



## **BEIS – Understanding the Reasons for Incorporation**

### **Qualitative Testing Summary**

November, 2020

*This note summarises the main findings from the survey design and testing phase, involving 20 cognitive interviews.*

#### **1. Objectives**

The purpose of the design and testing phase was to find examine the views of limited companies and sole traders concerning different facets of their legal status. In particular, to:

- test whether customers understood what the survey was about and what its purpose was
- understand what and how much contextual information was required by customers
- test the layout and appearance of the survey
- test how much effort was required to complete the survey
- assess how easy or difficult it was to complete and to assess the clarity of instructions
- evaluate how well people understood the choice experiments;
- understand the thinking behind how customers made their choices; and
- establish how much influence Covid-19 had on people's answers.

#### **2. Research Process**

The survey design and testing phase utilised 20 cognitive interviews undertaken in September and October 2020, at a time when Covid-19 restrictions in place. The interviews were therefore carried out online, across four phases, each one comprising five one hour Zoom sessions. Each phase had a mix of limited companies and sole traders, 9 from the former and 11 from the latter.

The survey design and testing phase assessed all the materials (questionnaire wording and showcards) to check they were clearly understood by respondents. It sought to clarify any ambiguities and ensured that information could be presented in the most meaningful way to business owners and directors. It therefore played a crucial part in making sure the survey was fit for purpose before moving on to the pilot stage and eventually, the main stage of the survey.

In terms of recruitment, all respondents had to be an owner of a business operating as a sole trader or a founding director of a business operating as a limited liability company (LLC). The interviews were equally spread across both business types ranging from construction, retail, health and beauty, leisure and the motor trade.

#### **3. Key Findings**

##### **3.1 Survey Understanding**

Overall, people understood what the survey was about and what they were being asked to do in the cognitive interviews. They cited various responses as indicated in the Table 1 below:

**Table 1: Purpose of survey**

<b>Purpose of Survey</b>	<b>Number of Mentions</b>
Why people choose different legal structures	10
How different businesses are set up	6
What the key decision-making factors are for choosing different legal structures / what influences people's decisions	4
Making it easier / more attractive to become a limited company	4
Changing the way businesses are set up	4
Different fee structures for different types of business	3
How clued up people are about different options for running a business	3
Other	6

Some verbatim comments illustrating the above categories are shown below.

### **Why people choose different legal structures**

*“To understand why I chose a limited company...” – LLC, phase 1*

*“To understand our views on being a sole trader versus a limited company” – Phase 2*

*“...get understanding of why companies choose sole trader or limited liability companies – Phase 3*

*“The government want to get a grasp of why people set up business in a certain way” – Phase 4*

*“To find out why people choose sole trader and limited liability...” – Phase 4*

### **How different businesses are set up**

*“...it's looking at the way businesses are set up” – Sole trader, phase 1*

*“...what business owners are looking for as to what works best” – Phase 3*

*“...to decide how we want to set up the business and whether we want protection” – Phase 4*

### **Key decision-making factors**

*“...what was important as part of decision-making process” – LLC, phase 1*

*“...to understand what influences decisions when becoming a sole trader or limited company” – LLC, phase 1*

*“...what the deciding factors are for choosing either a sole trader or limited company” – Phase 2*

### **Making it easier to become a limited company**

*“To understand the incentives and benefits for becoming a limited company” – Phase 2*

*“The government would prefer them (businesses) to be limited companies – Phase 3*

### **Changing the way businesses are set up**

*“The government is looking to change the methods of incorporation” – LLC, phase 1*

*“Looking at trying to change the way businesses are set up...” – Phase 2*

*“...see what’s best for small business owners, what the differences are between sole traders and limited companies and what the potential changes might be for each; a review of the whole system” – Phase 3*

### **Different fee structures for different types of business**

*“...understand our willingness to pay an additional charge to run a limited company” – Phase 3*

*“...assume the idea is to offset any fees payable in setting up a limited company or sole trader versus higher taxes” – Phase 3*

### **How clued up people are about different options for running a business**

*“To understand all of the options for running a business, and how keyed up we are” – Sole trader, phase 1*

*“...show people the options of becoming a sole trader or limited company” – Phase 4*

### **Other**

*“The government is researching the workforce to encourage small businesses” – Sole trader, phase 1*

*“...a general review of business owners’ feedback” – LLC, phase 1*

*“...to show the process of establishing limited companies and how to help boost the economy” – Phase 4*

*“...to work on the balance of limited liability companies and sole traders” – Phase 4*

## **3.2 Ease of survey completion**

Generally, people found the survey fairly easy to understand and straightforward to complete.

*“Very easy, nothing too challenging, I understood what it meant and what it was asking me to do”  
– Sole trader, phase 4*

*“It was easy to understand, I didn’t find anything too difficult” – LLC, phase 4*

A small number were challenged by the choice experiments, taking their time to understand them and if necessary, re-reading them to ensure they had understood them correctly. Further details about completing the choice experiments are detailed later in section 3.8.

There was also some difficulty in understanding some of the terminology such as ‘business legal structure / status’ and ‘incorporation’. More detailed commentary on these aspects is provided in section 3.3 for the former, and 3.4 for the latter. Suffice to say, that to help validate people’s answers, a question about familiarity with company incorporation was introduced quite early in the second phase of testing. Unsurprisingly, sole traders were not that familiar with the concept, and even LLCs were only somewhat familiar.

