

Will private business drive the UK forward?

More than two thirds of privately-owned companies expect their businesses to do better in the next two years.

Stay ahead.

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Introduction

Faced with the recent troubled times, it is so pleasing to see that 75% of privately-owned companies in the UK think that the worst is behind them, and two thirds expect their businesses to do better in the next couple of years.



It is also great to see that these companies are moving quickly to help themselves in the changing economic environment, which underpins what we already know from our extensive work with the private business sector across the UK.

However, we remain concerned that only a third of private businesses believe the UK tax regime supports and encourages enterprise, and report that they lack an effective voice with Government.

Leaders of private companies are putting their careers, families and futures on the line, and are asking for as much certainty as possible in the tax system. They want to be able to make long-term business decisions with confidence that the rules are not going to change suddenly.

Private businesses are a huge personal commitment by the family or entrepreneur involved and make a major contribution to the UK economy. We would like to keep it that way for both current and future generations.

Private business is not a sector that is looking for a crutch. Entrepreneurial businesses represent the commercial powerhouse of the economy, and 99% of these companies have been taking active steps to thrive in the face of the recession.

Their message to Government is: "Give us the stability to keep the UK competitive and enable us to make sensible commercial decisions. Stop tinkering and let us get on with it".

A handwritten signature in black ink, appearing to read 'Mary Monfries', with a horizontal line underneath.

Mary Monfries
Head of private business
PricewaterhouseCoopers LLP

The aims of the survey

This third national survey of private businesses by PricewaterhouseCoopers (PwC) is part of our long-standing commitment to the sector.

Building on our findings from 2006 and 2007, the Enterprising UK research tracks how these companies perceive the UK tax regime, and its support of enterprise and growth.

This year, the research also investigated the attitudes of privately-owned company leaders to the economic downturn and their plans and challenges as we approach the upturn.

Understanding their concerns helps PwC provide a voice for private business with Government and a more tailored range of solutions for our clients.

Key findings

- Growing optimism and confidence for the future, with more than two thirds of privately-owned companies expecting their businesses to do better in the next two years.
- Private companies are seizing the opportunities offered by the recession to help themselves. The vast majority have updated their strategic plans within the last year, with half having done so in the last three months.
- A third of these companies have had their business plans compromised by a lack of access to financing.
- Private businesses are starting to switch from cost cutting to a focus on their customers, products and services, with better targeting of customers cited most frequently as their highest priority strategy over the next year.
- While almost nine in ten privately-owned companies have identified the key people in their organisation, only six in ten are confident that they have aligned their business strategy and their talent management strategy.
- Only a third of private businesses believe the UK tax regime supports and encourages enterprise, despite the wide range of tax reliefs available and the measures introduced in the 2009 Budget.
- An increasing proportion of companies are asking for stability in the tax system, with a call for a reduction in uncertainty and the rate of change, up from 8% in 2006 to 17% in 2007 to reach 25% today.
- Privately-owned businesses are prepared to pay their fair share of tax, but like any other cost, will seek to reduce the size of the bill.

Commentary

Increasing confidence and optimism

Despite the recent economic turmoil, privately-owned business leaders in the UK are increasingly optimistic as they look ahead.

Just over a third of the companies surveyed expect their business to do better over the next year, rising to more than two thirds who expect improvement over the next two years.

One in six expect their business situation to be a lot better over two years.

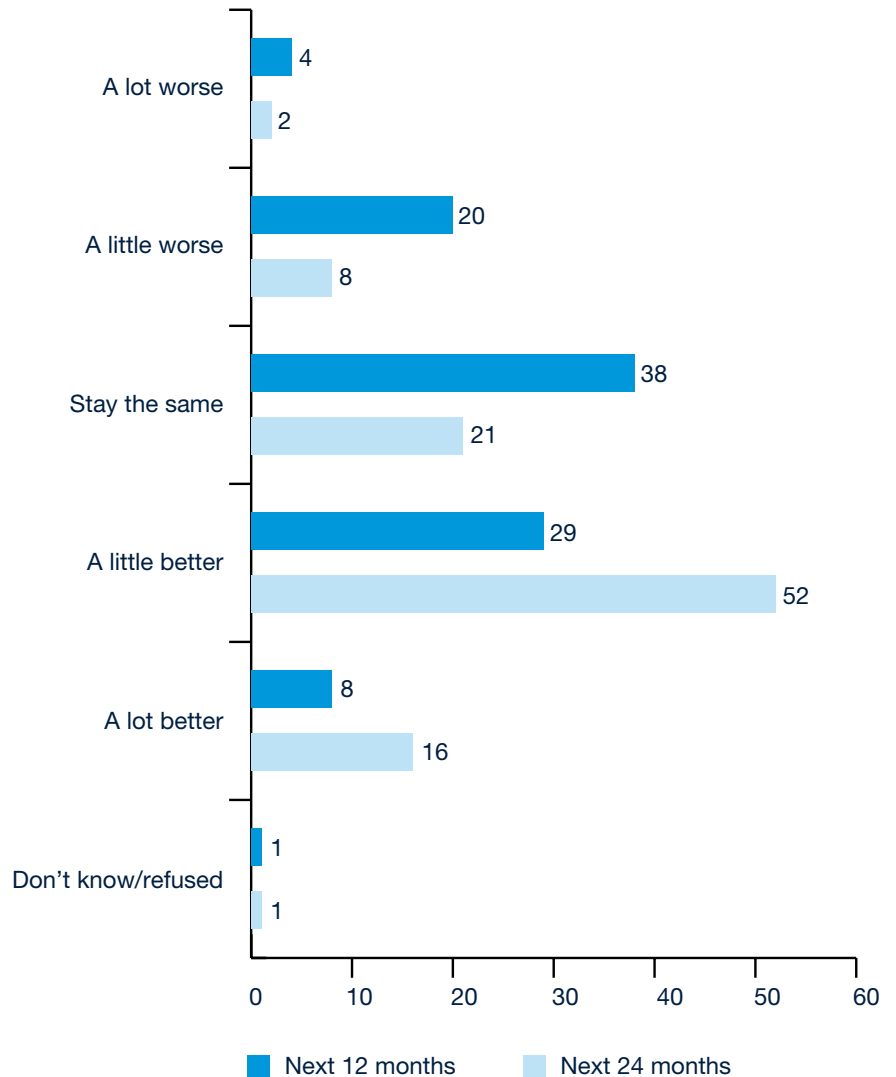
Encouragingly, management teams at these companies are planning for the future, and seizing opportunities to improve their competitive performance.

