Federation of Small Businesses

22nd November 2024

Dear Sir/Madam,

**RE: Invest 2035: the UK's modern industrial strategy: Open consultation**

The Federation of Small Businesses (FSB) welcomes the opportunity to provide a response to the above consultation.

FSB is a non-profit making, grassroots and non-party political business organisation that represents members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

We welcome the Government's commitment to tackling stagnant productivity growth and low rates of investment. This response outlines evidence-based policy interventions that could have a significant impact on the economy – and place small businesses at the centre of a comprehensive growth strategy. Indeed, with SMEs accounting for three-fifths of private sector employment and 99.9% of the business population, any successful plan for growth must have small businesses at its heart. A targeted approach to tackling barriers to small business investment is therefore very welcome.

We note also that although the focus-sectors for this Strategy only cover part of the UK economy, many of the interventions outlined in this response would support key supply chains and local infrastructure needed for the focus sectors to thrive. And for supply chains to be resilient, small business needs must be factored in right from the start.

Interventions proposed in this response that we think would be particularly impactful – and we go into more detail about include:

- **Set a target to get the SME population back up to 6 million.** The business population currently sits at 5.5 million, which remains below the pre-COVID peak of 6 million. Small businesses are at the heart of any truly dynamic and competitive economy. The Industrial Strategy should build on the UK's rich history of entrepreneurship and establish a target to increase the number of businesses back up to 6 million by January 2028, with specific targets for different demographics (such as disabled and female entrepreneurs, and ethnic minority-led businesses). Self-employment has a key role to play in this.
- **Small business representation in the Industrial Strategy decision-making bodies.** There should be small business representation on any decision-making bodies, including the Industrial Strategy Council and in the development of Sector Plans.

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- **Regulate personal guarantees as a barrier to investment.** Bank of England data shows that 77% of businesses would rather grow slowly than borrow money, and if the industrial strategy is to succeed, we need to remove barriers to risk-taking and investment. If personal guarantees were included within FCA's regulatory remit, by applying the consumer duty, it would free up more investment by limited company directors in key sectors.
- **Build resilient supply chains by flushing late payment out of the economy**. The Government now blocks businesses with poor payment performance (over a 55-day average) from bidding for new contracts from 2024, which will reduce to 45 days in October 2025. This should be extended to block these late payers from receiving Government grants (such as through Innovate UK).
- **Commit to an SME spend target for the Industrial Strategy.** The Government should commit to a 33 per cent SME target for all spending relating to the Industrial Strategy, including through the National Wealth Fund. Similar to the previous Government's SME procurement target, this should apply to both direct and indirect spend.
- **Transform planning policy with longer term strategy and lower barriers for SMEs.** Better resourced planning authorities are needed which leverage and align Local Plans and Local Growth Plans. This can provide channels for SMEs to fast track their development and strategically support key commercial zones, such as high streets and supply chain clusters to thrive.

It is key for the impact on small businesses to be taken into consideration and tracked as policies are implemented. With a membership of over 150,000 businesses, and a network of staff, volunteers and members at national, regional and local levels, FSB is uniquely placed to provide insight into the small business impact of the Industrial Strategy. We look forward to working with the Government in the coming weeks and months to develop Sector Plans and the full Industrial Strategy.

For late 2025/early 2026, FSB is exploring scheduling the first ever Small Business Growth Conference. This would be the biggest small business event in the annual calendar, with small firms attending from local business communities across the UK, focused on how to grow. We would be ready to incorporate the Industrial Strategy into much of the agenda for this, and with a Senior Government Minister to speak, to help bring the country and our community along with the plans - as long as they see themselves and their needs reflected in the strategy published in the Spring after this consultation.

We welcome the trio of papers due in Spring: the Small Business Command Paper, the Trade Strategy, and the full Industrial Strategy. Maximising the impact of these on growth will require that these strategies are developed in a coordinated way, so that they fit together and work cohesively, and have an amplifying effect rather than pulling in different directions.

The Industrial Strategy needs to fundamentally be a supply-side blueprint to not just strengthen but futureproof the UK economy against future shocks. Making sure our supply chains are more robust, that we're decarbonising at the pace and scale needed, and ensuring young people are able to benefit most from the opportunities of this long-term plan, are key. Small businesses can and should spearhead this phase for the UK economy – just as they did in the employment recovery following the Global Financial Crisis.

We have not commented on every section within the consultation, only those that we are able to share a valuable perspective on.

**Questions**

Question 3: *How should the UK government incorporate foundational sectors and value chains into this analysis?*

Sector analysis should account for the small businesses in the supply chains that support these sectors. This is especially important if the UK is to avoid falling victim to economic shocks, as in the past decade and a half. In particular, the impact that late payments have on supply chain resilience should be considered in analysis. Small businesses often have very tight cashflow, with late payments having a substantial effect on their ability to grow and invest. For some small businesses the effects are fatal, with FSB data showing that late payments cause 50,000 small business closures every year. This creates avoidable instability in supply chains. The announcements made by Business and Trade Secretary Jonathan Reynolds in September will play a key part in reducing late payment, and it is important that the planned consultation brings stronger accountability for large corporates, by making audit committees accountable for oversight of payment performance. Furthermore, Government has the chance to lead by example, making prompt payment a prerequisite for all recipients of Government funding, including grants, which will in turn improve the resilience of key supply chains. This would build on current Government policy which blocks businesses with poor payment performance for bidding for large Government contracts.

Question 6: What are the key enablers and barriers to growth in these subsectors and how could the UK government address them?

**Advanced Manufacturing**

Boosting industrial decarbonisation
Firms who get ahead in their decarbonisation journey will have a significant competitive advantage. Yet, there has been insufficient policy attention paid to decarbonisation of industrial processes in SMEs. To address this, we propose that Government should decrease the eligibility thresholds for firms to be eligible to apply for Industrial Energy Transformation Fund (IETF). The current SME threshold for energy efficiency and decarbonisation projects should be reduced from £75,000 to £20,000, to increase the rate at which UK decarbonises its Manufacturing sector.

On-shoring key supply chains

During the pandemic, and uncertainty around global supply chains, we saw more businesses move their manufacturing supply chains back to the UK. However, there are feasibility challenges that restrict some businesses' ability to do so. These may be related to not having enough suitable workers or certain parts being harder to access in the UK. Government should work with a diverse range of businesses who would like to on- or re-shore their manufacturing processes, identify the barriers that are preventing them from doing so and what policymakers could do to enable them to bring their manufacturing processes to the UK. This could include introducing skills bootcamps in certain areas or working out solutions to specific supply chain problems. If the pilot succeeds in encouraging the majority of these companies to bring a higher proportion of their manufacturing processes to the UK, it should then be expanded.

**Creative Industries**

The Creative Industries contributed £125bn Gross Value Added in 2023, an often-overlooked growth story in the UK economy. With 28% of those in this industry being self-employed, parity of support for the self-employed and small businesses is vital to ensuring the industry reaches its potential. Universal credit and the minimum income floor (MIF) rule are important policies for many of those working as freelancers in the industry. An area of growing concern is the influence of AI in creative industries. The start-up period under Universal Credit-MIF should give newly self-employed individuals on UC the time and space to focus on starting up as freelancer, which can often take longer than a year to start-up. The start-up period should be increased to two years.

Ensuring adequate protections for creators' work will be vital for building the confidence needed for the Creative Industries to thrive. 35% of small businesses that are currently using AI are concerned about the impact of AI on intellectual property rights. It is important that copyright laws protect the output of authors, creators, and other publishers from misappropriation and misuse from developers of foundation models. If we want to encourage creativity and new ideas, it is important that these rights are protected and respected. The Department for Science, Innovation and Technology should also work with small AI developers to enable them to use data in an ethical and effective way.

Where public money is spent on commissioning, the opportunities created for small production companies should reflect the value of small businesses to the economy. There should be a requirement on public service broadcasters to spend 33 per cent of their commissioning budget on small independent production companies, and to include this percentage in their published annual accounts. This would help public service broadcasters to decentralise production from London and to maintain a focus on distinctively British content.

Building a talent pipeline for young entrepreneurs in the Creative Industries will be key to the growth of this sector. The Creative Industries Clusters Programme should provide mentoring and networking opportunities to young entrepreneurs in creative industries. Our research shows that young people value mentoring and networking opportunities, which aligns with the 2024, *Beyond growth: promoting inclusive development of creative clusters in the UK* report which suggests programmes offering networking and mentoring to young people from disadvantaged backgrounds could support the development of inclusive clusters. Creative Industries Clusters led by UK Research and Innovation were introduced in 2018 with funding from the Industrial Strategy Challenge Fund. The House of Lords, 2022-23, *At risk: our creative future* report stated the Clusters Programme successfully engaged SMEs to become 'one of the most impressive investment programmes of recent times'. In June 2023, the Conservative Government committed £50 million for the second wave of the Programme with at least six new clusters.