The initial questions about people’s businesses helped to set the context and were all very easily understood. The definitions of a sole trader and limited liability company were clear and people had no issues answering questions about when the business was formed, what sector they were in, the number of employees and their annual revenues.

In the first phase of testing there was a question on how dependent business revenue was on the current status of the business. Similarly, people were also asked to estimate the proportion of their business revenue that was dependent on their current status. Both questions had little value, as unsurprisingly, people were

very dependent on their business revenue regardless of legal status. Subsequently, both questions were dropped from the survey for the rest of the cognitive testing.

### 3.3 Legal status

Overall, there were mixed levels of awareness regarding the different types of legal status. Most people had heard of sole traders and LLCs, although the extent to which each status was understood was much more variable. Indeed, some LLC owners and founding directors were quite clued up about the mechanics of both the aforementioned legal statuses. Although sole traders had heard of LLCs, they only had a rudimentary understanding about them, and in a couple of cases, this limited their ability to fully answer the survey.

*“While it (the survey) was quite easy and straightforward to complete, I’m not fully up on what limited means, so my understanding is not fully there” – Sole trader, phase 3*

*“I didn’t know about limited liability companies, so I could have been more informed if I knew more...but straightforward apart from that” – Sole trader, phase 4*

There were some mentions of other types of legal status such as charities and business partnerships but these were very much the exception.

#### **Pros and cons of legal status**

The amount of research that people did to establish the pros and cons of sole trader and LLCs was variable from being advised by external professionals:

*“My bank manager provided quite thorough and in-depth advice” – LLC, phase 1*

*“I didn’t do enough research; my accountant suggested limited liability, so I didn’t look at any other status” – LLC, phase 2*

*“A business adviser told me to stick with plumbing as a sole trader. I’d be daft not to take his advice” – Sole trader, phase 2*

*“..definitely not a default option, I spoke to my accountant...” – LLC, phase 4*

...to doing online research:

*“I did virtually all my research through the internet, but I knew I only wanted to be a sole trader” – Sole trader, phase 2*

...relying on the experiences of family and friends:

*“A lot of my research was based on other people’s experiences” – LLC, phase 1*

...or just arriving there by default:

*“It was the easier option, not a lot of thought at the time, I didn’t look into it and didn’t realise the options out there” – Sole trader, phase 3*

The questions relating to who and what advice people received in the first two phases of cognitive testing were open ended questions. Having obtained intelligence from both the original qualitative phase and the first two rounds of testing, coded lists were introduced for these questions in the last two phases of testing.

The advice people took and received played a very important role in choosing their legal status. Whether it was banks, accountants or family, business owners put a lot of sway on their advice. The advice of external

professionals when people set up their business was especially important because although they knew they wanted to have their own business, they had little idea about the various legal aspects and tax implications, and it therefore helped them to understand the level of risk.

There was the very rare occasion where people didn't think legal status was that important, but this was largely due to being uninformed.

*“I didn't think it important with the industry I'm in, and being so small” – Sole trader, phase 4*

### **Factors influencing legal status**

To understand why people chose the legal status for their business, they were asked what the important factors were for their modus operandi. People found it very easy to provide answers as to why people chose their preferred legal status. For the majority of business owners, it was definitely a choice they made rather than it being a default decision.

Sole traders tended to choose this model because they had experience of friends or family doing something similar, or they just wanted to have a second income. Where people had consulted external professionals, more often than not they went down the limited liability route.

Again, this question was open ended in phase one and two of the testing, but used a coded list for the last two phases of testing. The lists were based on responses from the original qualitative work, along with the answers from the first two rounds of testing.

### **Business Form**

In the first phase of cognitive testing the term 'business form' was used to convey the idea of legal status. For most people, 'business form' was not very intuitive, people associating it with legal forms that have to be completed.

*“...if it's anything to do with government and legal, you think what form have I got to fill in” – LLC, phase 1*

*“...business form is not that clear, sounds like you have to fill out a form...what form have I forgotten”  
– Sole trader, phase 1*

On the rare occasion that someone was clued up on the legalise, 'business form' was clear enough. A possible alternative of 'business type' was preferred as this was more easily understood; the problem with this phrasing was that it could be confused with business sector.

In the second phase of testing, 'legal status' was used in the early part of the survey, while 'business legal structure' was used instead of business form at question 19, just before the best-worst choice tasks. 'Business legal structure' also proved not to be the most intuitive terminology.

*“It sounds like it's describing various legal activities” – Sole trader, phase 2*

*“Status would mean more to me...” – LLC, phase 2*

Legal status was therefore used consistently in the last two phases of cognitive testing and it was understood.

## **3.4 Incorporation**

Incorporation is a term that is not very well understood, regardless of legal status. A very small minority had a clear idea of what incorporation entailed, but in the main, there was little to no understanding of what it meant especially amongst sole traders. This was a key finding from the previous qualitative research, so it was important to provide more definition about its meaning.

