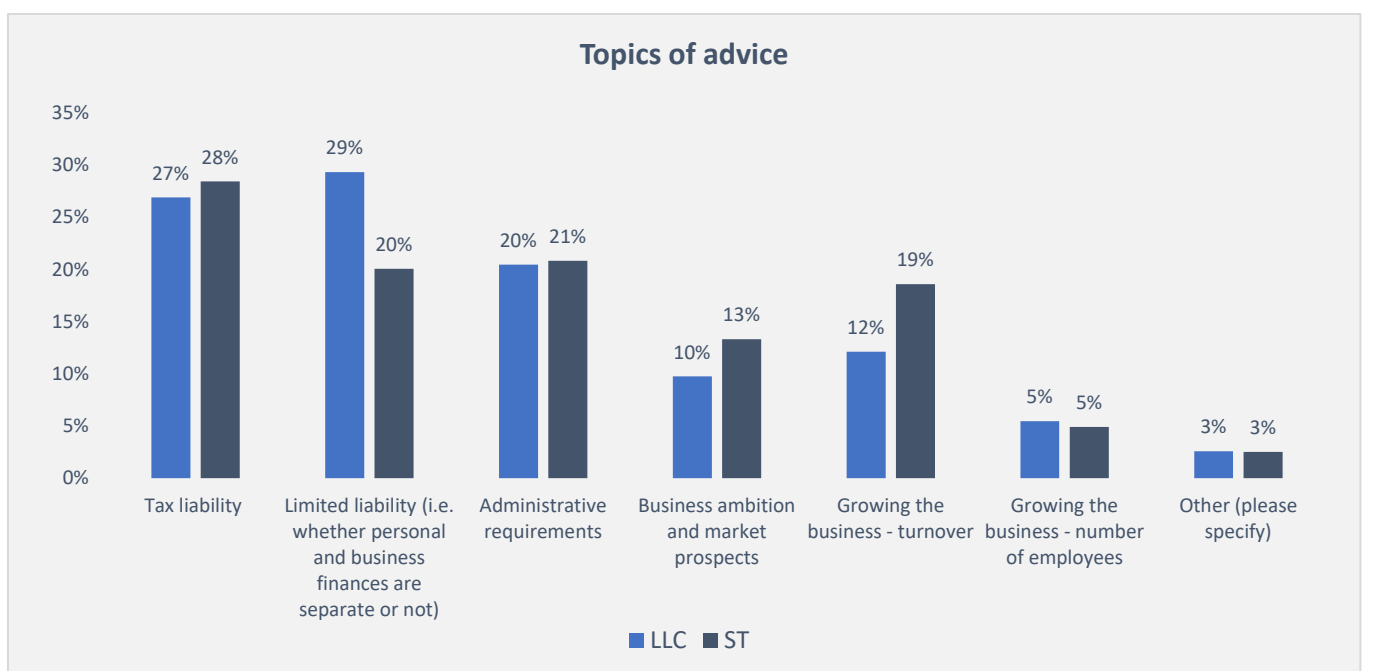


Figure 4.6 Topics of advice sought (n = 1,530)



Respondents were also asked what the most important factors for their decision on the legal status of their business, with LLC respondent’s top factors presented in Figure 4.7 and ST respondents top factors presented in Figure 4.8. A range of factors are considered important for LLC business owners, with protection of personal finances (i.e. limited liability), making it easier to secure contracts and opportunities to grow the business being the most frequently chosen. The top factors are primarily related to operation of their business and maximising their ability to succeed. A different range of factors are considered important by ST business owners, with being own boss, work life balance, being the most relevant structure, ease of setting up business, and keeping all profit being the most frequently chosen. Notably in comparison with LLC business owners, these factors are more related to quality of life and ease of doing business.

Figure 4.7 Important factors for operating as an LLC (n = 713)

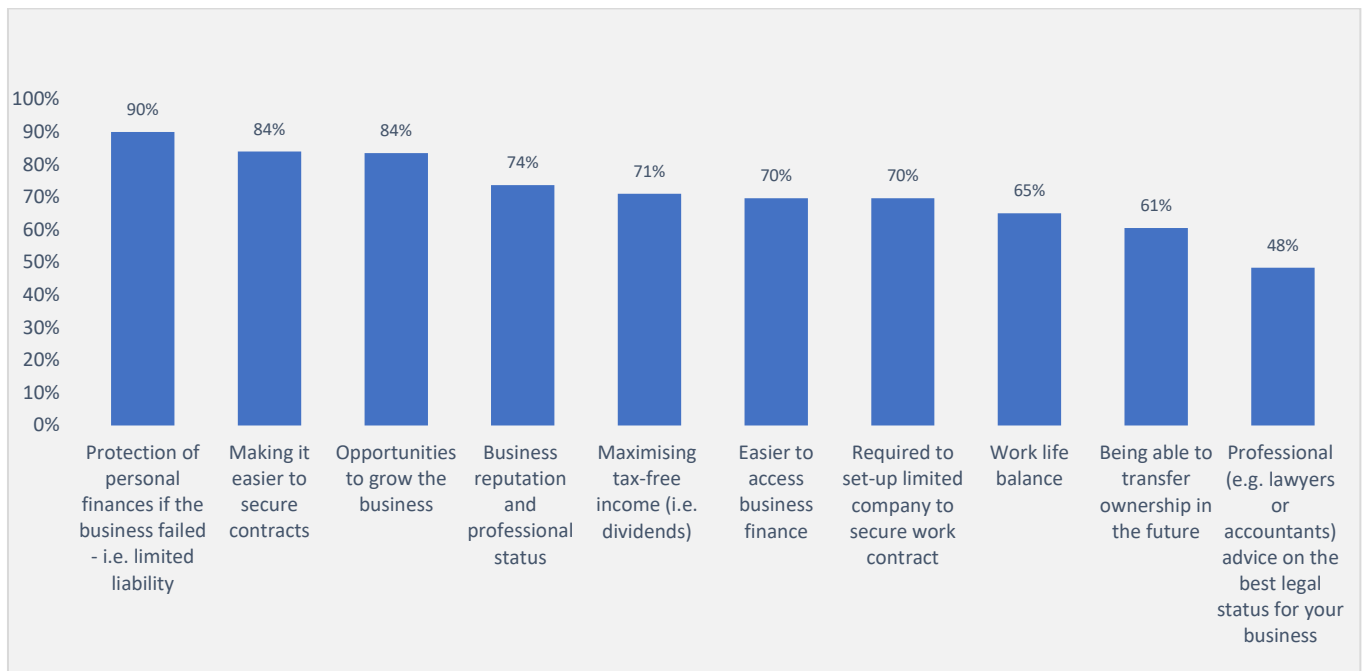
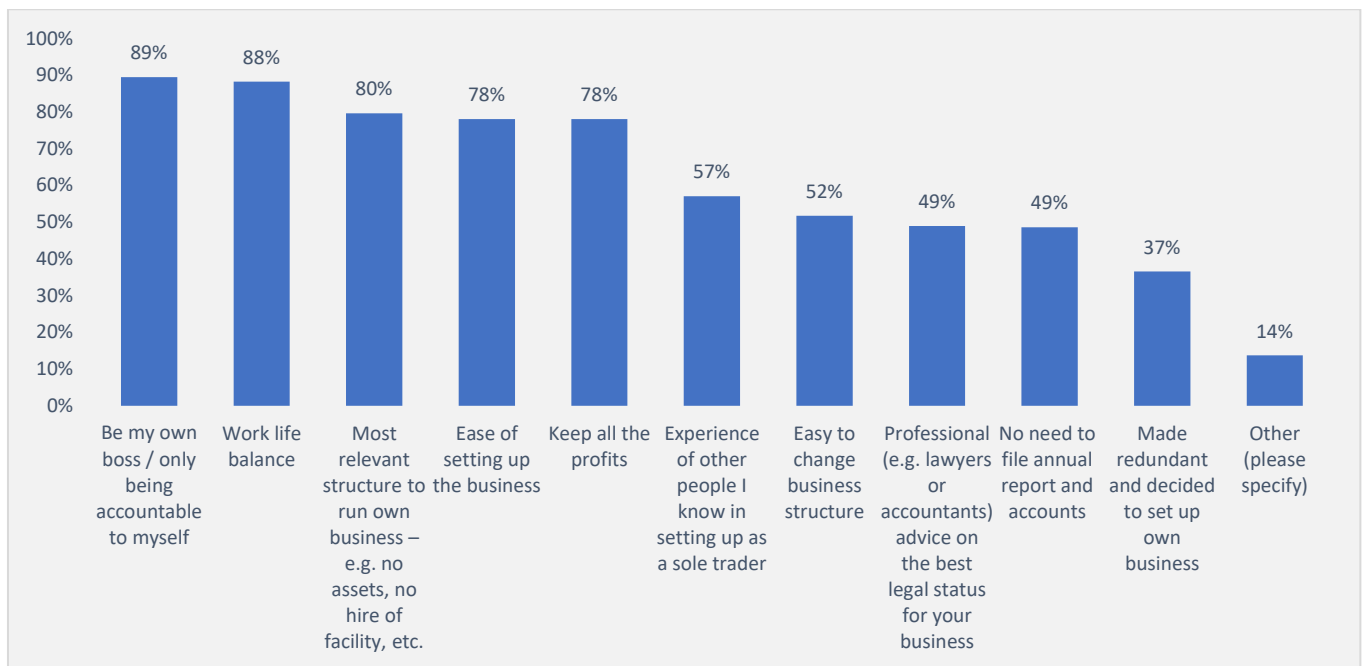
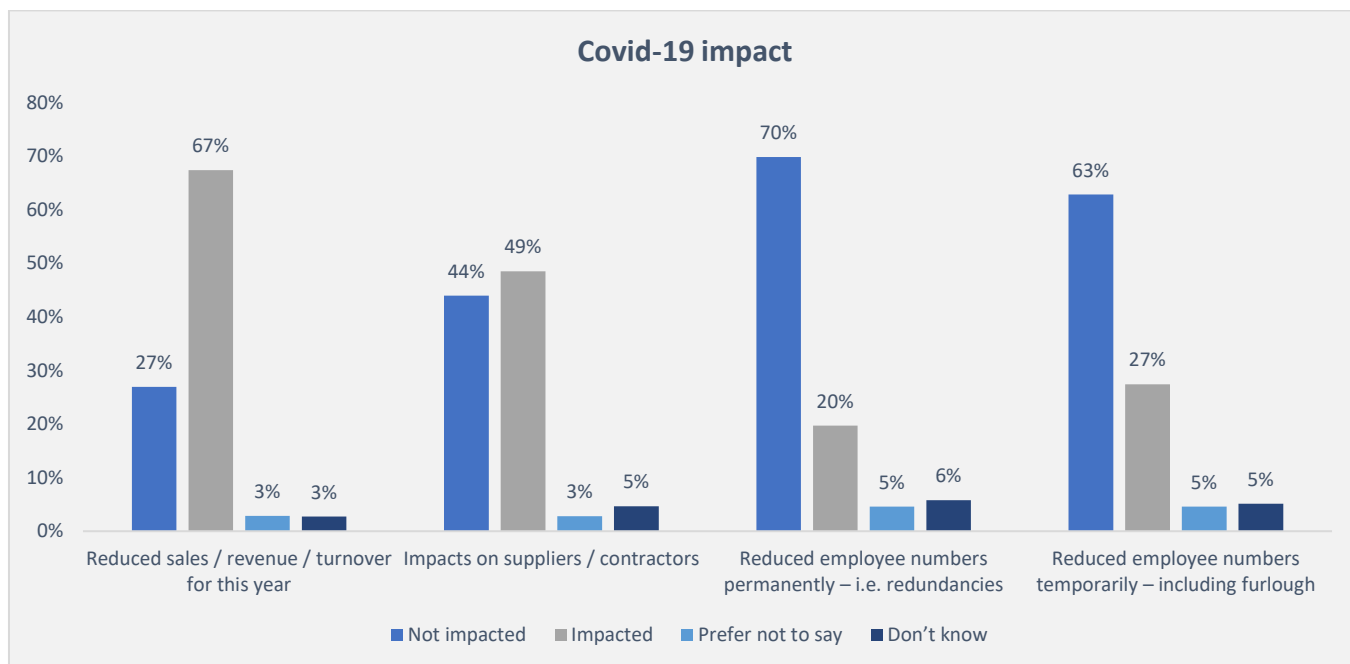