**Digital and Technologies**

Access to and effective use of technology must be central to any plan for growth. Some of the key barriers, and policy solutions within this sector are as follows:

<u>R&D tax relief</u>
R&D tax relief has been a significant catalyst for small businesses looking to innovate, boosting R&D investment among small firms. Of the small businesses which successfully applied for R&D tax relief in the last three years, it has led to the following: improved the cashflow for their business (64%), increased their investment in R&D (55%), increased their investment in future projects (41%), and led to them undertaking projects that would not have happened otherwise (35%). While it is understandable and right that Government wishes to minimise error and fraud in the R&D tax relief system, it must not do this at the expense of cutting off this vital tax incentive from small innovative firms.

<u>Technology adoption across the economy</u>
For the UK economy to derive widespread benefit from our digital and technology sectors, it is important that we see widespread adoption of new technologies across the economy. This will see productivity improvements across the entire economy and will drive demand for the products and services being developed by the sector. FSB would propose that the UK Government should spend the equivalent of at least 10 per cent of the overall Research and Development budget on the diffusion and adoption of innovation.

<u>Make patents more accessible for small firms</u>
In order to benefit from new inventions, firms need to be able to benefit from IP protections. The main barriers for small businesses accessing IP are related to a lack of awareness, the perception that registration procedures are complex and costly, and the high cost of enforcement of those rights. Updating patents also incurs significant additional costs. Given these factors, small businesses are at a competitive disadvantage when it comes to patents compared to large firms. This is why only 4% of small firms have applied for patents, although the figure rises to 15% in manufacturing.

Small businesses in UK's technology and advanced manufacturing sectors would benefit from accelerated handling to patent applications from first time applicants. This could be based on the Green Channel that the IPO currently operates, in which the applicant's patent request receives accelerated handling if they can explain why the technology is environmentally friendly. Additionally, firms could be encouraged to access patents for the first time with a financial incentive. A small business that hires a patent attorney to make the initial application could be reimbursed up to £4,000 by Government when the IPO has received their first application.

**Financial Services**

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Financial Services is an important sector in and of itself, as well as an important enabler for growth in other priority sectors and the rest of the economy. Here are some of the barriers, and proposed policy solutions, as they pertain to small businesses:

Regulatory fees
For financial services firms which are FCA-regulated, the level of regulatory fees presents a disproportionate challenge, and a barrier to entry, for new entrants. In 2022/23, the FCA proposed a change in the fee structure, which resulted in up to a ten-fold increase in the fees paid by the smallest firms providing credit-related activities. At the time, FSB asked FCA to reconsider, on the basis that the proposed fee structure was regressive and would price small firms out of financial markets. We would again call on FCA to reconsider their fee structures in order to encourage new innovative firms to enter the market.

Personal Guarantees and the Consumer Duty
The Chancellor has rightly identified the importance of regulating for growth. One way that the FCA could better regulate for growth is if the Treasury expanded the scope of the FCA Consumer Duty, so that it applies to personal guarantees given by limited company directors when borrowing money. There is currently a regulatory loophole whereby FCA regulation is not applied to personal guarantees given by individuals, typically company directors, against lending to limited companies. This makes what should be a business risk into a personal one. One of the biggest drags on small businesses' choice on whether to seek to grow is the understandable belief that doing so puts their homes or family finances at risk.

Overwhelming feedback from small business owners suggests that the fear of a personal guarantee being enforced is one of the key drags on willingness to invest. Negative perceptions of the banks' actions towards small business owners during the financial crisis, even if now increasingly second hand, and general lack of trust towards the banks, only exacerbates this.

Extending the Consumer Duty so it covers personal guarantees would address this. This light-touch regulatory solution would not preclude lenders from requiring a personal guarantee, but it would mean that a personal guarantee cannot be required by lenders as a blanket policy without any consideration of whether it is in the individual's interests to offer it.

Banks and financial institutions should also gather and publish better data on the proportion of applications and successful applications for finance from ethnic minority business owners, to help build trust among ethnic minority-led businesses.

**Professional and Business Services**

FSB would highlight the following barriers and policy solutions to boost small firms' growth in Professional and Business Services:

Better regulation of professions
Much of this sector is governed by professional regulators (such as accountants, solicitors, architects). Regulators' legal duties must reflect the importance of creating an environment that support small firms to provide competition. As such, it is vital that these professional regulators have

duties to keep barriers to entry and regulatory costs low for small firms. Professional regulators must also put in place progressive fee structures that keep regulatory fees low for small firms, to encourage new, innovative firms to be set up to challenge the large incumbents in these sectors and drive competition.

Professional Indemnity Insurance is a significant cost for many professional services firms, and it is often a pre-requisite to being able to practise in these sectors. The cost of PII will generally be a higher percentage of turnover for a smaller firm than a larger firm, and many professionals find it difficult to retire or sell their professional service business due to the need to purchase prohibitively expensive run-off cover. We believe there is a strong case for the FCA to carry out a market study into professional indemnity insurance, looking at ways to reduce the cost, which should also explore whether the "claims made" basis that PII currently operates under is undermining the attractiveness of setting up professional business services firms. This could have a significant impact on competition in the sector and drive innovation.

<u>Personal guarantees</u>
A pervasive barrier to investment is the over-use of personal guarantees by lenders, which deters limited companies and other legal structures from taking on debt to grow, and defeats the purpose of limited liability companies by making a business risk into a personal one. The simple policy response to address this barrier would be to include personal guarantees within the scope of the FCA Consumer Duty.

The legal sector faces a further problem with personal guarantees, with firm owners being asked by insurers to provide personal guarantees when taking out professional indemnity insurance policies that they are required to hold by the regulator.

<u>Tax</u>
Professional business services firms have long had a presence on Britain's high streets, but high costs of doing business risk endangering this. It is vital that business rates do not drive firms away from physical premises and away from high streets. Increasing the threshold for Small Business Rates Relief to £25,000 would support more small firms in this sector to remain on Britain's high streets, with positive knock-on effects for local economies.

<u>Trade</u>
For professional service providers to be able to access international markets, it is important that the UK's trade policy focuses on mutual recognition of professional qualifications, and supports the right of UK-qualified professionals to establish in overseas markets and partner with local firms. This will require partnership working between UK Government and the professional regulators who often ultimately decide which qualifications to recognise.

<u>Tech adoption</u>
For the UK's professional business services firms to remain internationally competitive, we need them to lead the way in technology adoption, including making the best use of artificial intelligence. While FSB data shows that professional firms lead the way among sectors in AI adoption[1], significant

[1] FSB, Redefining Intelligence, March 2024, https://www.fsb.org.uk/resource-report/redefining-intelligence.html

barriers remain, including the cost of adoption, access to information and skills. The Flexible AI Upskilling Fund Pilot was a good initiative to boost high-level AI skills in Professional Business Service sectors, but it would be even more effective if some of the funding of such initiatives could be used by small firms to buy in consultant expertise to advise the business on what technologies to invest in. Digital audit vouchers for small businesses should be introduced to enable more small firms to think about how they are using data and technology, enabling them to audit their tech needs and what technology they should consider adopting.

As PBS firms look to streamline their operations by delivering support functions with greater use of technology, making full use of this will require appropriately trained staff. There is therefore a case for boosting the corporation tax relief that can be received when staff with lower pre-existing qualification levels are retrained. To encourage employers to train those with lower qualifications, the relief should remain at 100 per cent those employees with a prior Level 6 qualifications, increased to 160 per cent for those without a prior Level 6 qualification and raised to 230 per cent for those without a prior Level 3 qualification.

## Creating a Pro-Business Environment

Question 7: *What are the most significant barriers to investment? Do they vary across the growth-driving sectors? What evidence can you share to illustrate this?*

**Tax**
Barrier to Investment: Imbalanced tax system > Policy Fix: Incentive-based tax framework

Tax rates have a significant, and often underappreciated impact on small businesses' ability to invest. In particular, pre-profit taxes like business rates and National Insurance contributions can hold back small business investment.