The vast majority have updated their strategic plans in the last year, with half doing so in the last three months. 99% of companies are now actively taking advantage of the opportunities created by the recession.

Counting the costs

The squeeze on funding by the banks has had a real impact, but perhaps has not hit private companies as hard as expected.

Figure 1: How do you expect your business situation to change over the next 12 months and the next 24 months?



“I don’t mind this recession particularly, it’s been healthy to cut costs and it forces you to re-examine your business model.”

Business leader’s view

David Gibbs, a Cambridge-based PwC private business partner, comments: “Private companies, and especially family businesses, in my experience tend to be far more risk averse about borrowing lots of money, and more inclined to grow through generating their own cash.”

“This helps private companies weather the recession and come out strongly, because they are not distracted by the problems and expense of refinancing and can focus on trading and building their market share.”

Nevertheless, a third of companies have had their business plans compromised by a lack of access to financing, and this rises to almost half of investor-backed companies and 43% of Scottish companies.

Mary Monfries, PwC head of private business, warned: “The impact of lack of access to financing shouldn’t just be measured in terms of business failures, but in terms of the economic growth lost or delayed.”

Raising money within the company

Rather than relying on banks, private companies have sought to free up cash from inside their businesses.

One of the respondents said: “In previous recessions, the banks were always there, strong in the background, but this time the banks were weak. We have been very much on our own in pulling ourselves out of this recession.”

The most popular ways to do just that, cited by around 80% of companies surveyed, were increasing profitability through cost containment, and focusing on liquidity.

Chris Romans, PwC private business tax partner in Birmingham, said: “During a recession, companies have to re-invest, rather than taking money out of their businesses.

“If the banks are reluctant to provide funding, you have to find money from other sources such as cutting costs.”

“We have an obsession about cash, which we were lazy about before.”
Business leader’s view

Identifying where to cut costs

The key areas where more companies were cutting costs than planning to invest were procurement, transport and logistics, supply chain and customer relationship management (CRM), finance and manufacturing.

As one company said: “The recession has pushed us to get our act together when negotiating with suppliers. Now we’re doing lots of things like assuring them of early payments for a reduction in prices, resulting in an increase in our margins.”

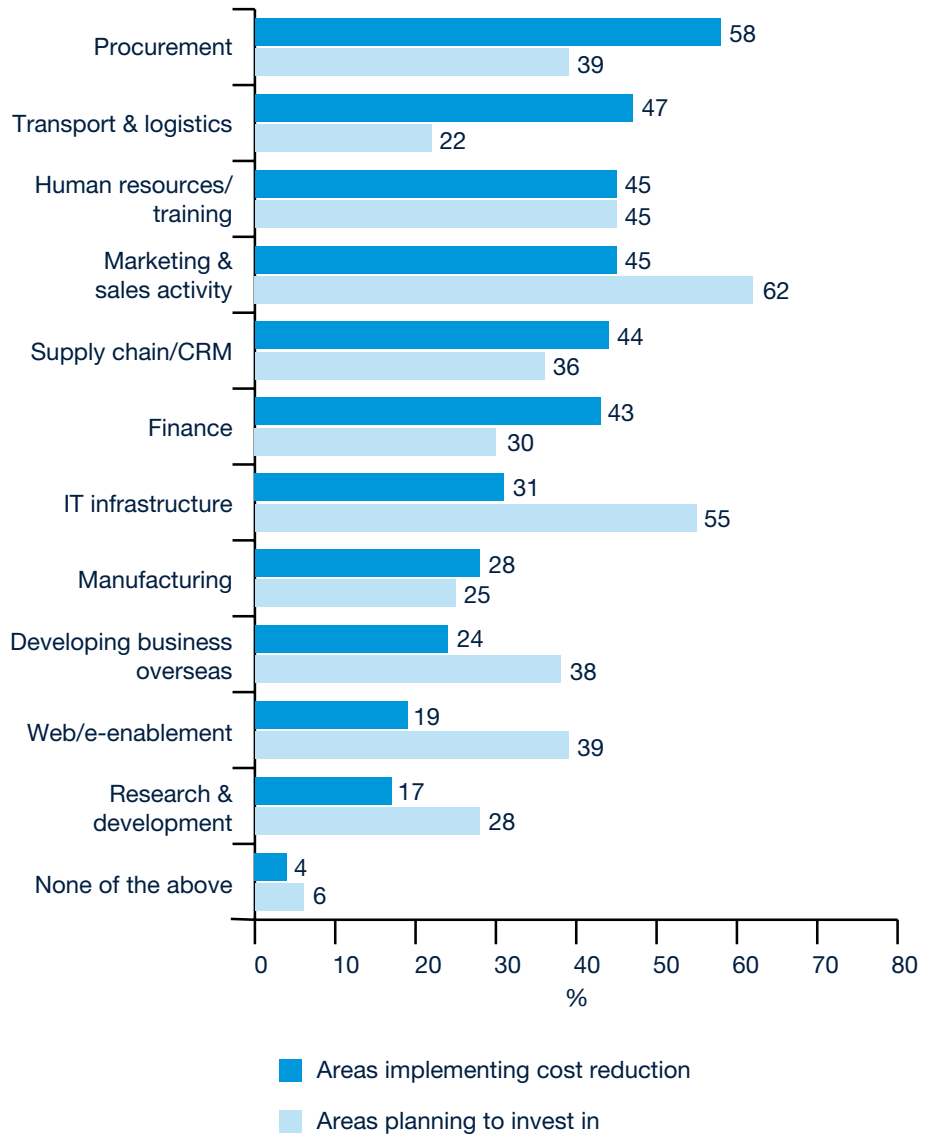
David Gibbs suggested that companies can be creative in cutting staff costs:

“Expenses and benefits can add an extra 10% to people costs, so companies need to do their housekeeping and check what they are spending, what they don’t need to spend, and what their employees won’t mind if they stop spending.”

“Employers could also look at flexible benefit arrangements and taking advantage of tax reliefs where available. For example, by offering extended holidays or reduced hours, I have seen some companies retain staff while cutting the cost of employment.

“One haulage client could not afford to give a pay rise, but by paying a tax-free round sum allowance to drivers out on location, it put more money in their pockets.”

Figure 2: Where are you currently implementing cost reduction in your company, or planning to invest?



“We are moving from the West End of London to Hammersmith to halve our rent. The alternative would have been to lose quite a few people, so I’m moving offices to keep the people.”

Business leader’s view

Investing to succeed

Switching from costs to customers

Many respondents viewed the recession as an opportunity for success, rather than solely a struggle for survival.

The three most popular strategies companies were considering to improve their competitive performance were: reducing the cost of operations; maximising return on investment; and better targeting of customers, with customer targeting as the highest priority over the next year.

David Gibbs added: “In the last recession, it was painful to see companies slash and burn, and lose good people.

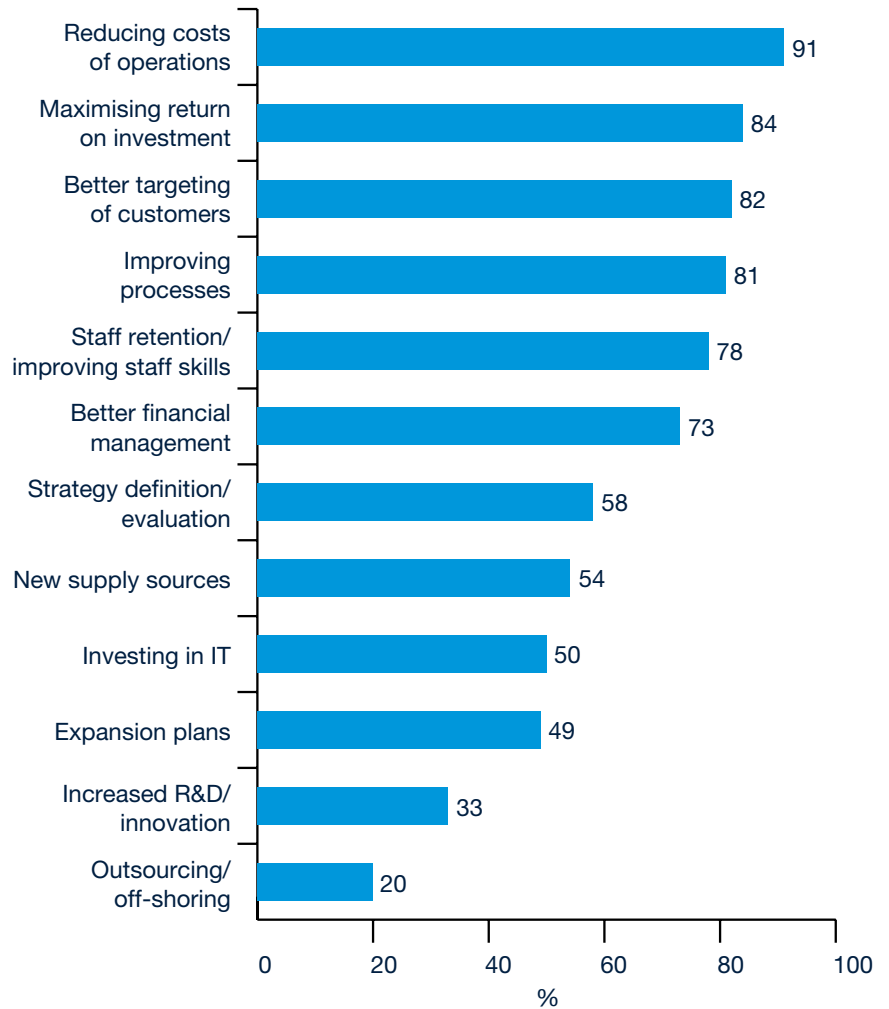
“This time round, private businesses are proving more resilient, trying to be more innovative in controlling people costs without losing employees, looking after their customers and improving their reputation.”

Julian Jenkins, a PwC private business partner in London, emphasised the need for business improvement and customer focus:

“Businesses shouldn’t take their foot off the pedal. They need to make sure they have the most efficient business model in place as the country starts coming out of recession.

“The companies who will win haven’t just been fire-fighting during the downturn, they have reshaped their business to trade in the new economic environment.”

Figure 3: Which strategies are you considering to improve competitive performance?



“Businesses need to adopt a back-to-basics approach, focusing on who their customer is, where their customer is, and how they can maximise their relationship over the next three to four years.”