Figure 4.8 Important factors for operating as an ST (n = 817)



COVID-19

During the study period (spring 2020 to spring 2021) the COVID-19 pandemic and its impact on the economy were significant. The survey was designed to mitigate the impact of COVID-19 on the choice task by focusing respondents on the longer-term implications of their choices. Nevertheless, as indicated in Figure 4.9 most respondents were impacted in some way by the pandemic. Two thirds had experienced reduced revenue, while half had experienced impact on suppliers or contractors. A smaller proportion had reduced employee numbers permanently or temporarily, although these were in the minority. Our analysis considers whether being impacted by COVID-19 has an effect on the reported value of incorporation (Section 4.3).

Figure 4.9 Impact of COVID-19 (n = 1,530)

4.3 Choice model analysis

The choice task (DCE) responses are analysed in discrete choice models that examine how respondents selected their preferred option (Option A, B, or C) in each repeated choice. As detailed in Section 3, the alternative options presented to respondents (Options A and B) featured varying profiles of legal status for a business, including with and without limited liability and different annual fee amounts. For LLC respondents the ‘fixed’ option in the choice (Option C) presented a feasible alternative (operate as sole trader; no cost), whilst for ST respondents it represented a status quo option (ST; no change).

The discrete choice model estimations quantify respondents’ preferences for different aspects of company incorporation, based on the likelihood of a respondent selecting an option as a function of the choice task attribute levels. Overall, the analysis examines business owner demand for incorporation by identifying how the different characteristics of business status influenced the simulated market choices.

The discrete choice model analysis provides a series of results:

- (a) Business owner preferences for company incorporation;
- (b) The value of incorporation to business owners in term of willingness to pay (WTP) for the attributes of legal status, including limited liability; and
- (c) Predicted shares that estimate demand for incorporation at different “price points” (i.e. business registration fee).

In accordance with the sampling approach, the main results are segmented according to legal status (LLC; ST) and company size (no. employees). A wider set of results are also provided for specific business owner and business characteristics.

Choice model estimation

The choice model estimation used is a mixed logit (MXL) model specification. The MXL model is an extension of the basic conditional logit (CL) specification that is the standard model estimation for DCE data¹⁴. The MXL model allows for variation in the intensity of preferences between respondents (preference heterogeneity), which in practical terms examines the extent to which different business owners have stronger or weaker preference for different aspects of company incorporation (compared to the average sample result). Formally the model allows for parameter estimates to vary over respondents according to some distribution reflecting their individual tastes.

The primary interpretation of the choice model estimations is based on: (a) the sign (positive/negative) of the estimated coefficients for each explanatory variable (the company incorporation attributes); and (b) their statistical significance. In combination, this indicates how respondents' choices were influenced by the levels of the attributes presented in the choice task.

The main expectations for the choice model results are:

- *Annual fee for business registration*: the coefficient estimate has a negative sign and is statistically significant. This would indicate that business owner preferences are constrained by the cost of incorporation and as the fee level increases fewer business owners opt for incorporation.
- *Change in tax paid*: like the cost attribute a negative and statistically significant coefficient estimate is expected for the business owner's tax liability. Options that increase the tax liability for respondents are not expected to be preferred (all else being equal).
- *Limited liability status*: it is reasonable to expect a positive sign and statistically significant coefficient estimate, which would signal that business owners prefer limited liability, since this is beneficial in protecting their personal finances. The strength of preference may, though, vary between LLC and ST respondents.
- *Company name registration*: this should also be preferred by business owners – signified by a positive sign and statistically significant coefficient estimate - as it implies protection of the business name and reputation.
- *Public record*: prior expectations are ambiguous for the requirement to file business records since business owners could view this as an overall advantage (e.g. legitimacy of a business) or overall disadvantage (e.g. administrative burden). As such, the estimation results and strength of preference could vary by segments (LLC vs. ST; no. of employees).

The model estimation also includes an alternative specific constant (ASC) parameter. In the ST segment model estimations, the ASC quantifies the (additional) weight that respondents placed on the status quo option (Option C) and no change from their current situation. For ST respondents the ASC parameter therefore captures any potential status quo effect – i.e. the additional weight assigned to remaining as a sole trader (assuming a positive sign and statistically significant coefficient estimate). For LLC respondents Option C represented a

¹⁴ The limitation of the CL model is that it is based on some practical but restrictive assumptions about individuals' preferences. In contrast the MXL specification relaxes these assumptions, for example by allowing preferences to vary across observed characteristics.

feasible alternative; hence the ASC in the LLC segment model estimations captures any (additional) disbenefit from being “forced” away from LLC status to ST status (assuming a negative sign and statistically significant coefficient estimate).

The final set of coefficient estimates featured in the MXL model estimation are the standard deviation (s.d.) parameters that summarise the distribution of business owner preferences around the average result in accordance with the preference heterogeneity assumption highlighted above. A statistically significant standard deviation parameter estimate signals that there is variation in the intensity of preference across respondents¹⁵.

Business owner preferences for company incorporation – LLC respondents

Table 4.2 presents the MXL model estimation results for the LLC respondents. Three separate estimations are summarised according to the company size segments (0 employees, 1-4 employees, and 5-9 employees)¹⁶. Each segment model estimation is robust in terms of overall explanatory power (fit to the data) and the statistical significance of the key parameter estimates.

Table 4.2: Choice model estimation – LLC segments by company size (no. employees)

	0 employees	1 – 4 employees	5 – 9 employees
Limited liability	2.922***	2.759***	1.742***
Public record	0.068	-0.028	0.027
Change in tax paid	-0.0003***	-0.0002***	-0.0001***
Company name registration	0.895***	0.615***	0.324**
Annual fee for business registration	-0.001***	-0.001***	-0.0003***
ASC (sole trader)	-0.973***	-2.537***	-2.397***
s.d. Limited liability	2.449***	2.203***	1.878***
s.d. Public record	0.915***	-0.310	-0.436**
s.d. Change in tax paid	0.0003***	0.0002***	-0.0001
s.d. Company name registration	1.131***	1.041***	0.631***
s.d. ASC (sole trader)	2.102***	-3.210***	-3.188***
No. observations	5,454	9,315	4,482
Pseudo R2	0.48	0.50	0.40

¹⁵ Note that the sign of the standard deviation parameter estimate (positive or negative) is not relevant to interpretation with respect to the preference heterogeneity. It is the statistical significance (or otherwise) of the coefficient estimates that signifies the degree of variation around the average result.

¹⁶ Statistical tests (LR test) indicated that the LLC sub-samples should not be pooled into a single model, since the intensity of preference for company incorporation differs across the three company size segments. This confirms the expectation that informed the stratification of the sample.

Notes: MXL model specification. Full results reported in Annex 6. * denotes statistically significant at the 10% level; ** denotes statistically significant at the 5% level; *** denotes statistically significant at the 1% level.

Findings are in line with prior expectations and the results are consistent across the three LLC segments. The main observations are:

- *Limited liability status*: the coefficient estimate for each segment is positive and statistically significant (at the 1% level). This means that - all else equal - LLC respondents preferred options that offered limited liability compared to those that did not.
- *Public record*: the coefficient estimate for each segment is not statistically significant. This signifies that LLC respondents were largely ambivalent to filing requirements and making company records public - i.e. this was not perceived as either an advantage or disadvantage of a given legal status for a business and therefore did not strongly influence choices between alternative options.
- *Company name registration*: the coefficient estimate for each segment is positive and statistically significant (at the 1% level for 0 and 1-4 employees; and the 5% level for 5-9 employees). This means that - all else equal - LLC respondents preferred options that offered protection of the business name compared to those that did not.
- *Change in tax paid*: the coefficient estimate for each segment is negative and statistically significant (at the 1% level). This means that - all else equal - LLC respondents preferred options that offered a reduction in tax liability.
- *Annual fee for business registration*: the coefficient estimate for each segment is negative and statistically significant (at the 1% level). This means that - all else equal - LLC respondents preferred options that offered a lower fee level for annual business registration.
- *Alternative specific constant (ASC) parameter*: the coefficient estimate for each segment is negative and statistically significant (at the 1% level). This means that for LLC respondents there was a disbenefit in being “forced” to switch to sole trader status even in a supposed circumstance where it offered the same attribute levels as LLC status. In effect, this reflects the weight that LLC respondents placed on retaining their current legal status beyond the benefits gained from limited liability, protection of company name and current tax status.
- *Standard deviation (s.d.) parameters*: in line with expectations most of the s.d. parameters for each segment are statistically significant (at the 1% level). This indicates that there is a varying intensity of preference from LLC respondents to the company incorporation attributes – i.e. some with stronger/weaker preference than the average results. One exception is for the change in tax paid for the 5-9 employee segment, where the coefficient estimate is not statistically significant. This signifies that LLC respondents in this segment had a similar intensity of preference as measured by the average result. The only other exception is the coefficient estimate for the public record requirement for the 1-4 employee segment, which has the same interpretation.