In the early part of the survey where ‘incorporation’ was mentioned, it was followed by (i.e. a limited company). This was a helpful signpost in the cognitive interviews to help people understand what it meant. In the later stages of the survey however, the definition was not provided so it was advised that these references be consistent with the earlier questions before going to pilot. This would help to ensure absolute clarity and avoid any ambiguity about the meaning of incorporation.

A question asking about the likelihood of sole traders changing their legal status to becoming a limited liability company in the future was included. While the question was understood, it changed to allow a Likert scale to be used. So instead of ‘do you think...’ it was changed to ‘how likely is it that...’.

### 3.5 Differences between LLCs and sole traders

Some key information was presented to participants about the composition of small business, i.e. those with less than 50 employees. This was useful contextual information before showing Table 1 below, which shows the key legal and tax differences between sole traders and LLCs.

**Table 1. Differences between LLCs and sole traders**

	<b>Company</b>	<b>Sole trader</b>
Business owner	Company director	Self-employed
Liability	Company is separate legal entity from business owner’s individual finances	No legal separation – business owner responsible for any losses
Minimum capital requirement	None	None
Set-up	Register with Companies House  One-off incorporation fee  File annual accounts and notify changes	Register for self-assessment tax with HMRC
Business tax	Corporation tax on company profit  £85,000 turnover threshold for VAT	£85,000 turnover threshold for VAT
Tax paid by business owner	Combination of dividend tax, national insurance and income tax	National insurance and income tax via self-assessment
Employment	Can hire employees	Can hire employees

The information presented in Table 1 was thought to be clear and easy to understand, as well as having enough information to help people make their choices.

*“The differences between each (legal status) were clear, and it all made sense” – Sole trader, phase 4*

While most people had heard of both types of legal status, their understanding of the legal and tax implications was variable. Indeed, while LLCs had a reasonable understanding of the requirements of both business structures, sole traders, on the whole, were only able to articulate the requirements relevant to them.

*“I’ve never looked into being a limited company, so I’m not aware of what’s involved” – Sole trader, phase 2*

That said, there was acknowledgement from LLC owners that they understand more now, compared to when they originally set up their business.

*“It’s clear and easy to understand, I’m familiar with company director and the other phrases, but starting out it might have been more difficult” – LLC, phase 1*

Prior to the choice tasks, there was a question about how important a range of financial and non-financial factors were when people set up their business. In the first two phases of testing there was a question for both sole traders and LLCs which was trying to determine a forward view of the importance of different factors in people choosing their preferred business modus operandi. However, the question was designed to look back at the important factors specifically to them in setting up a business. It was therefore trying to serve a dual purpose of understanding a historical and future perspective at the same time. Essentially, the question was repeating an earlier one, and as such, it caused some confusion. As the factors from the later question mostly focused on issues to do with company incorporation it meant that half of the statements did not apply to sole traders. Furthermore, the response list did not really resonate with people because it was not aligned to their reasons for setting up their business.

As a result, the last two phases had separate questions. One was concerned with what were important factors for people in setting up their business. There were separate response lists for both sole traders and LLCs based on the findings from the original qualitative phase. The second question asked ‘Thinking about the differences between sole traders and registered companies, how important would you say the following things are in deciding on the legal status of a business’. Not only is this question set in its proper context (i.e. after Table 1), it also enables a future focused understanding of the importance of different factors in deciding on a legal status.

### 3.6 Choice task attributes

Participants were asked to consider a number of business attributes that were each given descriptions. In the first phase of testing the attribute descriptions are shown in Table 2.

**Table 2. Choice task attribute descriptions, phase 1**

<b>Liability</b>	Protection for the business owner(s) (and shareholders), separating the business as a legal entity from their personal finances.
<b>Record filing</b>	Requirements to file annual accounts and other information about changes to the business with Companies House each year
<b>Minimum capital requirement</b>	The minimum amount of money that must be held in the business bank account, paid for by the business owner(s) – either 100% or with contributions from other shareholders.
<b>Tax paid by business owner</b>	The tax liability for the business owner and how this is paid – i.e. whether through dividend tax, income tax, national insurance
<b>Registration</b>	How the business is registered and whether this provides protection of the business name
<b>Registration fee</b>	Fee charged to small businesses (up to 10 employees) for annual registration.

Some of the attributes and their descriptions were more familiar than others, such as limited liability, tax paid by the business owner and the registration fee, therefore they were more quickly understood. While there was less familiarity with the other aspects, they were nonetheless, straightforward and easy to follow.

In phase two of the cognitive interviews, two of the attributes were re-defined to provide more accurate descriptions. Indeed, record filing led to a wrong emphasis where people focused on the administrative and sometimes onerous task of compiling the report and accounts to be submitted to Companies House. Instead it should have been described in terms of the annual accounts being on public record in Companies House.

The business name registration was the other attribute that was re-defined to make it more specific than was conveyed in Table 2. These revised attributes and their definitions are shown in Table 3 below.

**Table 3. Revised choice task attribute descriptions, phase 2**

<b>Public record</b>	Requirements to file annual accounts and other information about changes to the business each year, which are made publicly available by Companies House
<b>Business name registration</b>	Registration means that a business name cannot be used by another company operating in a the same or a similar sector. This is a form of protection for a business name (it is not, though, a trademark, which is a different form of protection).