Identifying where to invest

Alongside cost cutting, privately-owned companies are also conscious of the need for investment if they are to grow.

“Companies did exactly the right thing during the early stages of the downturn, in looking at where they could cut costs and control investment spend,” said Mary Monfries.

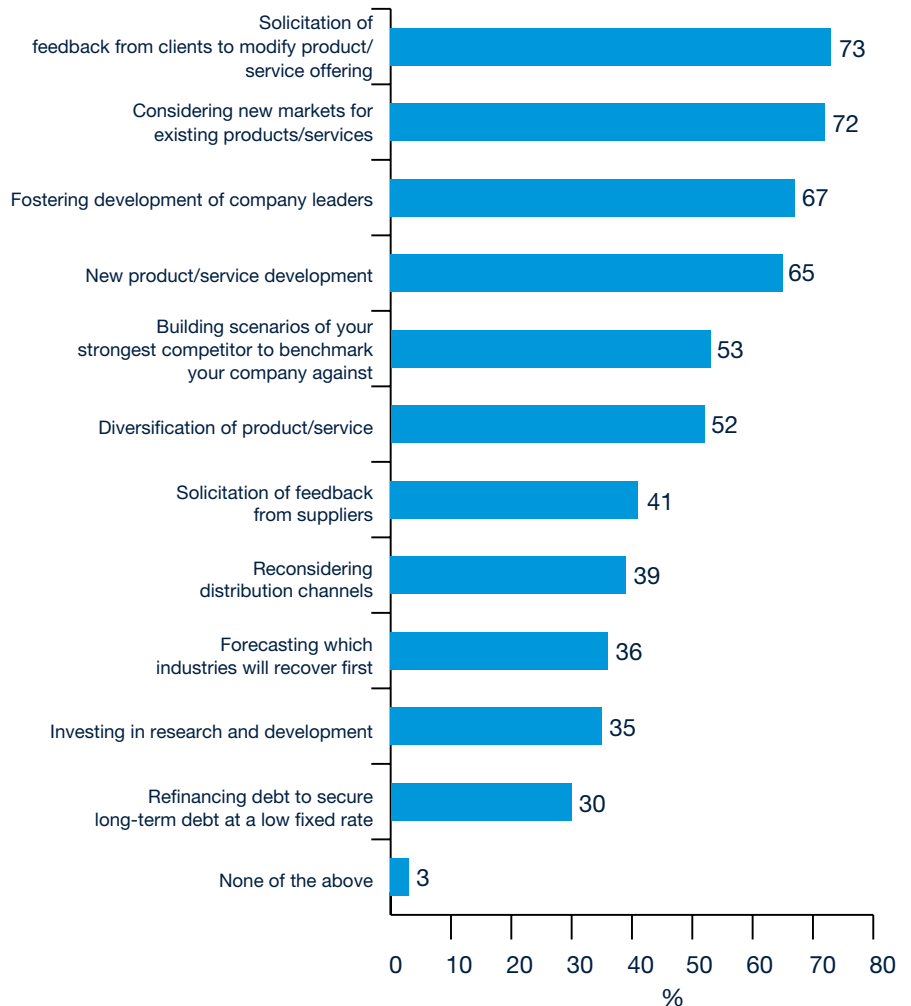
“The challenge more recently and as they move forward is where to focus investment, not only of cash but also of time and other resources, as they prepare to take advantage of the upturn.”

The key areas where more companies were planning to invest than cut costs were marketing and sales activity, Information technology (IT) infrastructure and web enablement.

Companies were divided about the expense of human resources and training, with 45% citing it as an area for cost reduction, while another 45% intended to invest.

One respondent said: “Where other people have had to cut back on the sales side, we have focused a lot more on sales training and are trying to be more creative than we have ever been about selling.”

Figure 4: Which of the following strategies have you employed to prepare your company for the upturn when it happens?”



“It is one thing getting contracts for business, another one being able to afford it, and the next one being able to produce and deliver them without letting down your existing customer base. We will have spent almost £750,000 this year on enhancing our production so it is quicker and more flexible.”

Business leader’s view

Mary continued: “A large proportion of companies are focusing on becoming closer to their customers and customer needs, which is crucial.”

Taking advantage of the internet

The huge acceleration towards trading over the internet and using digital platforms will enable companies to grow more effectively as the good times return.

The survey showed that 55% of businesses are planning to spend on IT infrastructure, and 39% on web enablement.

Alison Lees, a PWC senior private business partner, said: “I am surprised that more companies are not investing in these areas, given the growth of sales online compared to traditional distribution channels, and given the need for greater flexibility in the supply chain to respond more quickly to changing customer demand.”

Staying ahead and getting fit for the future

Looking ahead, the most popular strategies to prepare for the upturn are focused on products and services, whether soliciting feedback on how to change them, or considering new markets.

Alison Lees said: “Make sure you invest wisely, so you can come out of the recession strongly.

“Then stick to your knitting and focus on what you are best at.”

To protect against future economic downturns, more than nine in ten companies are taking steps to improve the quality and reputation of their business.

Finding new customers

The next most popular strategy to limit the impact of future downturns was to diversify their customer base, cited by almost 70% of those surveyed.

Julian Jenkins urged companies to consider the location of their customers, as the West has typically been harder hit by the recession than countries further afield such as India and the Far East.

Julian said: “For someone in the UK trading globally, the composition and source of their overseas business may have changed considerably, and increased in the Far East for example compared to mainland Europe.

“We invested heavily in a customer relationship management system this year, to help make the right decisions. It was a key strategic project which paid dividends.”
Business leader’s view

“I regret that we didn’t behave this way in the boom time, as we would have been substantially ahead when the crisis hit if we had.”
Business leader’s view

“Lots of companies need to start thinking about where their selling and manufacturing operations should be based, for the most profitable and sustainable growth.