Business owner preferences for company incorporation – ST respondents

Table 4.3 presents the equivalent MXL model estimation results for the ST respondents. Two separate estimations are summarised according to the business size segments (0 employees,

1+ employees¹⁷. Each segment model estimation is robust in terms of overall explanatory power (fit to the data) and all parameter estimates are highly statistically significant (at the 1% level).

Table 4.3: Choice model estimation – ST segments by company size (no. employees)

	0 employees	1 – 4 employees
Limited liability	1.240***	0.559***
Public record	-0.417***	-0.148***
Change in tax paid	-0.368***	-0.141***
Company name registration	0.968***	0.375***
Annual fee for business registration	-0.002***	-0.0003***
ASC (sole trader)	3.694***	1.905***
s.d. Limited liability	-1.260***	0.806***
s.d. Public record	0.908***	-0.433***
s.d. Change in tax paid	0.378***	0.231***
s.d. Company name registration	0.917***	1.125***
s.d. ASC (sole trader)	3.503***	3.724***
No. observations	9,639	12,420
Pseudo R2	0.52	0.47

Notes: MXL model specification. Full results reported in Annex 6 * denotes statistically significant at the 10% level; ** denotes statistically significant at the 5% level; *** denotes statistically significant at the 1% level.

For the most part, the interpretation of the ST segment model results is the same as for the LLC segments:

- *Limited liability status*: the coefficient estimate for each segment is positive and statistically significant (at the 1% level). This means that - all else equal – ST respondents preferred options that offered limited liability compared to those that did not.
- *Public record*: the results for ST respondents for the public record are the one of the two observed differences in comparison to LLC results. Whereas LLC respondents were

¹⁷ As with the LLC analysis, statistical tests (LR test) indicated that the ST sub-samples should not be pooled into a single model, since the intensity of preference for company incorporation differs across the two business size segments.

largely ambivalent to filing requirements, there is a clear negative preference from ST respondents. For both ST segments the coefficient estimate is negative and statistically significant (at the 1% level), indicating that a public filing requirement was viewed as a disbenefit of company incorporation by ST respondents.

- *Company name registration*: the coefficient estimate for both ST segments is positive and statistically significant (at the 1% level). This means that - all else equal - ST respondents preferred options that offered protection of the business name compared to those that did not.
- *Change in tax paid*: the coefficient estimate for both ST segments is negative and statistically significant (at the 1% level). This means that - all else equal - ST respondents preferred options that offered a reduction in tax liability.
- *Annual fee for business registration*: the coefficient estimate for each segment is negative and statistically significant (at the 1% level). This means that - all else equal - ST respondents preferred options that offered a lower fee level for annual business registration.
- *Alternative specific constant (ASC) parameter*: the coefficient estimate for both ST segments is positive and statistically significant (at the 1% level). This means that for ST respondents there was an added benefit to retaining their current legal status – i.e. a status quo effect. This is discussed further below as part of the validity testing assessment for the choice model results¹⁸.
- *Standard deviation (s.d.) parameters*: all of the s.d. parameters for the two ST segments are statistically significant (at the 1% level). This indicates that there is a varying intensity of preference from ST respondents to the company incorporation attributes – i.e. some with stronger/weaker preference than the average results.

Validity of choice model results

The two main aspects for assessing the validity of stated preference studies are ‘content validity’ and ‘construct validity’. These considerations cover both the main empirical results from the study (the choice model analysis) and wider considerations in relation to respondent understanding and the motivations for their responses. The peer review commentary states that: *“From the reported statistics, content validity seems to have been satisfied: other studies have related similar statistics on the easy and difficulty of responding to the choice tasks. Construct validity is also satisfied, with coefficients having the right sign, being highly statistically significant across almost all the coefficients”*. The full peer review commentary on the research approach, survey design and the validity of the results is provided in Appendix 7.

¹⁸ There are multiple explanations for status quo effects and whether these represent rational or irrational preferences on the part of individuals. For example, lack of familiarity with company incorporation might cause ST business owners to be reluctant to “switch” from their current status. This could also be interpreted as an inertia or endowment effect. There is also the potential for a status quo effect to be induced by the survey design – for example due to the choice task and trade-offs being too complex and the respondent resorting to a simplifying choice heuristic (i.e. always choosing the no change option). If survey design effects are present, though, it would be reasonable to expect similar results for the ASC across the ST and LLC segments. Follow-up questions in the survey probed this issue as part of the assessment of content validity and examining the motivations underlying respondent’s choices.

Construct validity

Construct validity is primarily concerned with the robustness of the choice models and how well they explain business owner preferences based on reasonable expectations:

- Model estimates: all results are in line with reasonable prior expectations, and across the LLC and ST segments coefficient estimates have the expected sign – where relevant - and are found to be statistically significant at the 1% level. Overall, respondent choices were constrained by the cost attribute (incorporation fee) and were sensitive to limited liability status and tax implications. The observed difference in preference between LLC and ST respondents shows that administrative burden is potentially a barrier to incorporation for ST business owners – but this finding does need to be interpreted in light of the wider study results. In particular, the observed status quo effect for ST respondents, which has an overall greater influence on the preference for company incorporation than the administrative burden (see below). In contrast the view of LLC business owners – who have experience of the filing requirement – is more neutral, with no apparent view of it being either a benefit or disbenefit of company incorporation.
- Status quo effect for ST respondents: observation of systematic effects in stated preference choice task responses – such as a status quo effect - can be an indicator of poor survey design and low validity of results. A variety of motivations, though, can underlie such results reflecting a mix of valid reasons (respondent preferences) and potential response biases. The overall study results, including findings from the cognitive testing, pilot survey, and responses to wider questions in the main survey (see below), indicate strongly that observed effect is due to valid reasons and there are no obvious concerns in relation to survey design issues.
- Follow-up questions to the choice tasks probed respondents' reasons for their choices, including ST respondents who selected the status quo option (Option C; no change) in most of their responses¹⁹. Results are summarised in Table 4.4.

Table 4.4: Reasons for selecting status quo option (no change) – ST (n = 446)

	n	%
Operating as a sole trader is the best option for my business	282	63%
I think I am better off financially as a sole trader	62	14%
I think I would pay less tax as a sole trader	9	2%
The requirement to file annual accounts and company information would be too much effort	11	2%
Limited liability legal status would not benefit me or my business	13	3%
I object to paying money to register my business	10	2%
I don't think that business owners should pay to get limited liability status	4	1%

¹⁹ This question was asked to respondents if they selected the status quo option six or more times (out of 9 choices in total).

I would have liked to chosen options with limited liability status but the fee was too much	11	2%
The alternative options shown were not relevant to me and my business	30	7%
The alternative options shown were not credible	7	2%
Other (please state)	7	2%

Overall, for the ST sub-sample, 446 respondents (approx. 55% of all ST respondents) selected the status quo option in six or more of their 9 choices. Most of these respondents reported that they most frequently choose the status quo option because it was the best choice for their business (63%; 282 respondents)²⁰. A further 14% (62 respondents) stated that they would be better off financially as a sole trader. Very few respondents stated reasons that indicate survey-induced effects (lack of credibility) or protest-type responses (a rejection of the simulated market setting). These results provide assurance the observed status quo effect for ST can be attributed to a valid reason, such as the importance of wider lifestyle and convenience factors drawn out in the perceptions and experience responses (e.g. “being my own boss” – see Figure 4.8).

Content validity

While the choice model analysis demonstrates that the LLC and ST respondents provided valid responses to the choice tasks – i.e. respondents’ choices can be satisfactorily explained, and they are consistent with reasonable prior expectations – it is also important to examine wider aspects of the survey.

The assessment of the content validity is a more qualitative exercise and draws on both the survey design and testing process, and responses to the follow-up ‘diagnostic’ questions in the survey. The follow-up questions are intended to aid the interpretation of the choice model results and provide a basis for further assessing the study’s validity in terms of respondent understanding and motivations for their choices. This includes considerations such as the perceived credibility of the survey and the cognitive burden imposed on respondents in the choice tasks (i.e. respondent understanding):

- *Feedback from survey design and testing:* The survey design and testing stage provided the first opportunity to assess respondent understanding and engagement with the survey and choice tasks (Appendix 2). Whilst the primary objective of testing is to develop the survey materials, it also provides insight on how and why users answered questions, which helps to validate the subsequent choice model results. Overall, there was a good understanding of the survey purpose and a strong level of engagement in the survey materials leading to considered responses in the survey.
- *Ease/difficulty of choice tasks:* Table 4.5 summarises respondent feedback on the ease/difficulty of the choice task. Overall, most respondents stated that it was either ‘very easy’ or ‘fairly easy’ (69%; pooled sampled). A relatively small proportion stated that the choice task was ‘fairly difficult’ (13%). Very few – just 3% (39 respondents overall – stated that the choice task was ‘very difficult’.

²⁰ This is approximately one-third of all ST respondents (35% of 817).

Table 4.5: Easy or difficulty of the choice task (n=1,530)

	LLC		ST		Overall	
	n	%	n	%	n	%
Very easy	150	21%	237	29%	387	25%
Fairly easy	294	41%	374	46%	668	44%
Neither easy nor difficult	124	17%	114	14%	238	16%
Fairly difficult	116	16%	82	10%	198	13%
Very difficult	29	4%	10	1%	39	3%
Don't know / prefer not to say	150	21%	237	29%	387	25%

Respondents who stated that the choice task was either 'fairly difficult' or 'very difficult' (n=237; 16% overall) were asked a follow-up question to gauge why the exercise was challenging. The largest proportion of LLC and ST respondents (43%; 102 respondents) stated that it was difficult to decide which option they preferred for their business; i.e. weighing up the alternative options, attribute levels and associated cost. This is to be expected, since the DCE format can present respondents with challenging trade-offs; hence respondents stating that the choices were fairly difficult likely reflects the effort and consideration they gave to the survey, rather than an inherent difficulty in understanding the requirement of the choice task.