In the follow up debrief questions, people were asked about other possible attributes that could, or should be included at the expense of the ones put forward.

*“The current ones (attributes) cover the main issues” – Sole trader, phase 2*

*“These are the major factors, nothing springs to mind, so there’s no need to replace any of the (attributes)”  
– Sole trader, phase 3*

While there was a consensus that the above attributes were the right ones, there were some caveats around people’s perceptions. For example, one limited liability company would definitely include record filing knowing what they know now, but not at the time they were setting up. Other LLCs suggested that reputation was very important as part of the status of the business, but that this comes with time so it should not be included as an attribute when deciding on a legal status. An LLC in the third phase of testing thought that ‘minimal capital requirement’ was the weakest link and that it could be replaced, but was unsure what should replace it.

Further testing on the attributes was undertaken in phase four to ensure they were as specific and meaningful as they could be before being piloted. Table 4 below shows the final set of five attributes and their definitions, minimum capital requirement being removed for the reason explained in section 3.8. The different shading shows when the attribute definitions changed at various stages of the cognitive testing.

**Table 4. Final choice task attribute descriptions, phase 4**

<b>Limited liability</b>	Protection for the business owner(s) (i.e. shareholders), separating the business as a legal entity from their personal finances.
<b>Public record</b>	Requirements to file annual accounts and other information about changes to the business each year, which are made publicly available by Companies House.
<b>Difference in the amount of tax paid by business owner annually</b>	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, corporation tax, tax on dividends, etc.).
<b>Company name registration</b>	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).
<b>Annual fee for business registration</b>	Annual fee charged – currently this is paid each year when submitting required filings to Companies House.

Definition consistent throughout
  Definition changed for phase 2 onwards
  Definition changed for phase 4



All the above definitions were thought to be clear and comprehensive, enabling people to have enough information to choose between the options.

### 3.7 Best-worst scaling

In order to understand which aspects of company incorporation are most important to business owners, participants were presented with choice tasks. In the first two phases of testing, best-worst scaling (BWS) was utilised alongside discrete choice experiments (DCE).

#### Choice tasks

Having understood what the attributes people were going to be asked about, five exercises were presented where they were asked to indicate the best aspect of the scenario, and the worst aspect. An example scenario is shown in Figure 1 below.

Figure 1. Example of best-worst choice task

		Best	Worst
Liability	No limited liability - no separation of business and personal finances	<input type="checkbox"/>	<input type="checkbox"/>
Record filing	Annual filing required	<input type="checkbox"/>	<input type="checkbox"/>
Minimum capital requirement	£500	<input type="checkbox"/>	<input type="checkbox"/>
Tax paid by business owner	23%	<input type="checkbox"/>	<input type="checkbox"/>
Registration	Registered - no protection of business name	<input type="checkbox"/>	<input type="checkbox"/>
Registration fee	£15	<input type="checkbox"/>	<input type="checkbox"/>

Overall, participants did not find the BWS approach very intuitive. Indeed, without the interviewer talking them through the process, people would have struggled with what they were being asked to do. As such, the instructions needed to be clearer as people wanted to tick best or worst for each attribute.

*“The boxes outside make you feel you have to tick each time” – Sole trader, phase 1*

Given that this is an online survey with no-one being present to guide people through the process, it would be absolutely paramount to have very simple instructions that told participants to pick one attribute from the best column, and one from the worst column.

On a very practical note, the appearance of the showcard was clear and straightforward. People were positive about having some colour as opposed to it just being monochrome. They also thought it was not too busy and ‘did not have too much going on’.

#### Trading behaviour

Once people became familiar with what they were supposed to do, they invariably found it quite difficult to make a choice as choosing a best aspect and a worst one did not represent a real choice; the rationale being that you would assess all the attributes as a whole. Furthermore, in some cases it was quite predictable, for

example, LLCs chose best or worst depending on the status of limited liability; the former if there was limited liability, and the latter if not.

*“Every answer was based on protecting myself” – LLC, phase 1*

*“It’s easy to understand, but it’s not that applicable to me” – Sole trader, phase 2*

That said, people opted for the attributes that they liked most or least, and as such, their choices were both sensible and intuitive. For example, limited liability status was very often chosen as the best or worst attribute depending on whether there was liability or not.

### 3.8 Discrete choice experiments (DCE)

#### **Understanding the rationale**

The cognitive interviews showed that everyone who completed the survey was very comfortable with the concept of choosing between the different options. They also thought it was a more appropriate method of being asked to trade off the different attributes, compared to the best-worst scaling.

*“I like this, you know exactly what’s required; it’s self-explanatory” – LLC, phase 1*

*“The options are better because all the aspects are being traded off together” – LLC, phase 1*

*“...weighing up the pros and cons, pay more of one but it benefits you in another area” – Sole trader, phase 1*

*“...the options are better, it’s all on one page so you can see the packages and how they compare – LLC, phase 2*

*“...you’re not just taking one thing, you’re looking at it as a whole, so it’s easier to make a decision”  
– LLC, phase 2*

*“...it’s (DCE) better, because you can see what’s going to be the best option for the business”  
– Sole trader, phase 2*

*“...need to look at all aspects and consider how they might impact on the business” – Sole trader, phase 3*

*“...trading off different characteristics with each other” – Sole trader, phase 3*

*“...choose between limited liability and sole trader, and to explain the difference” – LLC, phase 4*

*“...different options for how I could register, pay a small amount with some benefits or have my name protected” – Sole trader, phase 4*

As a result of this positive feedback about DCE experimental design, and the fact that people did not feel they were making a realistic decision with the best-worst scaling, a decision was made to remove the latter approach from the remaining two phases of testing. There was an argument to potentially include BWS as a warm up to the DCE tasks, but given the potential confusion it was considered of little value, as well as unnecessarily adding to the survey length.