“Businesses should also consider how to mitigate foreign currency risks, especially if the volume and nature of their foreign currency flows has changed.”

Mergers and acquisitions can provide an opportunity for private companies to bolster their product range and customer base.

However, private companies looking to pick up assets cheaply in the current market should think through the tax implications of different ways of structuring the transaction before taking the plunge, according to Chris Romans:

“Acquiring a company directly, as opposed to through your business, could make the difference when you come to sell between paying 18% tax up to as much as 55%.”

Investing in talent

Putting the right people in the right place is vital to the success of any business.

The vast majority of private companies, almost nine in ten of those interviewed, have identified the key people central to their organisation.

However, only six in ten are confident they have aligned their business strategy and their talent management strategy.

Mary Monfries said: “One of the most important areas, in these times of constrained resources, is to ensure that incentive arrangements are underpinning the strategy of the business and driving the right behaviours.”

“Aligning personal motivation with the needs of the business, both short and longer term, is crucial.”

Alison Lees pointed out that family businesses in particular can face issues aligning their business and people strategies, especially if there is a lack of agreement between family members, or problems motivating employees to enhance the pot for the next generation.

“We are vulnerable to undercutting on price, so have to stress the quality benefits to our customers – another reason why we need really good marketing and PR people.”

Business leader’s view

Improving staff productivity

Faced with pressures to cut costs and staff, 95% of privately-owned companies are planning to improve staff productivity.

Preferred methods include structural reviews and promotions, for almost two thirds of the companies interviewed, followed by financial bonus schemes and training or education awards.

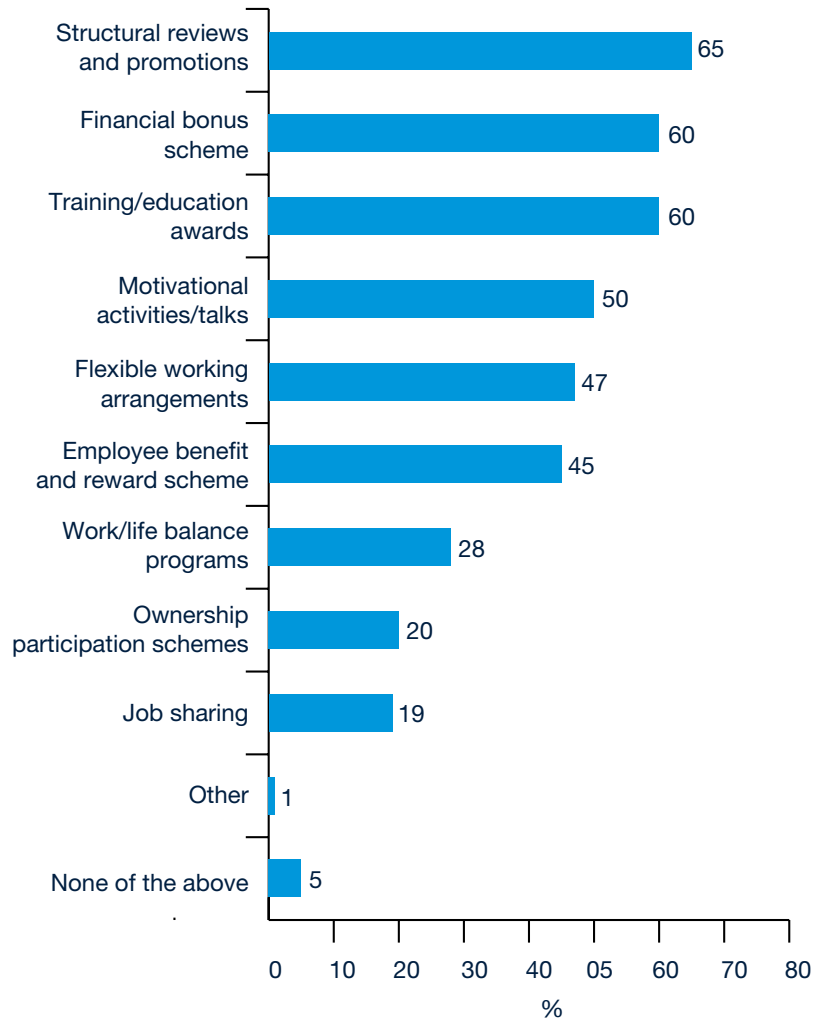
Financial bonuses appealed most to ex-management buy-out or management buy-in (MBO/MBI) companies, at 72%, and least to family companies at 54%.

Meanwhile companies concerned about the cost of training schemes could potentially take a more sophisticated approach, rather than simply cutting courses altogether, according to Isabel McGarvie, a Glasgow-based PwC partner specialising in human resources:

“For example, companies that are keen to retain staff and continue their career progression could still pay for leadership development training, but on the understanding that if the employee leaves within a certain amount of time after completing the course, they have to pay back a proportion of the cost.”

Only one in five companies were considering ownership participation schemes to improve staff productivity, despite the tax reliefs on offer.

Figure 5: How are you planning to improve staff productivity in the next year?



“We are demanding a lot harder work from everybody. We have upped staff targets and activity.”
Business leader’s view

Chris Romans pointed out: “Faced with the advantage of tying people in to the long-term success of the business, together with an overnight jump in the top rate of income tax from 40% to 50% next April, business owners might consider structuring remuneration packages so that their management is incentivised by capital returns and share-based participation, rather than increased salary.”

Recruiting new staff

Rather than using the recession solely as a chance to weed out weaker staff, forward-thinking companies can also take the chance to seek key talent elsewhere.