A small number of respondents did state that the options shown were not credible for their business (23%; 55 respondents). The larger share of these respondents were LLC business owners (39 respondents) rather than ST business owners (16 respondents). Overall, though, these respondents represent just 4% of the total sample and hence this level of feedback should not be a significant concern with respect to the quality of stated preference data and validity of the choice task responses. Similarly, very few LLC or ST respondents stated that not enough information was provided to make a choice (12%; 28 respondents) or that the instructions for the choice task were not clear (9%; 21 respondents).

- *Motivation for choice task responses*: responses to follow-up questions regarding the importance of each attribute to respondent choices are largely consistent with the model estimation results (Annex 5). Most LLC respondents stated that limited liability was very important or quite important in their choices (94%), followed by change in tax (79%), annual fee (77%), business name registration (62%) and public record (51%). Conversely, public record was identified most frequently by LLC respondents as either being not very important or not important at all to their choices (48%). This underlines the model estimation results that found that the public record requirement on average did not drive preferences with respect to company incorporation choices.

For ST respondents a slightly different pattern of responses is observed, where the majority stated that the annual fee was very important or quite important in their choices (78%), followed by change in tax (74%), limited liability (60%), public record (51%) and business name registration (44%). This places the cost attributes (fee and tax) over the

specific features of company incorporation in terms of respondents self-reporting of what drove their choices.

- *Consequentiality of responses*: feedback in relation to the perceived credibility of the survey were for the most part neutral or positive (Figure 4.10 and Figure 4.11). The largest proportion of LLC respondents stated that they thought their responses to the survey would influence the options that are available to set up and run a company (53%; likely or very likely). This was also the case for ST respondents although just under half respondents provided this view (48%; likely or very likely). Views were more mixed for both LLC and ST respondents as to whether the survey results would lead to changes to what business owners pay to set up and run a company – roughly an even balance between positive and negative views (i.e. that their responses were unlikely to influence decisions or result in changes).

Figure 4.10 Views on consequentiality of survey responses (ST) (n = 817)

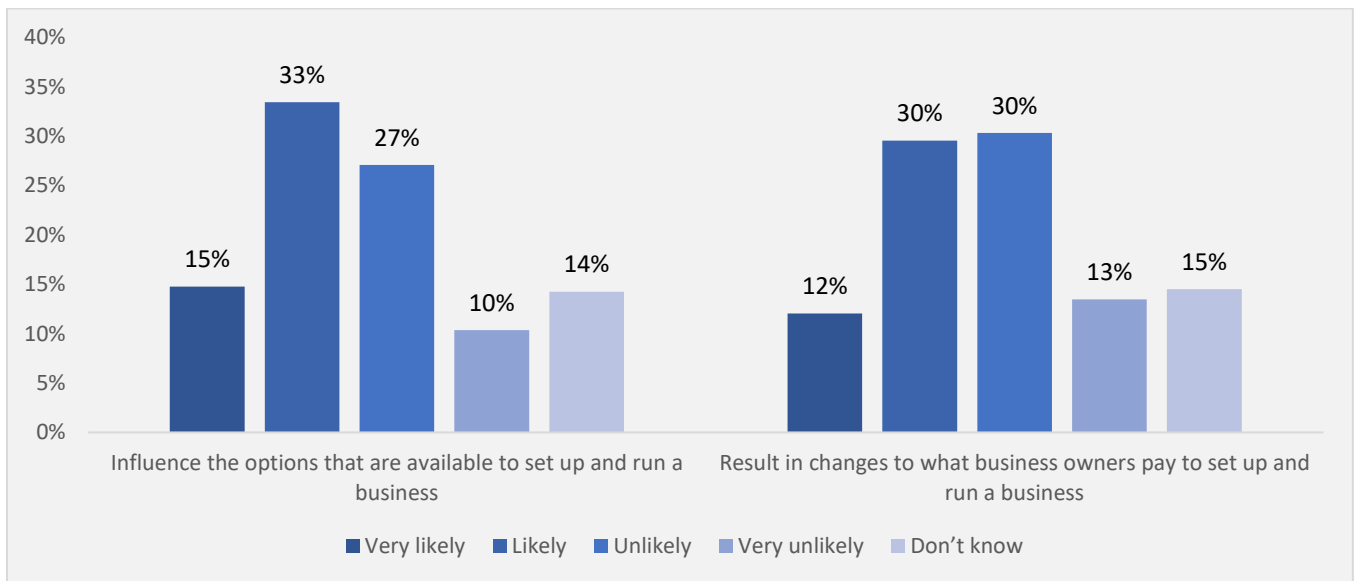
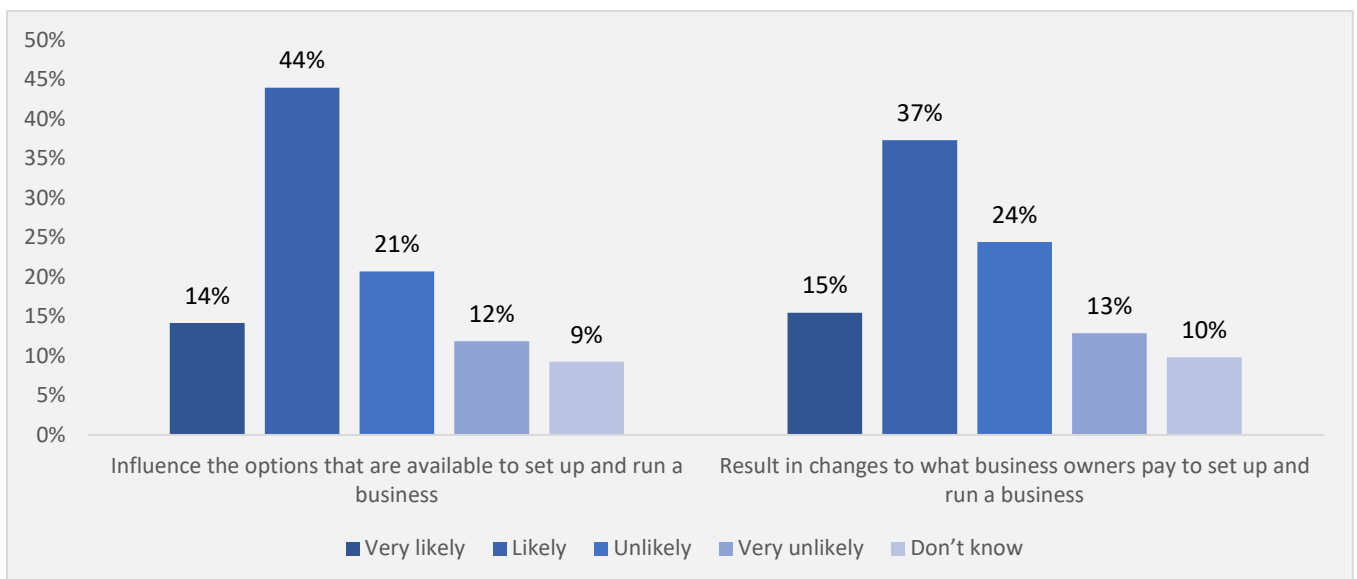


Figure 4.11 Views on consequentiality of survey responses (LLC) (n = 713)



A follow-up question was asked to respondents who provide a negative view (unlikely or very unlikely) to either of the above aspects on the consequentiality of their responses, to understand the reason why). In total this amounted to 691 respondents (45% of the overall sample). Table 4.6 presents reasons for their negative sentiment, the number of respondents indicating each reason, and the corresponding % for this reason both amongst respondents who had a negative view versus all survey respondents.

Table 4.6: Reasons for negative sentiment on consequentiality of survey responses for those that responded negatively (n= 691) and compared to the total sample (n=1,530)

	LLC			ST			Overall		
	<i>n</i>	<i>% of neg.</i>	<i>% of all</i>	<i>n</i>	<i>% of neg.</i>	<i>% of all</i>	<i>n</i>	<i>% of neg.</i>	<i>% of all</i>
The survey presents choices which are not realistic	94	31%	13%	41	11%	5%	135	20%	9%
The purpose and content of the survey is not credible	30	10%	4%	25	6%	3%	55	8%	4%
As an individual my responses don't have a real impact on decision-making	146	48%	20%	206	54%	25%	352	51%	23%
The government doesn't listen to business owners like me when making decisions	186	61%	26%	179	46%	22%	365	53%	24%
Other (please state)	26	8%	4%	23	6%	3%	49	7%	3%
Don't know	4	1%	1%	21	5%	3%	25	4%	2%

Responses show that the negative sentiment towards the consequentiality of survey responses is primarily attributable to scepticism over policy making processes (53% of those with negative sentiment; 24% of the total sample) and the influence the views of individuals have (51%; 23% of the total sample), rather than the credibility of the choices (20%; 9%) and the survey purpose, content, or choice task (8%;4%). Overall, this provides reassurance that respondents perceived the simulated choices as credible and provided considered choices. Respondents' views on the overall survey are reported in Table 4.7.

Table 4.7 Overall respondent feedback on the survey (n=1,530)

	No. responses	% of all survey respondents
Interesting	995	65%
Easy	407	27%
Too long	189	12%
Difficult to understand	92	6%
Educational	370	24%
Unrealistic / not credible	70	5%
Other (please state)	36	2%

None of these	34	2%
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Note: respondents could select multiple response options.

The largest proportion respondents stated that the survey was interesting (65%), indicating a good level of engagement across the sample. A number also indicated that the survey was educational (24%). Finally, consistent with other findings outlined above, very few respondents stated the survey was difficult to understand (6%) and/or that it was unrealistic/not credible (5%). Overall, respondents have a mainly positive view of the survey in terms of its relevance, usefulness, and comprehensibility.

Value of company incorporation

LLC and ST business owner willingness to pay

The value of incorporation is estimated in terms of business owner willingness to pay (WTP) for the company incorporation attributes presented in the choice task²¹. Unit value estimates are reported in Table 4.8.