While business rates are far from simply a high streets issue, FSB's 2024 research on the future of the high street shows that over half (54%) of high street small businesses say they would invest more or grow their businesses by hiring additional staff if the Small Business Rate Relief threshold was increased from £12,000 of rateable value to £25,000.[2] Increasing the Small Business Rates Relief Threshold to £25,000 would therefore have a significant impact on small business investment. A further, high-impact intervention would be to index the employers National Insurance contributions to the Employment Allowance, so it increases in line with increases to the National Living Wage providing certainty for small businesses looking to hire.

**Personal guarantees**
Barrier to Investment: Personal Risk > Policy fix: Personal Guarantees Changes

[2] FSB, The Future of the High Street, August 2024, https://www.fsb.org.uk/resource-report/the-future-of-the-high-street.html

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The over-use of personal guarantees by lenders is a pervasive barrier to small business investment. This deters limited companies and other legal structures from taking on debt to grow and defeats the purpose of limited liability companies by making a business risk into a personal one. The simple policy response to address this barrier would be to include personal guarantees within the scope of the FCA Consumer Duty.

**Skills**
Barrier to Investment: Skills shortage > Policy Fix: Rewarding traineeships and apprenticeships

For employers, the key barriers to investing in skills are: rising overall costs of employment which reduces small business' available capital to invest; concerns about poaching of upskilled staff and; the cost of employees being away from work for training (both time and financial). Data from the third quarter of this year shows that Labour continues to be the main cost to small business operations at 49 per cent[3]. 11 per cent of small business owners cite employees resigning after training as a barrier to providing training, with 25 per cent saying that employees are too busy and 27 per cent say training is too expensive[4]. These barriers can be addressed through a commitment to maintain the current levels of co-investment (95%/100%) in apprenticeship training costs for non-levy-paying businesses, and by introducing targeted incentives for employers to fund training through either corporation tax or National Insurance. For the self-employed, there is an opportunity to give improved tax relief for training costs and build on the Enterprising You pilot in Manchester. (Please see Question 8 for more detail.)

**Tech adoption**
Barrier to Investment: Information asymmetry > Policy Fix: Targeted tech adoption and AI protections for SMEs

Small businesses are very innovative, with 69 per cent having innovated in the last three years.[5] However, there is a substantial risk that small businesses will be left behind in the move to AI, with 37 per cent of small businesses concerned that large businesses have more resources to better utilise AI. Specific barriers that small businesses face in innovating include time (40%), cost (30%), skills (46% for AI), and concerns about AI (73%, with a further 31% concerned about how to manage the associated security risks).[6] There also are significant sectoral discrepancies in AI adoption and use, with 37 per cent of small Professional and Business Services firms using AI, contrasting only 1 per cent of those in Construction. Decisive and carefully targeted action is urgently needed to prevent these gaps widening. FSB data shows that 39 per cent of small businesses would be encouraged to innovate if they had more information or support to do so, and a further 46 per cent say additional tax reliefs would drive innovation. This is promising, as SMEs identify more efficient working as the top benefit of AI (40%), followed by automating tasks (29%), developing/improving products and services (24%) and improving customer service (22%).

[3] FSB, Small Business Index, Quarter 3, November 2024
[4] FSB, Scaling Up Skills, August 2022, https://www.fsb.org.uk/resource-report/scaling-up-skills.html
[5] FSB, The Tech Tonic, August 2023, https://www.fsb.org.uk/resource-report/the-tech-tonic.html
[6] FSB, Redefining Intelligence, March 2024, https://www.fsb.org.uk/resource-report/redefining-intelligence.html

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**Net Zero**
There is a lack of policy attention paid to SME decarbonisation, meaning that barriers such as high upfront costs of investment, low payback periods, and split incentives are holding SMEs back from decarbonising[7].

**People**
Sole traders say they would benefit from free or subsidised impartial business support advice (48%) and free or subsidised mentoring (38%), yet 38 per cent say that exclusion from Government support due to eligibility rules is a challenge[8].

Despite the increase in the numbers of those with disabilities in employment rising in recent years, in 2022 the gap in employment rates ('the employment gap') between disabled and non-disabled people remained significant at 28.1 per cent. Disabled workers have a self-employment rate of 13.8 per cent compared to 12.5 per cent for nondisabled workers. Self-employment can provide the flexibility for disabled entrepreneurs to participate in the workforce and should be seen as an opportunity to boost workforce participation.

**Planning**
The barriers that planning poses to business investment, and in particular, the small business community, are well-known, and were a major concern in our recent research on high streets[9]. Over a third (36%) of local businesses think planning regulations are provided poorly in relation to their local high street. Fifty per cent of local businesses in the North-West think these services are provided poorly, and similar perceptions are felt by small businesses in the South West (42%) and London (40%). Robust and agile high streets are core to resilient local economies, so these trends are particularly concerning.

**Infrastructure** (energy and water)
Cost of energy continues to be a major barrier, with 47 per cent of small businesses in the third quarter of this year saying that utilities are a main cost[10]. Data collected in the Energy Price Crisis of 2022 showed the 96 per cent of small businesses were concerned about rising energy costs, with 38 per cent extremely concerned[11]. Importantly, this has prompted 24 per cent of small businesses to cancel or scale down plans for investing or expanding their business. Limited access to water for non-domestic use is also being cited by small businesses as a barrier to growth, with those in certain parts of the country facing water moratoriums - something FSB has repeatedly raised as an issue with DEFRA, Ofwat and water suppliers.

**Transport**

[7] FSB, Accelerating Progress, November 2021, https://www.fsb.org.uk/resource-report/accelerating-progress.html
[8] FSB, Entrepreneurship, Start-Ups and Business Growth, November 2024
[9] FSB, The Future of the High Street, August 2024, https://www.fsb.org.uk/resource-report/the-future-of-the-high-street.html
[10] FSB, Small Business Index, Quarter 3, 2024
[11] FSB, Out in the Cold, September 2022, https://www.fsb.org.uk/resources-page/out-in-the-cold.html

As noted in the Strategy, a lack of transport causes a productivity gap of £8.8 billion per annum in the UK's major city regions; but transport is also a major barrier to investment in rural areas. The key issues here are cost, availability, and reliability of services. FSB data shows that 36 per cent of businesses overall saw the current public transport as being too inefficient or unavailable, and a further 18 per cent said it was too expensive. Public transport in rural areas has a particular impact on rural SMEs' ability to hire skilled staff, and to fill lower-skilled vacancies, with an average of 30 per cent of small rural firms reporting in 2022 that finding appropriately skilled staff is the greatest barrier to their future growth aspirations[12].

**Competition**
Small businesses are core to a dynamic and competitive economy, and measures to boost small businesses' ability to compete with dominant firms can be a significant source of growth. Access to data and recourse in online disputes are particular barriers to small businesses' ability to compete. Competition is also to some extent a numbers game. With the small business population sitting at 500,000 below the pre-COVID peak of 6 million, targeted support is needed to boost the start-up population.

**Regulation**
FSB research found that two thirds of the small business community perceive the current domestic regulatory environment to be more of a burden than a benefit to their business. 40 per cent of small businesses say that data protection is the most burdensome regulations; 34 per cent say tax; and 31 per cent say employment issues[13]. The main categories of regulation that small firms deal with are health and safety (71%), employment law (62%) and data protection (59%).

**Access to finance**
Access to finance is also a significant barrier to investment with see answers to questions 21, 22 and 23, below, for more detail.

<u>Question 8</u>: *Where you identified barriers in response to Question 7 which relate to **people and skills** (including issues such as delivery of employment support, careers, and skills provision), what UK government policy solutions could best address these?*

**People**
Support for self-employment and starting a business is key to growth and risks being overlooked in the strategy.

Facilitating self-employment could support people into the labour market and help tackle challenges around workforce participation. In particular, the flexibility of self-employment could help more disabled people to enter the workforce in a way that works for them. Introducing an Entrepreneurship Launch Fund for jobseekers, particularly disabled people, would help them transition into entrepreneurship by offering tailored support and increased payments. The new scheme, which would be a more effective and ambitious replacement for the New Enterprise Allowance (NEA), should be available to all of those not currently in employment.

[12] FSB, The Growth Belt, April 2023, https://www.fsb.org.uk/resource-report/the-growth-belt.html
[13] FSB, Escaping the Maze, June 2021, https://www.fsb.org.uk/resource-report/escaping-the-maze.html

A Help to Start programme could also have a significant impact on start-up numbers. This would provide free support for those considering starting a business or have started in the last three years. Mentoring, peer-to-peer support as well as easy to access information should be the core components of this scheme, which could feature within the department's Help to Grow campaign.

FSB also looks forward to reviewing the upcoming Get Britain Working white paper and working with the DWP to find effective solutions to inactivity in the labour market.