#### **Clarity of instructions**

As well as understanding what was required, most found the instructions clear and easy to follow.

*“The main characteristics are shown and you had to choose options to suit your needs and requirements”  
– Sole trader, phase 1*

In addition to the instructions, the layout and appearance of the choice experiment cards worked well which meant that people did not have to expend a lot effort to understand what they were being asked to do.

*“I like the blue highlighting, and with reading the option charts, it was easier to follow” – Sole trader, phase 2*

*“The blue stands out as what you’re asking us to look at...” LLC, phase 2*

*“The blue helps and the layout is quite straightforward” – Sole trader, phase 3*

*“The layout enables you to look at it clearly; it’s very easy to look down the column” – Sole trader, phase 3*

*“No more colours are required; the blue is striking and captures the attention more than monochrome”  
– LLC, phase 4*

*“I’d be adamant to have the blue box highlighted, otherwise I wouldn’t know where to begin – right, left or centre”  
– LLC, phase 4*

### **Ease of completion**

Most people found the choices straightforward to complete, some saying they were very easy. They understood what they were being asked to do in terms of choosing their preferred scenario. In addition, most people thought the choices were credible and realistic, and that there was enough information to enable people to make their choices.

A very small number of people found the choices challenging, not because they didn’t understand the concept, but because *‘it was hard to decide what you preferred’*.

*“The process was easy, but the content was quite hard” – LLC, phase 1*

*“A little bit of thought was required to give an honest answer” – Sole trader, phase 2*

*“...fairly difficult because of the challenge of choosing, rather than the process itself” – Sole trader, phase 2*

*“It wasn’t easy in relation to the DIY trade off, it was the content rather than the process that was quite difficult”  
– LLC, phase 3*

### **Trading behaviour**

This was a key part of the cognitive testing process as the choice experiments went through several iterations depending on participant feedback. An example choice experiment from the first phase is shown below in Figure 2. The attributes and their levels were the same as those used for the best-worst scaling. And as is customary with DCE tasks, the two options were presented alongside option C where there was no change.

In phase one, people traded between options A and B to some extent, although option B was mainly chosen because four of the five exercises had limited liability in option B, as well as lower tax implications. No-body chose option C, which in the first instance seemed a surprise. However, given that three of the five participants were LLCs, option B was attractive because of paying less tax. And the sole traders were attracted by the idea of limited liability and the potential to pay less tax than they may currently be paying.

**Figure 2. Example of discrete choice experiment, phase 1**

	Option A	Option B	Option C
<b>Liability</b>	No limited liability - no separation of business and personal finances	Limited liability - business is separate legal entity	<b>No change Business remains the same</b>
<b>Record filing</b>	No filing requirements	Annual filing required	
<b>Minimum capital requirement</b>	£500	£1,000	
<b>Tax paid by business owner</b>	23%	20%	
<b>Registration</b>	Unregistered - no protection of business name	Registered - no protection of business name	
<b>Registration fee</b>	None (£0)	£15	
<b>Which do you prefer?</b>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

One other point of note was that while the minimum capital requirement (MCR) was part of the decision-making process, some people thought the amounts were quite low in the first phase (nothing, £500, £1,000 and £5,000). Some people argued that this could be more, as people would be expected to have some capital to put into a business start-up.

*“I put £10,000 into my salon when I originally set up the business” – Sole trader, phase 1*

*“You’ve got to be willing to put something in, maybe £10-15k...perhaps it should depend on the sector – LLC, phase 2*

*“Minimum capital requirement is a good thing, but it could be hard to start with so much behind you” – Sole trader, phase 3*

As a result of these findings, it was clear that design of the choice experiment required changing. Subsequently, changes were made to the design of the choice experiments in the second phase of cognitive testing. To overcome the issue of option C in Figure 2, two sets of choice cards were produced, one each for sole traders and limited liability companies. This also ensured that people knew exactly how each attribute was relevant to their current legal status.

One of the iterations in the updated DCE design for phase two was the MCR amounts - zero, £500, £1,000, £5,000, £25,000 and £50,000. While people were comfortable with the principle of an MCR, they did somewhat balk at the idea of £50,000...

*“50k is too high...” LLC, phase 2*

*“I would think £,1,000 would suffice at the beginning, for equipment and any training...” – Sole trader, phase 2*

Examples of LLC and sole trader choice cards used in the second phase of cognitive testing are shown in Figures 3 and 4 below.