Table 4.8: Value of company incorporation – mean (average) WTP per year (£/year/business)

	LLC 0 employees	LLC 1-4 employees	LLC 5-9 employees	ST 0 employees	ST 1+ employees
Limited liability	£3,070 (£2,440 - £3,700)	£5,220 (£4,230 - £6,210)	£6,710 (£3,990 - £9,420)	£820 (£580 - £1,060)	£2,110 (£1,260 - £2,950)
Public record	-	-	-	-£280 (-£470 - -£90)	-£560 (-£1,080 - -£30)
Company name Registration	£940 (£530 - £1,350)	£1,160 (£630 - £1,690)	£1,250 (£20 - £2,470)	£640 (£420 - £860)	£1,410 (£530 - £2,300)
Total value of incorporation	£4,010 (£2,970 - £5,050)	£6,380 (£4,860 - £7,900)	£7,950 (£4,010 - £11,890)	£1,180 (£530 - £1,830)	£2,960 (£710 - 5,220)

Notes: All values are rounded to the nearest £10. Lower – upper bounds reported in parenthesis as 95% confidence interval.

²¹ Individual level WTP (£ per business per year) is calculated as: $WTP = -\beta(x) / \beta(\text{fee})$, where x is the attribute level (e.g. limited liability) and β is the estimated coefficient for the respective attribute from the choice model estimation (see model results). Note that tax attribute in the choice task is used as a control in the model so that other attributes are estimated independent of the (expected) tax liability effect for business owners. It is not included as an attribute of the company incorporation “good”.

For LLC respondents, mean (average) WTP for *company incorporation* overall ranges from approximately £4,000 per business per year for companies with zero employees to approximately £8,000 per business per year for companies with 5-9 employees. Across the three LLC segments, around 80% of the value assigned to company incorporation is attributed to limited liability (77% for 0 employees; 81% for 1-4 employees; 84% for 5-9 employees). In line with the choice model estimation results (Table 4.9), no value is assigned to public record requirements.

The difference in WTP for *limited liability* between the 0 employee segment (approx. £3,100/business/year) and 1-4 employee segment (approx. £5,200/business/year) is statistically significant - as signified by the non-overlapping 95% confidence intervals. Although the mean average values for limited liability are notably different (approx. £5,000/business/year vs. approx. £6,700/business/year, respectively), the same conclusion cannot be drawn for the difference between the 1-4 employee segment and the 5-9 employee segment. However, whilst the respective 95% confidence interval overlap, it is reasonable to interpret this as an issue of precision due to the smaller sample size achieved for the larger company segment; hence wider uncertainty band around the central WTP estimate for limited liability.

Reassuringly, mean (average) WTP for ST respondents for company incorporation is lower for ST respondents in comparison to the LLC results. It ranges between approximately £1,200 per business per year for the 0 employee segment and approximately £3,000 per business per year for the 1+ employee segment. In relative terms, less weight is assigned to limited liability (69% 0 employees; 70% 1+ employees) compared to the LLC results. WTP for limited liability is approximately £800 per business per year for the 0 employee segment and approximately £2,100 per business per year for the 1+ employee segment. Accordingly, company name registration accounts for a larger proportion of overall WTP. In addition, in line with the choice model estimation results, WTP for the public record requirement is negative (approx. -£300 to -£600/business/year), signifying it is a disbenefit to ST business owners – i.e. this is amount business owners would need to be compensated for annual filings.

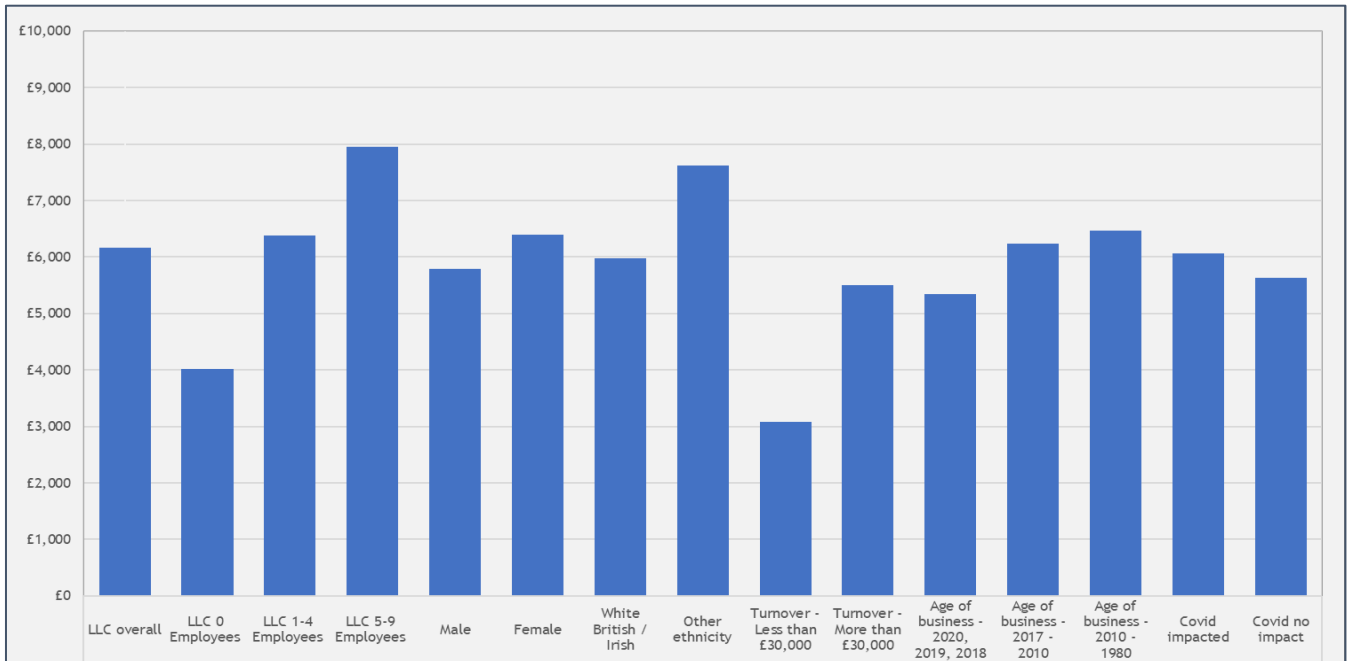
Comparison of willingness to pay for company incorporation by segments²²

Figure 4.10 compares the WTP estimates for company incorporation for the main LLC sample segments to a wider breakdown of business owner and business characteristics. The respective sample size for each segment are between 114 and 599 respondents.

The overall value of company incorporation is relatively consistent across the different segment. For example, there is minimal distinction in WTP between male and female business owners, or in relation to the age of the business. The clearest distinction is for company size in terms of turnover (less than £30k vs. more £30k), which largely represents the pattern in WTP shown in the main results relating to company size by number of employees. Encouragingly this suggests that the value of company incorporation is subject to a budget constraint (i.e. company turnover as a proxy). This provides added assurance to the conclusions drawn in the preceding section as to the validity of the research results.

²² Note that the WTP estimates presented in this section (Figure 4.10, Figure 4.11 and Table 4.9) are calculated from supplementary sub-sample model estimations. The respective sub-samples are relatively small and whilst in general the model estimates are in line with expectations, the precision of parameter estimates and consequently WTP values is lower compared to the main study results. Results should therefore be interpreted as indicative of general patterns in relative values for company incorporation.

Figure 4.10: Comparison of WTP for company incorporation - by business owner and business characteristics – LLCs (£/year/business)



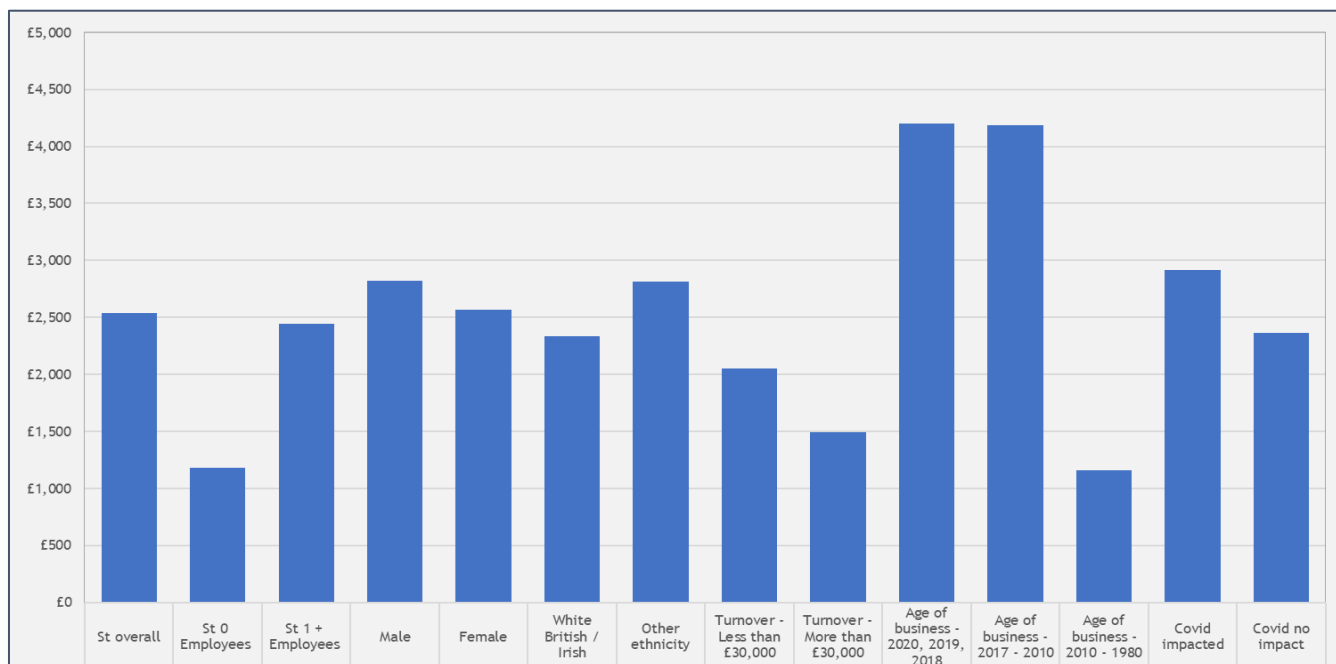
Notes: Sample sizes (n). LLC overall = 713; LLC 0 employees = 202; LLC 1-4 employees = 345; LLC 5-9 employees = 166; Male = 468; Female = 235; White British / Irish = 599; Other ethnicity = 114; Turnover less than £30k = 188; Turnover greater than £30k = 525; Age of business 2020, 2019, 2018 = 139; Age of business 2010 – 2017 = 328; Age of business 1980 - 2010 = 231; COVID impacted = 460; COVID no impact = 253.