**Skills**
As a decade-long strategy, this work should focus on both current employer needs and building the foundational skills for the future UK economy, especially 'soft skills' and basic digital skills. The number of adults attending Level 3 courses and below has also noticeably decreased, with 14.5% of 19-year-olds leaving compulsory education without Level 2 qualifications, up from 12.5 per cent in 2014-15.[14] A renewed focus on the lower-level qualifications will help develop a skilled and agile workforce to meet the evolving needs of the local labour market, and the wider economy. Skills England has an important role to play in this and provides an opportunity to coordinate the skills system to meet the needs of small businesses as it develops over the coming decade.

FSB's *Scaling Up Skills* report included a recommendation calling for an independent body similar to Skills England to be set up, so it is welcome that this body is now being established in Skills England.[15] We hope that the introduction of Skills England drives forward growth and productivity of the economy, increasing the co-ordination of the skills system, simplifying it for employers to understand, and identifying the needs of the labour market. All while placing small businesses and the self-employed at the centre of its mission and keeping them engaged. The important progress made in Local Skills Improvement Plans (LSIPs) should be built on, including through a national approach to join them up. It has been invaluable having small businesses engaged in identifying the needs of the local labour market, and LSIPs should be used when designing Local Growth Plans to ensure a locally joined up approach that capitalises on local expertise, which can sit alongside national join-up led through Skills England.

Small employers have a key role in increasing the number of lower-level apprenticeship starts and providing opportunities for young people. To address support them in this, Government should:

- Commit to maintain the current levels of co-investment (95%/100%) to apprenticeship training costs for non-levy-paying businesses (only 2% of small business employers saying they would take on apprentices if they had to fund apprenticeship training costs that are currently Government funded).
- Set targets target to increase apprenticeship starts in small businesses year-on-year.
- Introduce more appropriate apprenticeship Standards at Level 2 and 3, with a focus on key areas such as digital skills (33% of small business employers who currently employ apprentice(s) say

[14] Gov.UK, Level 2 and 3 attainment age 16 to 25, April 2024, https://explore-education-statistics.service.gov.uk/find-statistics/level-2-and-3-attainment-by-young-people-aged-19
[15] FSB, Scaling Up Skills, August 2022, https://www.fsb.org.uk/resource-report/scaling-up-skills.html

more relevant apprenticeship qualifications would encourage them to hire more apprentices in the future).

- Re-introduce the £3,000 incentive for those hiring an apprentice under 25 years old, exclusively for SMEs (73% of small business employers who currently employ apprentice(s) say the reintroduction of the £3,000 incentive would encourage them to employ more apprentices in the future).
- Reduce the paperwork and admin associated with hosting apprenticeships (36% of small business employers who currently employ apprentice(s) say reduced admin or paperwork would encourage them to hire more apprentices in the future).

Impactful interventions to train and upskill the labour market include:

- Allowing self-employed individuals to deduct training expenses for taxation purposes, where this training is intended to help them expand their business.
- Expanding Skills Bootcamps both as a rapid response to short-term skills challenges, and for long-term strategic economic needs, such as improved line management and in areas of growing importance in digital and green skills.
- Commit to the Help to Grow Management scheme and maintain the programme.
- Use the Greater Manchester Enterprising You programme as a model for a national scheme to help the self-employed improve and develop skills.
- Encourage further in-work training, by increasing the Corporation Tax relief for employers training their staff, particularly low or medium-skilled employees.
- Provide vouchers to small business employers to allow them to purchase external support to develop a training plan or a workforce development strategy.

Rising numbers of young people not in education, employment or training,[16] and those off work due to ill health (as highlighted in the Industrial Strategy paper), present an opportunity to fill these skills gaps. FSB's research in *Business Without Barriers* highlights the important support needed for disabled people and those with a health condition becoming a business owner or entering the workforce.[17]

Skills gaps will be a particular barrier for those in the Green Economy, and a good step would be to publish something in a similar vein to the previous Government's Nature & Net Zero Workforce Plan.

<u>Question 9</u>: *What more could be done to achieve a step change in **employer investment in training** in the growth-driving sectors?*

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[16] ONS, Young people not in education, employment or training (NEET), UK: August 2024, November 2024, https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/bulletins/youngpeoplenotineducationemploymentortrainingneet/august2024
[17] FSB, Business Without Barriers, April 2022, https://www.fsb.org.uk/resource-report/business-without-barriers.html

A "step change" in employer investment in training cannot occur with both costs and risks of employment rising significantly. Addressing these barriers will be key to providing small businesses with both the resources and security to boost investment in their workforce.

However, FSB research shows that employers are still investing in training, with 83 per cent of small business employers saying that they have provided training for the staff over the past 12 months[18]. Focusing exclusively on the volume of employer investment in training risks missing the more strategic question: How can employers be supported to invest most effectively in their staff's training, in the areas that will have maximum impact on their productivity and growth?

FSB believes that further incentives should be introduced to increase employer investment in training, with specific recommendations outlined below. Our research found that: 64 per cent of small employers in England said that government assistance with costs would help them provide more training, 48 per cent of small businesses in England said increased tax reliefs would be an incentive, and 37 per cent of small businesses highlighted that improved information, advice and guidance would be an incentive[19].

To support small employers' role in increasing the number of apprenticeship starts and providing opportunities for young people, Government should:

- Commit to maintain the current levels of co-investment (95%/100%) to apprenticeship training costs for non-levy-paying businesses (only 2% of small business employers saying they would take on apprentices if they had to fund apprenticeship training costs that are currently Government funded).
- Set targets target to increase apprenticeship starts in small businesses year-on-year.
- Introduce more appropriate apprenticeship Standards at Level 2 and 3, with a focus on key areas such as digital skills (33% of small business employers who currently employ apprentice(s) say more relevant apprenticeship qualifications would encourage them to hire more apprentices in the future).
- Re-introduce the £3,000 incentive for those hiring an apprentice under 25 years old, exclusively for SMEs (73% of small business employers who currently employ apprentice(s) say the reintroduction of the £3,000 incentive would encourage them to employ more apprentices in the future).
- Reduce the paperwork and admin associated with hosting apprenticeships (36% of small business employers who currently employ apprentice(s) say reduced admin or paperwork would encourage them to hire more apprentices in the future).

Impactful interventions to train and upskill the labour market include:

- Encourage further in-work training, by increasing the Corporation Tax relief for employers training their staff, particularly low or medium-skilled employees.

[18] FSB, Scaling Up Skills, August 2022, https://www.fsb.org.uk/resource-report/scaling-up-skills.html
[19] FSB, Scaling Up Skills, August 2022, https://www.fsb.org.uk/resource-report/scaling-up-skills.html

- Allowing self-employed individuals to deduct training expenses for taxation purposes, where this training is intended to help them expand their business.
- Commit to the Help to Grow Management scheme and maintain the programme.
- Use the Greater Manchester Enterprising You programme as a model for a national scheme to help the self-employed improve and develop skills.
- Provide vouchers to small business employers to allow them to purchase external support to develop a training plan or a workforce development strategy.

Question 10: *Where you identified barriers in response to Question 7 which relate to RDI and **technology adoption and diffusion**, what UK government policy solutions could best address these?*

We are pleased to note that the green paper shares our perspective that Research, Development and Innovation are all key aspects of realising the full benefits of new technology. The development and innovation aspects of this triad are currently under-emphasised – if we want to see the promised productivity gains of R&D, we must ensure we are building on the world-leading research we produce. This is not only commercialisation of R&D; this requires the diffusion and adoption of technologies across the economy, and especially the small business community.

To make the academic benefits of R&D an economic reality, Government should spend the equivalent of at least 10 per cent of the overall Research and Development budget on the diffusion and adoption of innovation, recognising that technology adoption is crucial to productivity growth (this could be taken from Innovate UK's current budget.) Alongside this, Treasury should introduce a modernisation and diversification tax relief scheme based on the structure of the R&D scheme, to support small businesses adopting technology or processes new to their firm.

Tackling barriers to small business adoption of technology will also be key. Top barriers to small business innovation include time (40%), financial cost (30%)[20], skills (46% for AI), and concerns about AI (73%).