Isabel McGarvie said: “If you are forced to restructure your business to survive these difficult times, ask yourself whether you have the right people with the right skill sets to cope not just today, but also to take advantage of growth in the future.

“A company that needs to take the tough decision to reduce headcount should consider strategic recruitment at the same time.”

David Gibbs also thinks that the recession can provide an opportunity to recruit high-quality employees:

“Nowadays private businesses should be in a better position to compete with listed companies for top talent, as employees realise that the share options offered elsewhere don’t always deliver a pot of gold.”

David recommended that owners forced to put plans to sell their business on hold during the downturn should look at getting great people in to help run their company, and empowering their management team:

“This way, you can go through the sale when the economy picks up without needing to stay involved.

“Offering increased responsibility and a stake in the future proceeds can also be a neat way to plan your own exit while keeping key personnel motivated.”

“I am actually an employer, trying to create wealth for the economy, and HM Revenue & Customs (HMRC) is coming in and trying to trip us up on technicalities.”

Business leader’s view

Support from the UK tax regime

Only a third of companies believe the UK tax regime supports and encourages enterprise, despite the wide range of tax reliefs available and the measures introduced in the 2009 Budget.

Nearly one in six regard the tax system as not supportive at all.

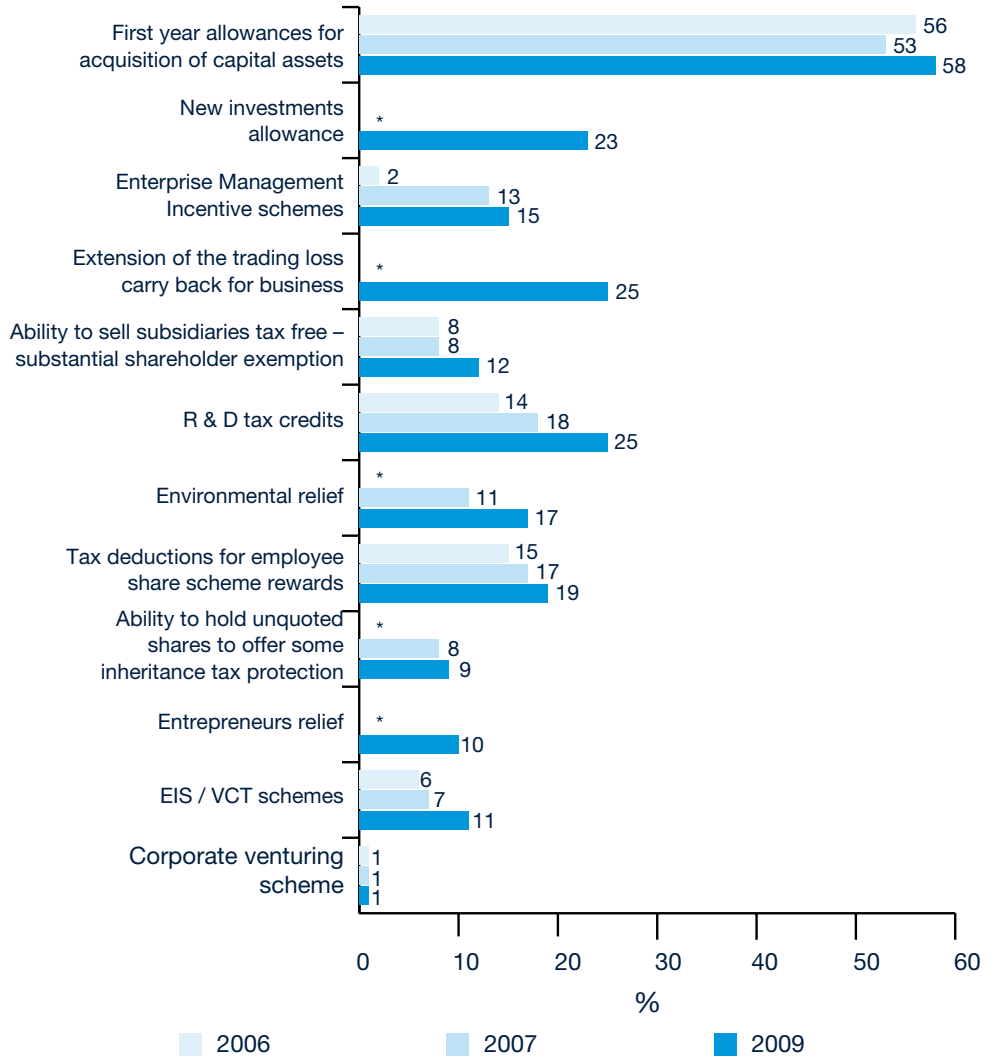
Usage of the various tax incentives on offer remains low. Consistently only a minority of companies has taken advantage of the incentives and reliefs on offer, with the exception of first-year allowances for the acquisition of capital assets, used by 58%.

First-year allowances for the acquisition of capital assets were also cited most frequently as the tax incentive with the greatest impact on commercial behaviour. 21% of companies using at least two of the twelve different schemes surveyed cited these first-year allowances, while a further 18% judged R&D tax credits to have the greatest impact.

Of the companies who had not used them, at least two thirds said it was because either their company did not qualify, or because the relief was not applicable to their business.

Just less than half (45%) of the companies eligible for the much-publicised Enterprise Finance Guarantee (EFG) scheme, designed to help businesses with a turnover of under £25 million get access to funding, were aware of the scheme, and 3% of these had taken advantage of it.

Figure 6: Which tax incentives and reliefs have you taken advantage of?