Equivalent comparative results are shown in Figure 4.11 for ST business owner WTP for incorporation. Sample sizes are between 114 and 702 respondents for each segment.

Generally, there is a similar level of consistency in the estimates, although the effect with respect to company turnover as a constraint is less marked. Instead, the result is more distinct in the comparison of WTP by company size based on number of employees as well as the age of the business, with business owners who set up their business between 2010 and 2020 placing greater value on incorporation than owners of more established businesses set up prior to 2010.

Note that in both the LLC and ST segments, those impacted by COVID-19 and those not impacted by COVID-19 have similar WTP values, indicating that respondents took a longer-term perspective when making their choices.

Figure 4.11: Comparison of WTP for company incorporation - by business owner and business characteristics – STs (£/year/business)



Notes: Sample sizes (n). ST overall = 817; ST 0 employees = 357; ST 1+ employees = 460; Male = 410; Female = 397; White British / Irish = 702; Other ethnicity = 114; Turnover less than £30k = 555; Turnover greater than £30k = 262; Age of business 2020,2019, 2018 = 223; Age of business 2010 – 2017 = 336; Age of business 1980 to 2010 = 253; COVID impacted = 455; COVID no impact = 362.

Willingness to pay for company incorporation – business owners who have switched legal status

The overall sample included a number of business owners who indicated that they had switched legal status either from operating as an LLC to a ST (n=63), or from operating as an ST to a LLC (n=74). Strictly the respective sample sizes for “switchers” are too small to estimate reliable results for, but nevertheless it is informative to examine the value placed on company incorporation by these respondents since they have “observed” experience of both a LLC and ST (Table 4.9). The current LLC (but former ST) value is in line with the overall LLC value for company incorporation. The ST current (but former LLC) value is higher than both the 0 employee and 1+ employee valuation for incorporation, potentially suggesting a greater appreciation for the benefits of company incorporation, despite having switched to ST.

Table 4.9: Comparison of the value of company incorporation for business owners who have switched business status (£/year/business)

Business status change	WTP for company incorporation
Current ST (former LLC) (n=63)	£3,560 (£280 - £6,850)
Current LLC (former ST) (n=74)	£5,860 (£2,970 - £8,760)

Notes: All values are rounded to the nearest £10. Lower – upper bounds reported in parenthesis as 95% confidence interval.

Value of status quo - STs

A notable result in the choice model estimations for ST respondents is the status quo effect and relative weight placed on the current situation via the ASC parameter compared to alternative legal status options. This effect can be further contextualised by estimating the value of the status quo²³ (Table 4.10).

Table 4.10: Mean (average) value of status quo - ST business owners (£/year/business)

Segment	Value of status quo
ST overall (n=817)	£6,420 (£5,910 - £6,940)
ST – 0 employees (n=357)	£8,200 (£7,510 - £8,880)
ST – 1+ employees (n=397)	£5,050 (£4,320 - £5,780)
ST (former LLC) (n=63)	£1,670 (£170 - £3,500)

Notes: All values are rounded to the nearest £10. Lower – upper bounds reported in parenthesis as 95% confidence interval.

For STs, the key observation is the calculated value of the status quo is greater than the value of company incorporation (Table 4.8). Some caution is required in this interpretation since the ASC parameter can capture multiple effects (see earlier discussion). It is not possible to fully disentangle each effect to quantify the degree to which different factors contribute to the status quo preference for ST respondents. However, based on the validity testing assessment, it is reasonable to conclude that observed effect can be mainly attributed to valid reasons, such as the importance of wider lifestyle and convenience factors.

Given this, the study results suggest that overall aspects of company incorporation such as the administrative burden or (current level of the) registration fee are not the key determining factors for a reluctance on the part of a ST to incorporate. Moreover, it is reasonable to infer that modest adjustments to these requirements are unlikely to have a significant effect on the rate of incorporation from existing STs. Instead – based on additional evidence from the qualitative research and wider survey results – it is ‘lifestyle’ factors that appear to underlie the decision by many business owners to operate as a ST. Indeed, the perception from the interviews with ST business owners was that their choice of legal status meant they were able to achieve a better work-life balance and maintain control over their time than they would as an LLC. This view is backed up by the wider survey results, which found high levels of agreement

²³ The value of the status quo can be calculated from the ASC parameter estimate in the same way as individual level WTP for the company incorporation attributes (£ per business owner per year) – i.e. as: $\text{value of status quo} = -\beta(\text{ASC}) / \beta(\text{fee})$, where ASC is the alternative specific constant parameter included in the choice model estimation for the fixed choice alternative. The analysis reported here is based on supplementary analysis of choice model responses that estimates the value of the status quo for each respondent, from which the (mean) average value is calculated.

on the importance of lifestyle factors such as ‘be my own boss’, ‘work-life balance’, and ownership factors such as ‘most relevant structure’, ‘ease of setting up business’ and ‘keep all profits’. Overall, it appears that there is a significant ‘lifestyle’ aspect to operating as a ST for many individuals, which is not fully compensated for or offset by the benefits of company incorporation.

Value of status quo - LLCs

Equivalent analysis for LLC respondents shows the disbenefit of being forced to switch to ST status from their current LLC status. This can be interpreted as the value of the status quo in terms of the amount an LLC business owner would need to be compensated for if they were to switch to ST status (Table 4.11).

Table 4.11: Mean (average) value of status quo for LLC business owners (£/year/business)

Segment	Value of status quo (disbenefit of ST status)
LLC (n=713)	£3,700 (£3,420 - £3,980)
LLC – 0 employees (n=202)	£3,230 (£2,720 - £3,740)
LLC – 1-4 employees (n=345)	£3,940 (£3,550 - £4,320)
LLC – 5-9 employees (n=166)	£3,780 (£3,150 - £4,410)
LLC (former ST) (n=74)	£3,750 (£2,890 - £4,600)

Notes: All values are rounded to the nearest £10. Lower – upper bounds reported in parenthesis as 95% confidence interval.

The main observation is that the value of the status quo is consistent across LLC the business size segments, as well as for those LLCs which used to operate as STs. Again, some caution is required in interpreting the result since the ASC parameter can reflect multiple effects. For LLCs specifically an added dimension is the potential uncertainty of the ST status (i.e. a non-experienced outcome for some LLC business owners) – although largely this reinforces the interpretation that LLC respondents were reluctant to opt for ST status in the choice tasks because they placed greater weight on their current circumstances.

5. Aggregation

5.1 Overview

This section presents an estimate of the annual aggregate benefit of incorporation for the UK. The aggregate benefit estimate represents the economic welfare value to business owners, based on their demand for company incorporation. The valuation reflects the private benefits of incorporation and should be interpreted as a partial account of the total societal benefit of company incorporation. It does not capture potential wider benefits to society, for example, from greater business transparency. Nevertheless, it is reasonable to assume that business owners are best placed to estimate the value of incorporation to their business and themselves, and by aggregating this benefit across the total number of LLCs, an informative estimate of the value of incorporation to businesses across the UK can be derived.

Based on this study's results, two approaches can be employed to estimate aggregate benefits:

- Approach 1: applying average WTP estimates for the company incorporation attributes to the total LLC population to calculate total annual benefits (Section 5.2).
- Approach 2: estimating the total economic surplus²⁴ to LLC business owners based on predicted demand for company incorporation and a marginal WTP schedule (Section 5.3).

In combination, the alternative approaches can be expected to provide a range estimate for annual aggregate benefits. In the context of this study, Approach 2 will provide a more conservative estimate of aggregate benefits because the demand schedule is conditional to a baseline reflecting a small nominal fee for incorporation relative to the overall value derived by to business owners²⁵. In contrast, Approach 1 represents an "unconditional" estimate of aggregate benefits, based on the average value across the business population.

For this reason, Approach 1 is recommended as the main headline result for the study. Approach 2 can be interpreted as a lower bound sensitivity and estimate of the minimum value associated with company incorporation.

²⁴ Economic surplus is the difference between what a good is valued at by a consumer, and the price that they have to pay for it; i.e. it is the surplus value created by a transaction. In this case, the WTP value measures the total value a business owners places on incorporation, while the registration fee is the price that they have to pay. The difference between the two is the economic surplus.

²⁵ In this case, the very small fee relative to the overall value of incorporation in the baseline constrains the demand schedule, likely under-estimating the surplus value to business owners.

5.2 Estimated aggregate benefits

For Approach 1, the aggregate annual benefit for company incorporation is calculated as the average benefit per LLC (the sum of mean average WTP values for the company incorporation attributes) multiplied by the total number of LLC businesses in the 0-9 employee bracket. The aggregate value is estimated for each company size segment using the business population estimates in the BPE (0 employees, 1-4 employees, and 5-9 employees) and then summed across. In addition, the study results also enable the calculation of an aggregate value of limited liability, as a component of the benefit of company incorporation. Results are presented for the value of limited liability only and the whole company incorporation package (Table 5.1).

Table 5.1 Annual aggregate value of limited liability and company incorporation

	LLCs 0 employees	LLCs 1-4 employees	LLCs 5-9 employees
Value of limited liability (£/year/business)	£3,070	£5,220	£6,710
Value of incorporation (£/year/business)	£4,010	£6,380	£7,950
Number of businesses (BPE; 2020)	945,545	631,900	218,945
Annual aggregate benefit – limited liability (£m/year)	£2,904m	£3,298m	£1,469m
Annual aggregate benefit - incorporation (£m/year)	£3,793m	£4,033m	£1,742m

Notes: All values are rounded to the nearest £10

The total value of limited liability to owners of companies with 0 to 9 employees in the UK is estimated to be £7.7 billion per year, while the total value of incorporation to business owners in the UK is estimated to be £9.6 billion per year.

5.3 Illustrative policy scenarios

Whilst Approach 2 is recognised as a more conservative approach for assessing the aggregate benefits of company incorporation, estimation of a demand schedule allows for different “*what if*” policy scenarios to be simulated²⁶. Specifically, the effect of alternative policy scenarios can be examined, to assess the change in the number of incorporated companies and associated economic surplus relative to a baseline representing the current policy regime.