Use of AI should be appropriately regulated so that small businesses have the confidence to adopt AI. This will be key to realising the projected productivity gains from AI - especially as, with 73 per cent of small businesses concerned about AI, the SME community risks being left behind. Key concerns in the small business community include managing security risks (31%), the impact of deepfakes on their brand or reputation (24%) and abuse of their Intellectual Property rights (20%). A pro-growth regulatory framework should be developed to address these issues, in a way that centres small businesses and provides certainty without stifling innovation. This should include proportionate regulatory requirements that are regularly reviewed to ensure relevance and interoperability. An aspect of this is that small businesses should be able to make use of AI through fair and clear ownership of AI outputs. Clarity on where IP rights for AI outputs sit is a key aspect of this, one that is causing confusion and concern for those across the economy and is deterring small businesses from using these technologies. The Department for Science, Innovation and Technology and the

[20] FSB, The Tech Tonic, August 2023, https://www.fsb.org.uk/resource-report/the-tech-tonic.html

Intellectual Property Office should work to strengthen IP law to ensure clarity that copyright protection can only sit with a human author, initially by requesting a Law Commission review of the Copyright, Designs and Patents Act 1998. Existing legislation could also be updated to clarify that the use of deepfake technology with the intent to cause commercial damage is clearly illegal and that victims have potential legal remedies open to them.

Our research further shows that 39 per cent of small businesses would be encouraged to innovate if they had more information and support. This needs to be clear and easily accessible. One programme that has shown very positive early results is the Made Smarter tech adoption programme for small manufacturers, recently expanded in the Autumn 2024 Budget. The Industrial Strategy should build on this success and establish similar bodies to Made Smarter for different sectors across the country – these organisations should be focused on enabling small businesses to adopt innovation and technology, including AI. Private sector experience and knowledge of business innovation should be essential criteria in its expansion. As is the case with Made Smarter, these would be focused on certain sectors and geographies. Additional business support should also be provided at a local and regional level, making full use of Growth Hubs, which are currently the main option for delivery in many areas. Another intervention that would be particularly impactful would be to introduce digital audit vouchers for small businesses and the self-employed. These would enable small businesses to better understand their tech needs and what technology they should consider adopting to maximise productivity.

<u>Question 11</u>: *What are the barriers to **R&D commercialisation** that the UK government should be considering?*

For small businesses facing a tough economic climate and rising costs, up-front investment in R&D can be a significant risk for a small firm. However, 46 per cent of small businesses identify additional tax relief as a driver of innovation – unsurprising, as R&D tax relief has been highly effective in encouraging more small businesses to conduct R&D. Of the small businesses which successfully applied for R&D tax relief in the last three years, it has produced substantial benefits: improved cashflow for their business (64%); increased their investment in R&D (55%); increased their investment in future projects (41%); them undertaking projects that would not have happened otherwise (35%)[21]. Despite the clear benefits of R&D tax reliefs for both small businesses and the wider economy, we are concerned that small businesses are receiving lower levels of support through the new R&D expenditure credit (RDEC) and enhanced R&D intensive support, following the abolition of the SME R&D scheme. To ensure that these reliefs are targeted at the firms that need them most, Government could commission an independent review on the impact of recent changes made to R&D tax relief levels.

Disincentives to spin-out valuable research taking place within universities are also a major barrier to commercialisation of R&D. There is much that can be done to make it easier for those working in the sector to take the plunge and set up strong businesses of the future. Preventing universities from dissuading spin-outs through an over-zealous approach to Intellectual Property (IP) rights, in relation to their academic staff, would make a significant difference. More broadly, universities should provide

[21] FSB, The Tech Tonic, August 2023, https://www.fsb.org.uk/resource-report/the-tech-tonic.html

up-front clarity on IP ownership before conducting joint R&D activity with businesses, as this lack of clarity can also be a deterrent for collaboration.

Efforts to boost commercialisation of R&D should also factor in the importance of diffusing new technologies throughout the economy, and especially to the small business community which can be difficult to reach. The Government should spend the equivalent of at least 10 per cent of the overall Research and Development budget on the diffusion and adoption of innovation, recognising that technology adoption is crucial to productivity growth. In addition, Treasury should introduce a modernisation and diversification tax relief scheme based on the structure of the R&D scheme, to support small businesses adopting technology or processes new to their firm.

Question 12: *How can the UK government best use **data** to support the delivery of the Industrial Strategy?*

To gather the 'high-quality data' that the Strategy hopes to use, it is vital that data frameworks account for small business needs so that the resulting information provides an accurate representation of the economy. Data collection and collation is often resource intensive for SMEs. This is especially important to ensure that the Industrial Strategy Council and others are able to fully assess the impact of the Strategy on the small business community, along with larger businesses in supply chains. Any framework for data requests must be designed in cooperation with the small business community to ensure it is not overburdensome for small businesses.

For example, FSB data shows that 69 per cent of SMEs do not know how to calculate their carbon footprint, with only 9 per cent having measured it so far[22]. The clear risk is that a range of different and diverging requests for emissions data leaves small businesses, who are less likely than larger organisations to have compliance experts or energy managers, effectively frozen out of Government procurement opportunities or supply chains. FSB calls on the Government to stick to a principle of 'Think Small First' when designing data request frameworks.

Question 14: *Where you identified barriers in response to Question 7 which relate to **planning, infrastructure, and transport**, what UK government policy solutions could best address these in addition to existing reforms? How can this best support regional growth?*

**Planning**
Speedy decision-making and a streamlined planning application process are essential for small business growth. To ensure planning restrictions do not unnecessarily restrict the growth of high street businesses, the planning process should be revolutionised with newly designated High Street and Town Centre Action Zones. More flexibility needs to be provided to planning authorities to develop housing projects and for housing space to be developed above shops, balancing the substantial need for additional housing while protecting core parts of high street spaces. For example, the Government could build on previously introduced planning deregulation to ease the use

[22] FSB, Accelerating Progress, November 2021, https://www.fsb.org.uk/resource-report/accelerating-progress.html

of empty shops for temporary businesses[23]. This has been well utilised by businesses and, if strengthened, could give even more flexibility to filling gaps. In addition, a target should be introduced to reduce the number of investment decisions dissuaded due to the planning process by a third over the course of the Parliament, and monitored by an annual, independent assessment. This would help the Government to identify existing issues and target interventions.

Small housebuilders should also be front-and-centre of planning reform. The availability of housing is a prerequisite for a mobile and dynamic workforce, and small construction firms will be key to reaching the Government's new housing targets. Interventions that would boost small construction firms' ability to contribute include establishing a comprehensive database of available public land for development and joint-venture opportunities to help small construction businesses identify future projects as soon as they become available.

**Energy**

There are two ways that the Government could tackle the high cost of energy. From a top level, they need to protect customers from the volatile shocks within the international gas market by decarbonising the grid and passing the low-cost of renewable energy directly to consumers; they further need to work to help businesses become more energy efficient and protect small businesses as consumers within the market. An impactful policy intervention on energy efficiency would be a national expansion of the Business Energy Advice Service pilot. This is currently running in the West Midlands and provides a free energy audit to small businesses (providing them with useful information that can help them make cost-saving changes), and for some, the grant funding to implement those changes. To maximise its impact, the expanded BEAS should have increased grant funding per participant so that all but the best-resourced SMEs are able to put the audit recommendations into practice.

Existing and future energy projects provide an opportunity to benefit from small business strengths and catalyse the development of resilient supply chains. For example, the Floating Offshore Wind (FLOW) project in the Celtic Sea and possible future licensing rounds elsewhere in the UK represent a significant economic opportunity to not only develop energy resilience for the UK, but also grow valuable skills, develop innovative capacity within small businesses, and reinforce the Government's place-based ambition for the Industrial Strategy. A priority in procurement for such projects should be to encourage the development and growth of domestic supply chains.

**Transport**

FSB has long supported an integrated transport network, including integrated ticketing services. High standards should be imposed on the railways for all those travelling for business or work, focusing on customer-centric improvements for a more reliable, affordable and usable railways service, as well as integrated ticketing systems so they better match business need.

The bus network is also vital for many SMEs. In 2021, 17% of SMEs said the reason they hadn't changed business transport habits due to it being too expensive for them or their staff, rising to 19% in rural areas. The bus network is vital for rural SMEs, with 30% stating that a lack of a public

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[23] Ministry of Housing, Communities & Local Government. Pop-up shops and entrepreneurs to prosper from high street changes., 2012.

transportation network was a barrier to hiring skilled staff, any increase in the flat fare will likely exacerbate this further. The recent 50 per cent increase in the bus fare cap from £2 to £3 risks disincentivising the desired modal shift toward public transport.