*This question was not asked in 2006 and 2007

“Whenever we have looked at any support that has ever been offered to businesses by governments or councils, we never qualify for anything. It’s so hard to get anything that most people give up at the first hurdle.”

Business leader’s view

While the current tax reliefs and incentives on offer are not having as wide an impact as Government might hope, it should not be forgotten in any usage statistics that many reliefs are specifically targeted, and therefore will not be relevant to a broad population. This includes the crucial assistance offered by the Enterprise Incentive Scheme and Venture Capital Trusts, which help narrow the UK's 'equity gap', by providing funding and skills for early stage growth companies.

Budget 2009, what impact?

Fifty percent or more of companies did not think key proposals in the 2009 Budget would impact on their business decisions. These included the introduction of a top rate of 50% income tax, the return to 17.5% value-added tax (VAT) from 2010 and the restrictions on tax relief on pension contributions for high-earners.

However, Isabel McGarvie warns: "A lot of people might think that the 50% top rate of income tax for those earning more than £150,000 a year will not affect them, but if you take into account bonuses, long-term incentives and any other taxable income from employment or elsewhere, then even staff with a base salary considerably under £150,000 could be hit."

Concerns were also raised that changes such as the introduction of a top rate of 50% income tax could make the UK less appealing to international entrepreneurs and business builders compared to other countries.

Chris Romans said: "The Government needs to ensure the UK is an attractive place to do business, by not taxing the wealth creators too highly.

"Otherwise we risk losing key entrepreneurs and the jobs they create to overseas locations."

Paying a fair share

Two thirds of companies agreed that tax is the licence fee you pay to society, and you need to pay a fair share.

However, a higher proportion of companies – at almost eight in ten – agreed that they would seek to reduce their tax savings, where this did not involve entering artificial arrangements.

By taking advantage of the legitimate tax reliefs on offer, businesses can cut their tax bills down to size.

Chris Romans said: "Often the best tax planning is the simplest: get your house in order, so you are claiming all the reliefs you are entitled to.

"For example, there are a host of reliefs available for environmentally-friendly expenditure, which can potentially give 100% capital allowances.

"Most companies who do some form of research and development (R&D) will be able to get R&D tax credits, but only about a quarter of the businesses surveyed were claiming."

"The VAT cut did not provide a significant enough saving. Obviously it impacts our business, because all our systems have to be changed, which costs us a few thousand pounds. The return to the standard rate will have zero impact, except in helping the IT department work overtime because of all the things they have to do to change our systems."
Business leader's view

“In addition, employee share ownership schemes can be used not only by listed companies but also by private companies, and offer significant benefits to both the employee and the company.”

Creating a more competitive tax system

When it comes to improving the competitiveness of the UK tax regime, just over half the companies interviewed would like to see tax rates cut, but more than a quarter focused on reducing the burden of compliance.

As one company said: “The Government should be doing more to help businesses who want to reinvest money and create jobs, but the tax rates are ridiculously high.”

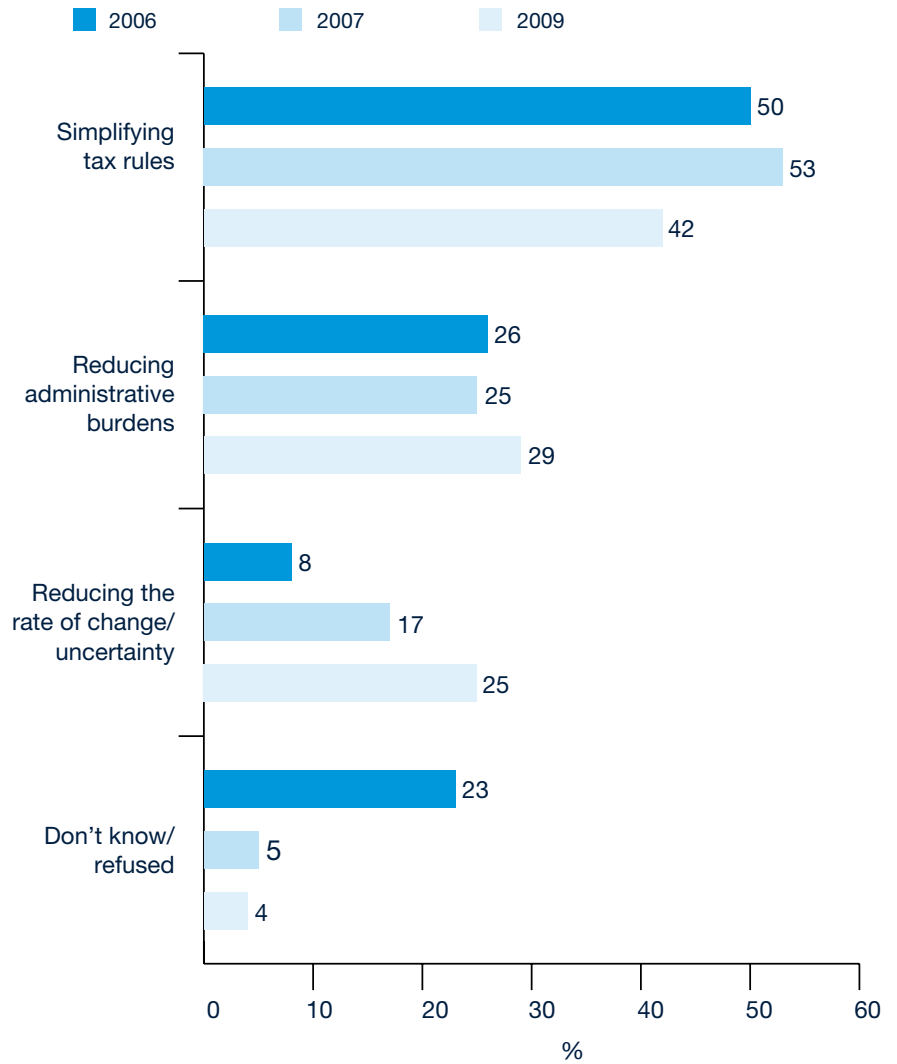
Mary Monfries commented: “Reducing tax rates would be a challenge for any government in the current economic climate, but a reduction in the rate of change and uncertainty should be easier to deliver.