²⁶ Policy scenarios can be ‘simulated’ using the choice model estimation results and specifying alternative circumstances for company incorporation via the choice experiment attributes and levels.

Current policy regime

There are approximately 1.8 million LLCs with less than 10 employees under the current policy regime. Using the choice model estimations the demand schedule is plotted by simulating "predicted shares" (no. LLCs) at different "price points", which represent the annual fee for company incorporation (the initial incorporation fee and then ongoing annual filing fee). The demand schedules for LLCs with 0 employees and LLCs with 1 to 9 employees are presented in Figures 5.1 and 5.2, respectively. The plots present the company incorporation fee on the vertical axis, and the predicted number of businesses that would incorporate at that fee on the horizontal axis.

Figure 5.1 Demand for company incorporation (LLCs with 0 employees)

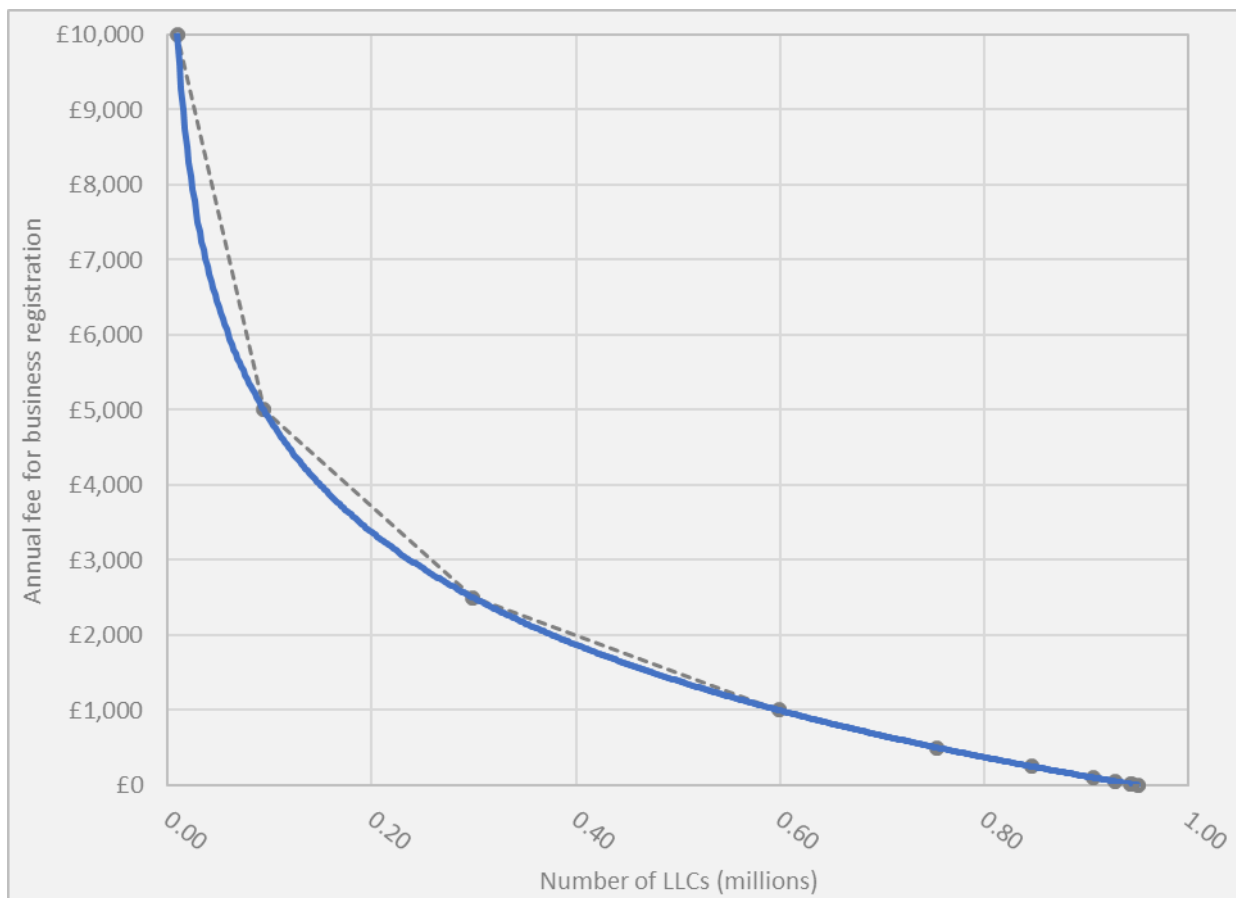


Figure 5.2 Demand curve for company incorporation (LLCs with 1 to 9 employees)

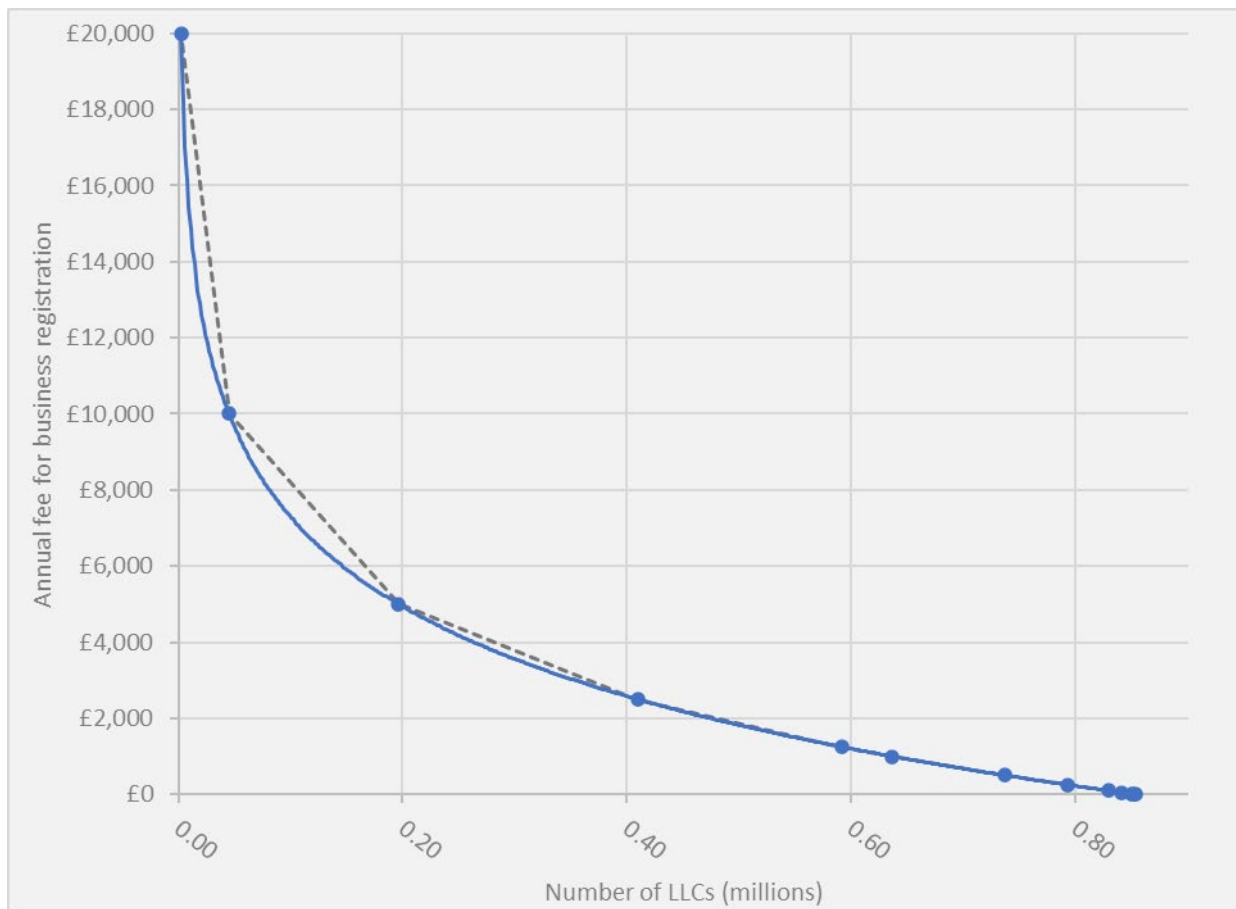


Table 5.2 reports the estimated number of LLCs at each price point corresponding to the demand schedules shown in Figures 5.1 and 5.2. Note that the reduction in LLCs at higher price points does not represent the termination of the business, but that the business owner may opt to operate as a ST rather than pay that fee to be a LLC. Therefore, the economic activity from businesses that switch from LLC to ST is not necessarily ‘lost’ but rather occurs under a different legal status.

Table 5.2 Estimated number of small LLCs at varying price points (‘000s of LLCs)

Annual fee for business registration	LLCs (0 employees)	Compared to “current” demand (%)	LLCs (1-9 employees)	Compared to “current” demand (%)
£0	951	101%	854	100%
£15 (approx. current price)	944	100%	850	100%
£50	929	98%	841	99%
£500	755	80%	737	87%
£1,000	599	63%	636	75%
£2,500	299	32%	409	48%
£5,000	94	10%	196	23%

The area under the demand schedules shown in Figures 5.1 and 5.2 represents the total benefit (welfare value) of incorporation to business owners (i.e. the total WTP of all business owners) (Table 5.2). For the current policy regime, the total benefit estimate across the combined segments is approximately £5.2 billion. As noted above, this is interpreted as a lower bound estimate compared to the main results reported in Table 5.1. The economic surplus estimate - approximately £5.1 billion - is the total welfare value minus the price paid (i.e. the net benefit after the annual fee).

Indicative policy scenarios

Two indicative policy scenarios are simulated: (i) a case where public record filing is no longer a requirement of incorporation; and (ii) a case where the tax “benefit” of incorporation (vs. ST status) is reduced. Case (ii) is modelled as a £1,000 increase in annual tax paid by LLC business owners.

Indicative policy scenario (i): no public record filing requirement

The estimated number of LLCs under different price points for the no public filing requirement scenario is reported in Table 5.3. At the (approximate) current price point (£15 per year) there is an estimated 6 percentage point reduction in the number of 0 employee LLCs and a 2 percentage point reduction in the number of 1-9 employee companies. The fairly marginal effect is consistent with the relatively low level of importance of the public filing requirement observed for LLC respondents in the main choice task results.