Local roads are of critical importance for SMEs, but they are often in poor conditions and filled with potholes, with the Asphalt Industry Alliance finding that 17 per cent of roads were in poor condition[24]. FSB data found that the quality of local road networks have a cost impact for SMEs. Over a third (37%) of all small firms say pothole damage has cost them more than £100 in the last year, according to the data based on a survey of 1,341 small business owners. A quarter (24%) were forced to pay out more than £300 in the same period, while potholes have caused over £500 worth of damage for more than one-in-ten (13%) small firms. With an additional £500 million pledged at the Budget to fixing roads over the next year, it's crucial that local authorities ring-fence funds specifically for potholes and local road maintenance, as well as publish these plans, making sure this money is not absorbed into wider transportation or general funding pots.

**Water**
We also note that many of the sectors the Industrial Strategy aims to grow are water intensive, such as Advanced Manufacturing and AI (within Technology). This comes at a time when small businesses in certain parts of the country are facing water moratoriums - something FSB has repeatedly raised as an issue with DEFRA, Ofwat and water suppliers. Water efficiency can be achieved without preventing small firms from growing, but some of the existing moratoriums are too blunt a tool and are preventing businesses from increasing their water use, even if they would do so efficiently.

<u>Question 15</u>: *How can investment into **infrastructure** support the Industrial Strategy?*

The upcoming Infrastructure Strategy must build on the existing work of the National Infrastructure Commission, and the work of both must have SME needs and offerings at their heart. With the National Infrastructure Commission's advisory role likely to expand in the near future due to the Industrial Strategy and the Infrastructure Strategy, it is vital that the Commission's work proactively accounts for the needs and offerings of SMEs (including in supply chains). Infrastructure has the potential to create economic growth across the UK if it supports small businesses in their transportation habits, connectivity needs and provided a consistent supply of utilities.

The provision of cloud services is an increasingly vital part of the national infrastructure, and it should be treated as such. 43% of small businesses use cloud computing, but we risk progress stalling as SMEs report lock-in effects and high data extraction costs when using the commercial cloud. Ofcom's remit should be broadened so that it includes regulation of cloud services in the same way that utility providers are currently regulated. Ofcom would be charged with ensuring that cloud infrastructure remains affordable, and providers do not charge excess egress fees.

<u>Question 18</u>: *Where you identified barriers in response to Question 7 which relate to **competition**, what evidence can you share to illustrate their impact and what solutions could best address them?*

[24] Asphalt Industry Alliance, Annual Local Authority Road Maintenance Survey Report, March 2024, https://www.asphaltuk.org/wp-content/uploads/ALARM_Survey_2024.pdf

Data is crucial for conducting basic business operations for the majority of small businesses, and is likely to become even more so as small businesses start to use data-intensive AI tools. Small business access to data is therefore fundamental for fostering competition, growth and innovation The Competition and Market Authority (CMA) should review and enforce data interoperability between different software that require large data input from SMEs. Given the importance of data for innovation, encouraging more firms to use the latest products that bring most value for them is crucial. To support small businesses' ability to compete in the AI space, an obligation should also be introduced for providers of the largest foundation models to provide information to downstream AI developers who intend to integrate those models into their systems. These foundation model providers should additionally be required to keep up to date technical documentation of the model for oversight purposes.

The newly created regulatory regime for digital markets is welcome and we believe it is a good opportunity to address the imbalance that exists in the market between small and large organisations. Our research shows that two in five of small businesses (39%) who have had an issue with a platform found it 'difficult' or 'very difficult' to resolve that issue.[25] Similarly, one in six of the small businesses taking part in the research who reported issues with platforms (16%) said they were resolved 'very unfairly' and a further sixth reported that the platform took no action resolve. It is therefore welcome that the Digital Markets, Competition and Consumers Act 2024 requires large platforms to have effective dispute resolution processes in place and trade on fair and reasonable terms. Unfair terms can be particularly detrimental for small businesses, as they are often more vulnerable in the market and therefore, have no choice but to accept them when faced with large competitor which can lead to un-competitive behaviour. Enforcing this will be key to enabling small businesses to have the confidence to grow their e-commerce platforms.

Start-ups are also key to driving competition. Having a healthy business population is central to any competitive economy – making the UK the best place to start and grow a business must therefore be a priority for the competition aspect of this Strategy. The Industrial Strategy should build on the UK's rich history of entrepreneurship and establish a target to increase the number of businesses from the current 5.5 million back up to pre-pandemic levels of 6 million by January 2028. This should include targets for different demographics to ensure growth is truly inclusive, such as for disabled and female entrepreneurs, and ethnic minority-led businesses. Effective support for start-ups would include launching a Help to Start programme that provides free support for those considering starting a business or have started in the last three years. Mentoring, peer-to-peer support as well as easy to access information should be the core components of this scheme, which could feature within the department's Help to Grow campaign. To monitor this, the annual official statistics for 'Business population estimates for the UK and regions' should be updated so that they include a more granular regional breakdown of the number of businesses at a local level, by employment size bands. Please see FSB's Self Employment report for further recommendations targeted at supporting start-ups and the self-employed.

<u>Question 20</u>: *Do you have suggestions on where **regulation** can be reformed or introduced to encourage growth and innovation, including addressing any barriers you identified in Question 7?*

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[25] FSB, Net Benefits?, October 2023, https://www.fsb.org.uk/resource-report/net-benefits.html

We agree that for regulation to be effective it needs to be created in partnership with business as the regulatory environment has a significant impact on small business growth and productivity. The cumulative burden of regulation, as well as regulatory complexity and the quality of regulatory design, have an impact on small businesses' ability to run their day-to-day operations. Regulatory requirements that are overly prescriptive could impede a small businesses ability to innovate. An example of this is when requirements dictate that businesses undertake multiple compliance activities, which can require both expertise and time that can be a substantial burden on smaller organisations. Another example is inflexibly-implemented regulation that unnecessarily restricts a business’s ability to bring new digital or tech products to the market. For small businesses to reach their potential to contribute to a thriving, innovative business ecosystem, regulatory requirements must be flexible, proportionate, and account for business size and ability to comply.

**Tiered approach**
Where appropriate, a tiered approach to regulation according to risk and size of organisation should be considered, whereby greater requirements are placed on large organisations which have the resources to implement them, to minimise unnecessary regulatory burdens on small businesses.

**Flexible and proportionate enforcement**
Enforcement should be similarly flexible and proportionate, with inadvertent breaches of regulation treated as opportunities for small businesses to develop their expertise. Where small businesses have not acted in bad faith, helping them to comply should be the priority before starting any enforcement action - particularly where cases are not severe and/or where there are new requirements. This is likely to be especially key for growth in the fast-moving Digital and Technologies sector, in which both products and regulation are evolving quickly. Additionally, given that small business owners have a range of responsibilities, it is vital that they are given adequate notice of new regulations and time to implement them.

**Regulatory fees**
For financial services firms which are FCA-regulated, the level of regulatory fees presents a disproportionate challenge, and a barrier to entry, for new entrants. In 2022/23, the FCA proposed a change in the fee structure, which resulted in up to a ten-fold increase in the fees paid by the smallest firms providing credit-related activities. At the time, FSB asked FCA to reconsider, on the basis that the proposed fee structure was regressive and would price small firms out of financial markets. We would again call on FCA to reconsider their fee structures in order to encourage new innovative firms to enter the market.

<u>Below are some regulatory interventions that would be particularly impactful for small business growth and investment:</u>
**Use of AI**
The use of AI should also be appropriately regulated so that small businesses have the confidence to adopt AI. This will be key to realising the projected productivity gains from AI - especially as, with 73 per cent of small businesses concerned about AI, the SME community risks being left behind. Key concerns in the small business community include managing security risks (31%), the impact of deepfakes on their brand or reputation (24%) and abuse of their Intellectual Property rights (20%). A pro-growth regulatory framework should be developed to address these issues, in a way that centres small businesses and provides certainty without stifling innovation. This should include

proportionate regulatory requirements that are regularly reviewed to ensure relevance and interoperability. An aspect of this is that small businesses should be able to make use of AI through fair and clear ownership of AI outputs. Clarity on where copyright for AI outputs sits is a key aspect of this that is causing confusion and concern for those across the economy and is deterring small businesses from using these technologies. The Department for Science, Innovation and Technology and the Intellectual Property Office should work to strengthen copyright law to ensure clarity that copyright protection can only sit with a human author, initially by requesting a Law Commission review of the Copyright, Designs and Patents Act 1998. Existing legislation could also be updated to clarify that the use of deepfake technology with the intent to cause commercial damage is clearly illegal and that victims have potential legal remedies open to them.