Figure 3. Example of phase 2 LLC choice card

	Option A	Option B	Option C – Current situation
Liability	No limited liability - no separation of business and personal finances	Limited liability - business is separate legal entity	Limited liability - business is separate legal entity
Public record	Annual filing of business ownership information and accounts required	No public record requirements	Annual filing of business ownership information and accounts required
Minimum capital requirement	£50,000	£1,000	None (£0)
Tax paid by business owner	20%	25%	No Change
Company name registration	Registered - business name protected	Registered - no protection of business name	Registered - business name protected
Registration fee	£500	£15	No Change

Which do you prefer?

Figure 4. Example of phase 2 sole trader choice card

	Option A	Option B	Option C – Current situation
Liability	Limited liability - business is separate legal entity	No limited liability - no separation of business and personal finances	No limited liability - no separation of business and personal finances
Public record	No public record requirements	Annual filing of business ownership information and accounts required	No public record requirements
Minimum capital requirement	£1,000	£5,000	None (£0)
Tax paid by business owner	23%	25%	No Change
Company name registration	Registered - business name protected	Registered - no protection of business name	Unregistered - no protection of business name
Registration fee	£500	£50	None (£0)

Which do you prefer?

People felt that the MCR could be a barrier to enabling people to set up their business. If there was genuinely a chance that this could be introduced, the amounts need to be realistic for business start-ups. As it stands, the premium amounts are not reasonable, with £15,000, in the third phase of testing, being cited as ‘a bit steep’ by an LLC and a sole trader saying that it would be pointless as it would deter people from setting up.

Due to the lack of credibility and the potential barrier to entry for business start-ups, it was decided to remove the MCR from the choice cards for phase four of the cognitive interviewing.

Tax liabilities were a key reason for people’s choices (see below). However, part of the challenge with the tax attribute is that people tended to leave their financial affairs to their accountants, which means they were largely unaware of what, and how much they were paying. In turn, this meant that people could not relate the tax levels to what they are currently paying. One of the consequences of this is that people automatically chose the status quo (see below) because they feared the implications about a tax increase.

To account for these issues, the DCE choice cards were modified for the fourth wave of testing, with both LLC and sole trader examples being shown in Figures 5 and 6 below. Of particular note is the change to the taxation relative to what people are paying now. For LLCs there was a range of potential tax increases, and for sole traders, a range of potential tax decreases. This enabled people to make comparisons in a more credible and realistic fashion, even if they did not like the potential impacts of these fluctuations.

The changes to the tax levels worked well, providing a more realistic and credible choice as well as enabling people to see clearly how tax impacts could potentially impact on them.

Figure 5. Example of phase 4 LLC choice card

	Option A	Option B	Option C
Limited liability	No limited liability - no separation of business and business owners' personal finances	Limited liability - business is a separate legal entity to business owner(s)	Limited liability - business is a separate legal entity to business owner(s)
Public record	No public record requirements	No public record requirements	Annual filing of business ownership information and accounts required
Difference in the amount of tax paid by business owner annually	Yes, increase in tax of £250	No (pay current tax rate)	No (pay current tax rate)
Business name registration	Registered - business name protected	Unregistered - no protection of business name	Registered - business name protected
Annual fee for business registration	£50	£2,500	£12

Which do you prefer?

Figure 6. Example of phase 4 sole trader choice card

	Option A	Option B	Option C
Limited liability	No limited liability - no separation of business and business owners' personal finances	Limited liability - business is a separate legal entity to business owner(s)	No limited liability - no separation of business and business owners' personal finances
Public record	No public record requirements	No public record requirements	No public record requirements
Difference in the amount of tax paid by business owner annually	Yes, decrease in tax of £60	Yes, decrease in tax of £2,750	No (pay current tax rate)
Business name registration	Registered - business name protected	Unregistered - no protection of business name	Unregistered - no protection of business name
Annual fee for business registration	£50	£2,500	£0

Which do you prefer?

### 3.9 Motivations for Choices

Across all the cognitive interviews, everyone felt there was enough relevant information to enable them to make their choices. The reasons for people’s choices were varied, and can be split into three pairs of

importance – high, medium and low. The two key factors which were consistently mentioned as highly important were liability and tax.

- **Liability:** Protection for the business owner(s) (and shareholders), separating the business as a legal entity from their personal finances.

*“...mainly starting with very little money, so liability was most important” – Sole trader, phase 1*

*“Liability is most important, having the company separate from my personal finance...” LLC, phase 2*

**Tax:** The tax liability for the business owner and how this is paid – i.e. whether through dividend tax, income tax, national insurance which were consistently mentioned.

*“After weighing everything up, tax was the most important” – Sole trader – phase 1*

*“Options A and B often increased tax liability...” – LLC, phase 3*

*“Tax increases are not good in the current time we are in” – Sole trade, phase 3*

The factors which were considered of medium importance were minimum capital requirement and company name/business registration.

**Minimal capital requirement:** while some thought the MCR was a plausible idea as long as it was a sensible, there were others who thought it would act as a barrier to business start-ups.

*“Minimum capital requirement would be a barrier to getting off the ground, you’d be taking on a huge debt”  
– Sole trader, phase 3*

One sole trader felt the MCR should be based on the type of business one is setting up; if low set up costs, the MCR should be lower than a business that has higher set up costs.