Table 5.3 Estimated number of small LLCs at varying price points – no public filing requirement (‘000s of LLCs)

Annual fee for business registration	LLCs (0 employees)	Compared to current demand (%)	LLCs (1-9 employees)	Compared to current demand (%)
£0	899	95%	839	99%
£15 (approx. current price)	892	94%	835	98%
£50	878	93%	827	97%
£500	713	75%	724	85%
£1,000	566	60%	625	73%
£2,500	283	30%	402	47%
£5,000	89	9%	193	23%

The associated change in total benefit and economic surplus is shown in Table 5.4, relative to the lower bound estimates for the current policy regime (£5.2 billion and £5.1 billion).

Table 5.4 Change in small LLC business owner economic surplus – no public filing requirement (£bn)

	Total benefit (£bn) (@£15 annual fee)	Change from current value (£bn)	Economic surplus (£bn) (@£15 annual fee)	Change from current value (£bn)
LLC – 0 employees	1.98	-0.11	1.97	-0.11
LLC – 1-9 employees	3.02	-0.05	3.01	-0.05
Total	5.00	-0.17	4.98	-0.17

Indicative policy scenario (ii): reduction in tax benefit

The estimated number of LLCs that under different price points for the increase in tax liability (£1,000 per year) is reported Table 5.5. At the current (approximate) price point there is greater reduction in the number of incorporated companies compared to scenario (i) - in region of 12 to 17 percentage points for the company size segments.

Table 5.5 Estimated number of small LLCs at varying price points - £1,000 increase in tax liability ('000s of LLCs)

Annual fee for business registration	LLCs (0 employees)	Compared to current demand (%)	LLCs (1-9 employees)	Compared to current demand (%)
£0	791	84%	755	89%
£15 (approx. current price)	786	83%	752	88%
£50	773	82%	744	87%
£500	628	66%	652	77%
£1,000	498	53%	563	66%
£2,500	249	26%	362	43%
£5,000	78	8%	174	20%

The associated change in total benefit and economic surplus is shown in Table 5.6, relative to the lower bound estimates for the current policy regime (£5.2 billion and £5.1 billion). The overall loss in both cases is around £700m per year - approximately 86% of the lower bound aggregate estimate for the current policy regime.

Table 5.6 Change in small LLC business owner welfare and consumer surplus - £1,000 increase in tax liability (£bn)

	Total benefit (£bn) (@£15 annual fee)	Change from current value	Economic surplus (£bn) (@£15 annual fee)	Change from current value
LLC – 0 employees	1.74	-0.35	1.73	-0.35
LLC – 1-9 employees	2.72	-0.35	2.71	-0.35
Total	4.46	-0.70	4.44	-0.70

For businesses that continue to operate as LLCs, the increase in tax liability (£1,000 per year) represents a transfer of wealth to the exchequer rather than a net economic loss. Likewise, some of the businesses that cease to operate as LLCs would switch to operate as STs, and the reduction in tax benefit (i.e. increase in tax owed) would also represent a transfer to the exchequer. However, it cannot be assumed that all companies that cease to operate as LLCs would switch to ST status. Some business owners may prefer not to operate at all and this effect would represent a net economic loss²⁷.

²⁷ For example, owners of businesses with low revenue who decline to operate as an LLC in the absence of the tax benefit, may also decline to operate as a ST due to the additional cost to the business from public liability insurance to replace the limited liability benefit of incorporation, thus ceasing to be economically active.

6. Discussion

6.1 Main findings

The study provides evidence on business owners' reasons for company incorporation and the value of different aspects of incorporation status. The stated preference survey was developed through multiple rounds of testing and revision, building on initial qualitative research to understand the context for the research question and the characteristics and perceptions of owners of small businesses. The respondent feedback to the survey through both cognitive testing and follow-up questions in the survey itself indicate good level of understanding, engagement with, and consideration of the alternative options in the central choice tasks. This suggests the research results are valid results from a content validity perspective. The survey produced a high-quality dataset and the choice model estimations and their results are robust, providing a good fit to the data, and WTP estimates with a reasonable degree of precision.

The peer review found that: *“the methodology, and questionnaire, using stated preference choice experiments, worked well. Respondents could clearly understand the tasks required and gave valid responses to questions asked. The data analysis was skilfully implemented and produced statistically significant estimates. The WTP values for business owners' preferences on incorporation, appear to be accurate, and most seem to be intuitively reasonable. The impact of attributes and WTP values on demand for incorporation conform to economic theory.”* (see Appendix 7).

As would be expected a multitude of prior experiences and perceptions shape business owner's decisions. The survey results show that most LLCs and STs did seek advice when setting up their business. Of those that did, accountants were the most common source of advice for both LLC and ST business owners, while STs also more commonly sought advice from family and other people in their sector than LLCs. A range of operational and success factors are considered important for LLC business owners, with protection of personal finances (i.e. limited liability), making it easier to secure contracts and opportunities to grow the business being the most frequently chosen.

The total value of limited liability to owners of companies with 0 to 9 employees in the UK is estimated to be £7.7 billion per year. This represents approximately 89% of LLC businesses in the UK by company size (no. employees). The total value of company incorporation to business owners in the UK is estimated to be £9.6 billion per year. Based on the survey results limited liability is the most important aspect of company incorporation, for both LLC and ST business owners. In general, the estimated values for LLCs and STs align with expectations. In particular, LLC business owners place greater value on limited liability and incorporation overall compared to ST business owners, and that larger business owners have higher values for limited liability and incorporation overall than smaller business owners. One difference between the results for LLCs and STs relates to the value placed on public record filing requirements. Whereas LLC respondents were largely ambivalent to filing requirements, ST respondents view it as a disbenefit of incorporation.

There is also an observed preference for the 'status quo' for STs. By and large this effect can be attributed to valid reasons such as the importance of wider lifestyle and convenience factors for ST respondents. Indeed, the wider survey results highlight the importance of a range of factors such as “being own boss” and work life balance, along with ease of setting up business as being the key considerations for ST business owners for their choice of legal status. Notably

in comparison with LLC business owners, these factors appear to be more related to quality of life and the ease of doing business.

Business owner sentiment on achieving their business objectives and other factors influencing their business legal status:

Ensuring a good work-life balance was a key objective [...] and working for themselves.

- ST 5 – 9 employees

The legal obligations of being of a company director were not fully explained [...] it would have been considerably more helpful to have understood these responsibilities.

- LLC, 1 – 4 employees

Quite familiar with limited liability companies from previous role [...] this was the simplest approach and did not want to make 'life more difficult than was necessary', by adopting a more complex business structure involving more administration and taxation procedures.

- ST, 1 – 4 employees

Business plan objectives were growth, both in terms of turnover and employee size, so being a sole trader did not match the ambitions, and so was aware that LLCs were better suited.

- LLC, 5 – 9 employees

The requirement to file accounts and other records with Companies House was seen as a positive because 'it keeps it all above board' and 'knew exactly where they were' [...] contrary to being an administrative burden, it gave a sense of confidence in how the business was running.

- LLC 1 – 4 employees

Changing status from sole trader to LLC meant that the business had turned into 'proper company that gives it more strength on stage when trying to win business'. As such, it acted as a catalyst to help grow the company.

- LLC 1 – 4 employees

The overwhelming reason for choosing LLC status was one of legal entity – 'if the company is failing, it's reassuring that they can't take money from us and that our assets are safe'

- LLC 1 – 4 employees

Strongly agreed with the statement 'it is important to focus on non-financial reasons for being a sole trader or incorporation, such as reputation, level of control, and privacy'.

- ST 1 - 4 employees

Being a sole trader was the simplest way of running their own business. With the ease of set up and low start-up costs [...] effortless to manage in conjunction with bringing up their family.

- ST 1 – 4 employees

tax liability for LLCs were estimated to lead to relatively modest reductions in the number of companies expected to incorporate at different price points. In practice this may not lead to a change in economic activity if businesses switch to operating as STs, but there would likely be a net reduction in economic welfare due to a loss of the beneficial aspects of incorporation. In the increased tax liability scenario part of the loss is a transfer to the exchequer.

Business owner sentiment on what the future looks like:

They wished they had set up the company earlier. The idea of changing back to sole trader status is a non-starter because of a good work / life balance, and they wish to maintain their financial freedom. Furthermore, the positive psychological impact of running the company is not to be underestimated, it is 'helping them to believe and feel proud in themselves'

- LLC 1 – 4 employees

I simply work to earn enough money for a reasonably comfortable lifestyle with the least amount of stress!

- ST 1 – 4 employees

While it was tricky balancing the needs of a young family in the early days, they are reaping the rewards now with a better way of life and financial security.

- LLC 5 – 9 employees

They do not see any need to do anything different in the future, and does not see any reason to go back to limited liability status, as she feels that would be irrelevant for her now.

- ST 1 – 4 employees

6.2 Conclusion

Company incorporation is a valuable service (“good”) provided by the government to business owners. The total benefit created is substantial, and with only a nominal administrative fee paid for this service, most of the benefit that is created goes to the private sector (i.e. business owners). As a (quasi) non-market good, the value created from company incorporation is not well understood and does not appear in national statistics. The stated preference approach applied by this study provides a means to understand both the value of incorporation, and the value of specific components of incorporation, such as limited liability. This evidence is a useful contribution to understanding the reasons for incorporation and its value.

The results from this study should be understood as a partial account of the total societal benefit of company incorporation. The analysis is focused on small business – defined as those operating with 0 to 9 employees - and the benefits accruing to business owners. There is additional value to larger LLC employers, as well as broader societal benefits, for example from increased risk taking (i.e. due to limited liability) and transparency (i.e. due to requirements for public record filing). While some of the benefit of incorporation may be realised elsewhere (e.g. public liability insurance is available from the market for a price comparable to the WTP for limited liability), the government effectively subsidises these goods through the incorporation process, encouraging businesses to operate as LLCs.

From an individual business owner perspective there is a clear cost versus benefit equation in the decision to incorporate or not. Indeed, the study results show there is a preference for the ST status for a subset of the total population of business owners that is based around non-economic factors, and the loss of these benefits would outweigh any gain from company incorporation. This finding helps illustrate that choice to incorporate a business is not based only on financial or administrative burden factors that are within the direct control of business regulation and policy-making. Whilst these factors do matter and at the margin changes in incorporation fee, tax liability, and administrative requirements will impact LLC business formation, a richer set of influences also matter and in some cases are more material to business owners than the direct policy levers.

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