**Personal Guarantees and the Consumer Duty**
One way that the FCA could better regulate for growth is if the Treasury expanded the scope of the FCA Consumer Duty, so that it applies to personal guarantees given by limited company directors when borrowing money. There is currently a regulatory loophole whereby FCA regulation is not applied to personal guarantees given by individuals, typically company directors, against lending to limited companies. This makes what should be a business risk into a personal one. One of the biggest drags on small businesses' choice on whether to seek to grow is the understandable belief that doing so puts their homes or family finances at risk.

**Professions**
Much of this sector is governed by professional regulators (such as accountants, solicitors, architects). Regulators' legal duties must reflect the importance of creating an environment that support small firms to provide competition. As such, it is vital that these professional regulators have duties to keep barriers to entry and regulatory costs low for small firms. Professional regulators must also put in place progressive fee structures that keep regulatory fees low for small firms, to encourage new, innovative firms to be set up to challenge the large incumbents in these sectors and drive competition.

**Professional Indemnity Insurance**
Professional Indemnity Insurance is a significant cost for many professional services firms, and it is often a pre-requisite to being able to practise in these sectors. The cost of PII will generally be a higher percentage of turnover for a smaller firm than a larger firm, and many professionals find it difficult to retire or sell their professional service business due to the need to purchase prohibitively expensive run-off cover. We believe there is a strong case for the FCA to carry out a market study into professional indemnity insurance, looking at ways to reduce the cost, which should also explore whether the "claims made" basis that PII currently operates under is undermining the attractiveness of setting up professional business services firms. This could have a significant impact on competition in the sector and drive innovation.

Question 21: *What are the* ***main factors that influence businesses' investment decisions****? Do these differ for the growth-driving sectors and based on the nature of the investment (e.g. buildings, machinery & equipment, vehicles, software, RDI, workforce skills) and types of firms (large, small, domestic, international, across different regions)?*

Small businesses cited Domestic Economy (64%), Consumer demand (33%), and Tax burden (32%) as the top barriers to growth in the third quarter of this year[26]. These barriers to growth in the next 12 months will all influence small business investment decisions – these are the factors that small businesses consider when deciding whether or not to grow.

A further factor is high costs, which can cause small businesses with tight cashflow to save to pay business costs rather than investing further in the business. This is concerning, given that 79 per cent of small businesses said that the cost of running their business increased in the third quarter of the year relative to the same period in 2023. Main factors to changes in cost were Labour (49%), Utilities (47%), Inputs (36%) and Fuel (27%).

FSB data shows that 59 per cent of SMEs have applied for finance over the last five years. Broken down by size, this reflects 43 per cent of self-employed, 61 per cent of micro-businesses and 72 per cent of small businesses. The larger the business is, the more likely it is to have applied for finance. This reflects the fact that the self-employed and micro-businesses often face multiple difficulties when applying for finance, such as not having assets to secure loans against, reluctance from lenders to lend to smaller businesses, and, for start-ups, a limited transaction history within that line of business. Policy action targeted at these issues faced by self-employed and microbusinesses would likely have a disproportionate effect on the Creative Industries, which Creative UK have found is made up of 28 per cent self-employed workers.[27]

Access to affordable finance is also a major factor in SMEs' investment decisions. High interest rates from banks place huge pressure on small businesses and make it harder for them to grow as they have to make greater repayments or are unable to borrow as much. There has been some progress made in interest rates offered to small businesses, with FSB data showing an increase in the number of small businesses offered a competitive rate of interest (below 4%) in the second quarter of this year. This is a good boost for small businesses seeking traditional bank loans as finance. However, with 31 per cent of small businesses offered an interest rate of 11 per cent or more, very high interest rates remain a significant deterrent to investment.[28]

Access to finance is also about credit success rates. 16 per cent of small businesses applied for credit in the third quarter of this year; of those who applied, 56 per cent were successful, which remains below the pre-covid success rate of 65 per cent for small businesses. Being successful in credit applications is an important encouragement for small businesses when considering investment decisions.

<u>Further key factors that influence small business investment decisions include:</u>
**Tax**

[26] FSB, Small Business Index, Quarter 3, 2024
[27] Creative UK, Statistics, https://www.wearecreative.uk/champion/statistics/
[28] FSB, Small Business Index, Quarter 3, November 2024

Federation of Small Businesses

Tax rates have a significant, and often underappreciated impact on small businesses' ability to invest. In particular, pre-profit taxes like business rates and National Insurance contributions can hold back small business investment.

While business rates are far from simply a high streets issue, FSB's 2024 research on the future of the high street shows that over half (54%) of high street small businesses say they would invest more or grow their businesses by hiring additional staff if the Small Business Rate Relief threshold was increased from £12,000 of rateable value to £25,000. Increasing the Small Business Rates Relief Threshold to £25,000 would therefore have a significant impact on small business investment. A further, high-impact intervention would be to index the employers National Insurance contributions to the Employment Allowance, so it increases in line with increases to the National Living Wage providing certainty for small businesses looking to hire.

**Personal guarantees**
The over-use of personal guarantees by lenders is a pervasive barrier to small business investment. This deters limited companies and other legal structures from taking on debt to grow, and defeats the purpose of limited liability companies by making a business risk into a personal one. The simple policy response to address this barrier would be to include personal guarantees within the scope of the FCA Consumer Duty.

**Skills**
For employers, the key barriers to investing in skills are: rising overall costs of employment which reduces small business' available capital to invest, concerns about poaching of upskilled staff and the cost of employees being away from work for training (both time and financial). Data from the third quarter of this year shows that Labour continues to be the main cost to small business operations at 49 per cent.[29] 11 per cent of small business owners cite employees resigning after training as a barrier to providing training, with 25 per cent saying that employees are too busy and 27 per cent say training is too expensive.[30] These barriers can be addressed through a commitment to maintain the current levels of co-investment (95%/100%) in apprenticeship training costs for non-levy-paying businesses, and by introducing targeted incentives for employers to fund training through either corporation tax or National Insurance. For the self-employed, there is an opportunity to give improved tax relief for training costs and build on the Enterprising You pilot in Manchester. (Please see Question 8 for more detail.)

**Tech adoption**
Small businesses are very innovative, with 69 per cent having innovated in the last three years. However, there is a substantial risk that small businesses will be left behind in the move to AI, with 37 per cent of small businesses concerned that large businesses have more resources to better utilise AI. Specific barriers that small businesses face in innovating include time (40%), cost (30%), skills

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[29] FSB, Small Business Index, Quarter 3, November 2024
FSB, Small Business Index, Quarter 3, November 2024
tps://www.fsb.org.uk/resource-report/scaling-up-skills.html"https://www.fsb.org.uk/resource-report/scaling-up-skills.html

(46% for AI), and concerns about AI (73%, with a further 31% concerned about how to manage the associated security risks). There also are significant sectoral discrepancies in AI adoption and use, with 37 per cent of small Professional and Business Services firms using AI, contrasting only 1 per cent of those in Construction. Decisive and carefully-targeted action is urgently needed to prevent these gaps widening. FSB data shows that 39 per cent of small businesses would be encouraged to innovate if they had more information or support to do so, and a further 46 per cent say additional tax reliefs would drive innovation. This is promising, as SMEs identify more efficient working as the top benefit of AI (40%), followed by automating tasks (29%), developing/improving products and services (24%) and improving customer service (22%).

**Net Zero**

There is a lack of policy attention paid to SME decarbonisation, meaning that barriers such as high upfront costs of investment, low payback periods, and split incentives are holding SMEs back from decarbonising.[31]

Question 22: *What are the main barriers faced by **companies who are seeking finance to scale up in the UK or by investors who are seeking to deploy capital**, and do those barriers vary for the growth-driving sectors? How can addressing these barriers enable more global players in the UK?*

A pervasive barrier to investment is the over-use of personal guarantees by lenders, which undermines the purpose of the limited liability company by making a business risk into a personal one. Indeed, Bank of England data shows that 77% of businesses would rather grow slowly than borrow money. The simple policy response to address this barrier would be to include personal guarantees within the scope of the FCA Consumer Duty – this would free up investment by limited company directors in key sectors.

Small businesses cited Domestic Economy (64%), Consumer demand (33%), and Tax burden (32%) as the top barriers to growth in the third quarter of this year.[32] These barriers to growth in the next 12 months will all influence small business investment decisions – these are the factors that small businesses consider when deciding whether or not to grow. (See question 21 for more detail on barriers to small business investment.)