*“It should be a maximum of £5 to £10k, depending on the type of business” – Sole trader, phase 3*

As mentioned above, this attribute was removed for the fourth stage of cognitive testing.

- **Company name/business registration:** How the business is registered and whether this provides protection of the business name

The two least important factors in people making their choices were public record and the annual business registration fee:

- **Registration fee:** Fee charged to small businesses (up to 10 employees) for annual registration

Regarding the annual registration fee, a question was asked in the cognitive debrief as to the maximum amount people would be willing to pay for their preferred option. The amounts shown to people in the first round of choice experiments were zero, £15, £15 and £100. To a large the answers depended on the type of business being set up and whether the company was incorporated or not. Limited liability companies were willing to pay more than their sole trader counterparts.

*“I would pay £400-£500 without blinking” – LLC, phase 1*

*“I’d pay a maximum of £150...you pay ongoing fees in the form of tax” – LLC, phase 1*

*“£500 wouldn’t bother me at the beginning...” – LLC, phase 2*

*“A £30 fee is fine; a small fee is acceptable, any more I would be concerned if it was not a success” – Sole trader, phase 2*

*“Anything over £50 would put you off; starting up, you don’t want lots of outgoings” – Sole trader, phase 1*

And asked whether it should be an annual fee or a one-off fee, there was a mix of views depending on the size of the fee. If it was a small fee, most people suggested it should be a one-off amount for registration; however, it was felt a larger amount then there should have the option of monthly payments.

*“Monthly is not an issue if it’s a small amount, a one-off payment is fine; £1,000 would be different”  
– Sole trader, phase 2*

*“If it was £500, I’d want to pay it monthly, 250 I’d pay outright” – Sole trader, phase 3*

*£15 a month would be fine” – LLC, phase 3*

Furthermore, people thought the size of the annual registration fee should be scaled according to the size of business turnover; for example, the larger the turnover the more it should attract a more sizeable fee.

*“...not one size fits all, it’s fairer. If not a massive turnover, make it £50, if bigger make it £250”  
– Sole trader, phase 3*

*“Should be incremental and based on turnover or profits” – Sole trader, phase 4*

*“I’d pay zero as a sole trader unless there’s other benefits; certainly not £500, but maybe £100 for some form of protection” – Sole trader, phase 4*

**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

There were no substantive comments on this, it was just considered the least important attribute in people’s decision making.

### **Status quo choices**

**Phase two** - As discussed above, no-one chose the status quo option in the initial phase of testing. In phase two however, one LLC chose the current status, as did one sole trader. The reason for the former was that limited liability was so important nothing else really mattered. In addition, they liked the idea of keeping a zero minimum capital requirement, and were happy with their current tax arrangements.

The sole trader did not want to see anything that involved upward pressure on finances, which was the case with the MCR, the registration fee and the tax arrangements.

**Phase three** – As with the second phase, there was one sole trader and one LLC who opted for ‘no change’. The sole trader was not convinced by what seemed like a way of re-organising the tax revenues, and was quizzical about the need for an annual business registration fee.

*“If the annual business registration fee replaces what we currently have to pay, then fine...but it has to be instead of and not in addition to” – Sole trader, phase 3*

The LLC felt that options A and B often increased tax liability, as well as removing both limited liability for the business and protection of the business name.

**Phase four** – Both LLCs chose option C. One, because limited liability was non-negotiable and he wasn’t ready to compromise on that or anything else. The other LLC was also adamant about limited liability, but he also felt the ‘costs fluctuated wildly’, especially the potential tax implications.

### 3.10 Follow up questions

There were a series of follow up questions which were more to do with macro aspects of company incorporation, and how it impacts on both the economy and the success of any given business. These are looked at in turn below.

#### ***Impact of company incorporation***

There were two aspects to this. One was how company incorporation impacted on a business or director. In the first phase of testing, sole traders struggled with the point of this question, one saying ‘*I don’t understand what it’s after*’, and another saying it was a ‘*weird*’ question. Sole traders also queried why it was being asked of them when they were unable to relate to the question having no experience of company incorporation. And in phase two, one of the sole traders felt ‘*impact on the owner or director*’ was too vague and not specific enough, questioning whether it was referring to liability or protection.

The other aspect was how much impact company incorporation had on the wider economy. While people understood the question per se, they felt somewhat ill equipped to answer it as they felt it required an understanding of the relationship between company incorporation and the wider economy. People were more interested in getting on with running a business and were not really cognisant of issues to do with the wider economy.

*“...no grasp of what it’s on about; it’s not on my radar...that was my weakest area of understanding”  
- Sole trader, phase 1*

*“...the bit about the wider economy was a bit of a challenge” – LLC, phase 1*

*“I had to read it three times over as it did not make sense to me” – Sole trader, phase 1*

One limited company in the second phase of cognitive testing did not know what either question was getting at. In light of this feedback, these questions were dropped after the second phase of testing.

#### ***Financial / business aspects of setting up a business***

There were two questions which sought to provide further understanding about people’s choices for setting up as an LLC or being a sole trader. The first was a list of statements using a Likert scale on the extent to which people agreed or disagreed with them. While the statements were understood, sole traders were unable to answer the first two (see below) unless they had knowledge or experience of what was involved in company incorporation.