“Businesses need to trust that the rules as they know them are going to stay the same.”

On the positive side, the online service provided by HMRC is proving even more popular with privately-owned businesses than two years ago.

A larger proportion of companies are now going online to submit their returns for corporation tax and VAT, to deal with pay-as-you-earn (PAYE) and to claim benefits, up from 67% in 2007 to 78% this year.

Figure 7: What is the most useful change government could introduce to reduce red tape and the burden of compliance?



Respondents were also much more likely to perceive dealing with HMRC over the internet as quick, easier, more convenient, more accurate and more secure.

Desire for stability

Simplifying the tax rules remains the most popular measure Government could take to lighten the burden of compliance, but an increasing proportion of companies are calling for a reduction in uncertainty and the rate of change, up from 8% in 2006 to 17% in 2007 to reach 25% today.

Mary Monfries said: "Trust that the tax rules will not keep changing is just as important as the underlying tax rate in attracting entrepreneurs and investors to the UK."

Research conducted by the World Economic Forum, in its *Global Competitiveness Report 2009-2010*, also identified tax regulations and tax rates as major concerns for business. Both appear in the top five most problematic factors for doing business in the UK, where 13% cited tax regulations and 12% tax rates, along with access to financing (22%), inefficient government bureaucracy (14%) and political instability (11%).

"I don't know how you can simplify the tax system, because there are so many different aspects to it, but what really irritates me is when you have changes in the rules."

Business leader's view

Where is the voice of private business?

While the companies surveyed raise multiple concerns about the tax regime, they do not feel their messages are getting through.

More than eight in ten companies agreed that privately-owned businesses need an effective voice with HM Revenue & Customs (HMRC) and HM Treasury.

However, almost half do not feel the private business sector is able to make its views heard by Government, and less than a fifth believe that Government acts on the concerns expressed.

PwC is using the research to further inform our ongoing discussions with Government on how the tax regime can be improved to help private businesses for the long term. This continues PwC's long-standing commitment to private businesses, helping them to have a louder voice and a better understanding of the reliefs and incentives available.

Conclusion

Privately-owned businesses have demonstrated growing optimism about both economic recovery and their opportunities for the future in this third national Enterprising UK survey conducted by PricewaterhouseCoopers (PwC).

Rather than a struggle for survival, many private companies have used the recession as a reason to re-examine and refine their business models.

The credit crunch forced companies to focus on freeing up cash by cutting costs. Now, however, these businesses are making plans to take advantage of the expected upturn, by investing in their key customers, products, markets and employees.

While the overwhelming majority of private companies are working hard to help themselves, many are frustrated by the ever-changing, highly-complicated tax system.

Only a third of private businesses believe the UK tax regime supports and encourages enterprise, and only a minority have taken advantage of the raft of incentives and tax reliefs on offer.

PwC looks forward to continuing to work with both the private business sector and Government to improve the tax system, and companies' understanding of it.

How the survey was conducted

The research for the survey was co-ordinated by PricewaterhouseCoopers' International Survey Unit, based in Belfast.

391 companies, with annual turnovers ranging from less than £5m to more than £200m, were surveyed, across a wide variety of industries and regions throughout the UK.

Telephone interviews were conducted with chief executive officers (CEOs), finance directors, managing directors and proprietors of privately-owned businesses, between 4 June 2009 and 7 August 2009.

Figures are weighted to reflect the profile of companies participating in 2009, and therefore may show minor differences compared to the figures published in the 2007 PricewaterhouseCoopers *Enterprise in the UK survey*.

The survey results have been shared with the Department for Business, Innovation and Skills, HM Revenue & Customs and HM Treasury.

Contacts

Mary Monfries
mary.c.monfries@uk.pwc.com

London

Julian Jenkins
julian.s.jenkins@uk.pwc.com

Alison Lees
alison.lees@uk.pwc.com

Ruby Parmar
ruby.parmar@uk.pwc.com

South East

David Gibbs
david.c.gibbs@uk.pwc.com

Lynn Piercy
lynn.m.piercy@uk.pwc.com

Ray Thomas
ray.e.thomas@uk.pwc.com

Midlands

Barry Smith
barry.k.smith@uk.pwc.com

Steve Snook
steve.r.snook@uk.pwc.com

West & Wales

Tracey Bentham
tracey.n.bentham@uk.pwc.com

North West

Arif Ahmad
arif.a.ahmad@uk.pwc.com

North East

Ian Morrison
ian.j.morrison@uk.pwc.com

Scotland

David Clarkson
david.j.clarkson@uk.pwc.com

Isabel Mcgarvie
isabel.mcgavie@uk.pwc.com

Northern Ireland

Paul Rooney
paul.g.rooney@uk.pwc.com

Lindsay Todd
lindsay.todd@uk.pwc.com

A sister report – *Enterprising UK: A voice for private business?* focuses on how private businesses perceive the UK tax regime and its support of enterprise and growth. To receive a copy of this report, please visit www.pwc.co.uk/privatebusiness.

Private business magazine – In November 2009 we will be launching a new magazine aimed at private businesses. Private business magazine is a quarterly publication which will cover hot topics and issues relevant to you and your business. If you would like to receive a copy please contact sarah.x.rodwell@uk.pwc.com.

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