1. Company incorporation is too easy. It should be made more restrictive to reduce the number of businesses incorporating.
2. Company incorporation is good for businesses and good for the economy, it should be encouraged by the government.

Another statement that people were unclear about was ‘There are other, more efficient ways to receive the benefits of incorporation other than incorporating’.

*“...yes, but not all were relevant” – Sole trader, phase 1*

*“...some I was not able to answer, and some I had no strong opinion on” - Sole trader, phase 1*

*“...too hard to answer properly, just tend to deal with my own business” – LLC, phase 1*



*“needs to be explained a bit more, needs to go into much more detail like with mortgages...government needs to speak people before starting up so that they are business ready” LLC, phase 3*

And there was a lesser point around the examples given on the statement ‘It is important to focus on non-financial reasons for being a sole trader or incorporate, such as reputation, level of control, and privacy’. One LLC thought the latter two examples should be spelt out in more layman terms.

A further question was asked around how different factors could influence the success of a business. These included a business’s reputation, the level of risk assumed, staff recruitment, and the ability to secure contracts. Participants had no issues with understanding this question.

### 3.11 General points

#### **Impact on government policy**

People were asked how they thought their answers might influence government policy both in terms of the options to set up and run a business, and in regard to the amount paid for setting up and running a business.

Overall, there was a mix of responses, some saying they were ‘fairly certain’ that it would make a difference, while others were ‘not very certain’. On the positive side people cited...

*“...the perception is that it’s a big scary thing, but this gives confidence for people to set up a business”  
– LLC, phase 1*

*“I’d like to say a lot, the government have to find revenue, and those earning have to pay” – LLC, phase 3*

There was a sense of the consultation being of little value if the government doesn’t use the results, especially if they are asking lots of people.

*“My opinion must be valued, but it’s a very small part” – Sole trader – phase 2*

*“They are speaking to a lot of people with different views, so there would be little value in doing the survey if they don’t listen” – Sole trader, phase 2*

*“Have they got pre-conceived ideas, or if lots of people say a certain thing, might they change”  
– Sole trader, phase 4*

*“...they wouldn’t be doing this research, it would be a pointless exercise otherwise...” – LLC, phase 4*

Where people were less convinced as to how much influence their answers would have, it was around the perception of the way government does things.

*“Government and HMRC move very slowly; my voice is one amongst many, and they’ll do it whether we like it or not” – LLC, phase 1*

*“...the government does what they want, so it doesn’t really matter to...” – LCC, phase 2*

*“...I’m not sure that little old me is going to make a difference” – Sole trader, phase 2*

*“I suspect it’s a done deal, they’ll re-market it, that’s how they’ve gone after small businesses in the last few years...if everyone says the same thing, they might do something” – Sole trader, phase 3*

*“I’d like to think they listen, but don’t think they’re going to do anything; they’ll just make their own decision”  
– Sole trader, phase 3*

*“I don’t know if anything will change as a result of public opinion” – LLC, phase 4*

*“They might take it into consideration, but don’t know how much they would act on it; they do what they like”  
– Sole trader, phase 4*

### **Length of survey**

Across all the phases of testing, all participants were comfortable with the length of the survey, with everyone saying it was fine and that there were no issues with the duration. That said, if there are opportunities to reduce the length and make it more manageable, that would help.

To that extent, removing the best-worst scaling questions, as well as the ones on the impact of company incorporation, will make the survey more relevant and enjoyable from a user perspective.

### **Coronavirus**

The cognitive testing phase was undertaken just as the number of Covid-19 cases started to increase in September and October 2020, and just before the government announced its tiered approach to lockdown. To understand the impact of the virus both currently and in the short to medium term, some questions were asked around how businesses had been impacted, specifically in regard to revenues compared to a year ago, what government schemes had been utilised, and how confident people felt about the outlook for their business in the next 12 months.

Overall, and unsurprisingly, most businesses had been impacted with revenues down, either slightly or significantly compared to a year ago, with some having to make redundancies and put people on furlough. Several government schemes had been used such as bounce back loans, council grants and furlough payments.

There was a mix of views around the future outlook for their business with some saying they were confident about the next 12 months, but others saying they were not.

Despite the impact of Covid-19 on people’s businesses, the majority of people were not really thinking about it during the survey, until the end when the specific questions were asked. However, a small number of people’s answers were influenced by coronavirus.

*“Covid-19 may have changed some of my answers, but not a great deal...” – Sole trader, phase 3*

*“...a little bit because of what’s coming next by way of extra fees etc...” – Sole trader, phase 3*

One sole trader had an altruistic perspective on how Covid-19 might affect government decision making in the future.

*“Having seen other companies fold and go out of business, would this change your decision going forward”  
– Sole trader, phase 3*

Overall, people found the questions about Covid-19 very easy to understand and had no issues with them.

### **3.12 Summary**

Overall, the survey is working well and is fit for purpose. People understood what was being asked of them, they comprehended the choice experiments and were able to articulate clearly the reasons for their choices. Although, there were issues with the MCR and tax attributes, these were overcome and enabled people to make realistic and credible choices.

Based on participant feedback, the changes described above were made to the survey as the cognitive testing unfolded, and final amendments were made prior to the pilot being launched.