A particular barrier facing small businesses looking to scale their operations is a lack of support for disputes with banks and lenders. While SMEs with a turnover of less than £6.5 million and fewer than 50 employees currently have access to the Financial Ombudsman Service (FOS), which according to the FOS's data covers 99% of small businesses in the UK, there still remain a further 55,000 SMEs without access to a complaints procedure for disputes with banks and lenders. This lack of support is further exacerbated by the imminent closure of the Business Banking Resolution Service (BBRS). Many of the small businesses that are currently too large for FOS eligibility are not of the scale to have the money, appropriate legal representation and time to sue their bank. Expansion of the FOS's remit to cover these businesses would therefore support small businesses to scale up. With small

[31] FSB, Accelerating Progress, November 2021, https://www.fsb.org.uk/resource-report/accelerating-progress.html

[32] FSB, Small Business Index, Quarter 3, 2024

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businesses vulnerable and increasingly reliant on access to finance and the types of finance lenders are willing to give them, it is vital that SMEs have access to an adequate complaints procedure. The pervasive use of unnecessary personal guarantees in small business borrowing is also a significant barrier to small businesses seeking to scale up. See Question 21 for more detail.

Question 23: *The UK government currently seeks to support growth through a range of financial instruments including grants, loans, guarantees and equity. Are there additional instruments of which you have experience in other jurisdictions, which could encourage strategic investment?*

As noted in the Green Paper, the UK has a world-leading Financial Services sector and a thriving financial ecosystem. We see no need to add further instruments to an already complex system – focus should instead be on ensuring that the existing offering is competitive, affordable, and accessible to small businesses. This could include expanding the British Business Bank's Start Up Loans programme and reducing the use of unnecessary personal guarantees on small business lending.

Equity finance is not suitable for all businesses; however, it can be a very lucrative finance channel for small businesses that want to grow. This can be especially true for start-ups, for which the price of lending reflects their status as an untried entity and can be prohibitive. Increasing awareness of equity, demystifying it, and providing information on how best to present an investment-ready case would boost access. Particular attention should be paid to boosting equity investment outside of London and the South-East, to ensure businesses across the UK are supported to scale up and grow.

Question 24: *How can* ***international partnerships*** *(government-to-government or government-to-business) support the Industrial Strategy?*

Small business exports have the potential to contribute significantly to growth and should be at the core of any international partnerships relating to trade. SMEs make up the majority of UK businesses but are under-represented in international trade – in 2020, businesses with over 250 employees represented just 2.5 per cent of UK exporters but over half the value of goods exported. With just over 11 per cent of SMEs across the UK putting their products and services to market overseas the UK is not yet reaching its full potential.[33] This represents a significant opportunity for growth.

We welcome the Government's commitment to including Small Business chapters or SME-specific provisions in new agreements. This should be complemented by clear guidance to help businesses take advantage of the opportunities available to them. Small businesses must also be supported to make use of the trade opportunities provided by international partnerships. As our recent SME Export Taskforce paper highlights, an assessment of existing initiatives is needed to determine their

[33] Department for Business and Trade, Number of exporting registered businesses in the UK, 2021, April 2024, https://www.gov.uk/government/statistics/number-of-exporting-registered-businesses-in-the-uk-2021/number-of-exporting-registered-businesses-in-the-uk-2021#:~:text=In%202021%20there%20were%20over,of%20goods%20and%2For%20services

effectiveness, decide whether Government or the private sector is best placed to deliver each initiative, and to remove duplication and lower-quality support. This should become an ongoing evaluation process of constant improvement, leading to a more positive and consistent approach to delivery. Support should also take into account and be tailored to the various means SMEs use to carry out trade activities, including the growing role of e-commerce in enabling SME participation in trade. How this support is delivered is as important as its content. Interventions to boost reach among small businesses should include improving, streamlining, evolving or replacing GREAT.gov.uk. Ongoing monitoring and updating of the Help to Grow site as needed would also be welcome.

The SME Exports Taskforce, convened by FSB and Jonathan Reynolds when he was Shadow Business and Trade Secretary, identified a further five Government priorities: adopting a cross-Whitehall approach to trade policy, fostering open and collaborative relationships with businesses, establishing global leadership in digital trade, providing immediate support for first-time exporters, and closing the finance gap that constrains growth. Government should also set a new target to grow the number of SMEs exporting. These should form the basis of any trade-related elements of the Industrial Strategy.

We look forward to the Trade Strategy due to be published in Spring 2025.

## **Place**

Question 28: *How should the Industrial Strategy accelerate growth in city regions and clusters of growth sectors across the UK through* ***Local Growth Plans*** *and other policy mechanisms?*

Resilient local economies are foundational for growth at both local and regional levels, and rely on supply chains, rural businesses and high streets.

Mayoral Combined Authorities (MCAs) have the potential to deliver significant local growth with support tailored to local economy needs. However, despite the trend towards mayors, small business representation remains an issue across MCAs. One effect of this is that there has been a tendency for MCAs to focus on urban and town locations to the detriment of rural locations. This is a mistake. Rural businesses form key elements of supply chains, and neglecting rural economies comes at the expense of overall local economic resilience. This is especially relevant for clusters that lie outside of traditional city regions. Similarly to MCAs, Local Growth Plans, and any equivalent local plans in Scotland, Wales and Northern Ireland, must include small businesses on governing bodies, and should have the health of the small business economy as a core part of their mandate. Small business expertise is key to successfully delivering growth at the local level. The important progress made in Local Skills Improvement Plans (LSIPs) should also be built on, including through a national approach to join them up. It has been invaluable having small businesses engaged in identifying the needs of the local labour market, and LSIPs should be used when designing Local Growth Plans to ensure a locally joined up approach that capitalises on local expertise, which can sit alongside national join-up led through Skills England.

Local Growth Plans also provide an opportunity to invest in resilient local high streets. The heart of local commerce, the traditional high street is evolving to meet the challenges of online shopping and the allure of out-of-town retail centres. An example of this is the rise of 'pop-ups' - the use of empty shops for temporary businesses. Government interventions to ease planning restrictions on this have been well-utilised by businesses.[34] Such innovations present an opportunity for growth - LGPs should capitalise on this to develop a clear, location-specific vision for their high streets, recognising that each has a unique character and needs.

Tackling needless instability caused by late payments would also have an impact on local economy resilience and growth. Small businesses often have very tight cashflow, with late payments having a substantial effect on their ability to grow and invest. For some small businesses the effects are fatal, with FSB data showing that late payments cause 50,000 small business closures every year. This creates avoidable instability in supply chains. Enforcing prompt payment practices for all recipients of Government funding, including grants, would be a good step to build resilient supply chains. This would build on current Government policy which blocks businesses with poor payment performance from bidding on Government contracts.

**UK Shared Prosperity Fund**
For more consistent economic support to businesses in all sectors, it is important to support local economies by delivering the UK Shared Prosperity Fund (UKSPF), which replaced the European Regional Development Fund (ERDF) following the UK's exit from the European Union. FSB was disappointed to see a reduction in the level of government investment in the UKSPF in the 2024 Autumn Budget.[35] The Government announced £900 million for UKSPF in 2025/26, even though they would need to allocate at least £1.3 billion to keep UKSPF monies at a consistent level.
Business support and local economic development are key ways of helping start-ups and supporting businesses to build their capability in the longer term. It is paramount that UKSPF funding from 2026/27 for new business start-ups matches or surpasses ERDF funding which averaged £1.5 billion between 2011 and 2023 for the equivalent local growth elements alone.[36]

Question 29: *How should the Industrial Strategy align with* ***devolved government economic strategies*** *and support the sectoral strengths of Scotland, Wales, and Northern Ireland?*

We welcome the Government's commitment to working with devolved governments to develop the Industrial Strategy in a way that respects devolution while providing a joined-up, UK-wide approach. Working with devolved governments will be key to understanding local and regional strengths and needs.

To capitalise on local expertise, the Government should consider administering the National Wealth Fund through devolved nations' own infrastructure, such as the Welsh Development Bank for Wales.

**Wales**

[34] Ministry of Housing, Communities & Local Government. Pop-up shops and entrepreneurs to prosper from high street changes., 2012.
[35] GOV.UK, Autumn Budget 2024, https://www.gov.uk/government/publications/autumn-budget-2024
[36] NAO, Supporting local economic growth, https://www.nao.org.uk/reports/supporting-local-economic-recovery/#downloads

We see the need for a Welsh component to the Mission for Growth and for implementation of the Industrial Strategy to account for different needs and the different institutional environment that will ensure appropriate key growth sectors for Wales.

UK Government should work in tandem with Welsh Government on the future of the replacement of Shared Prosperity Fund, Levelling Up, Community Renewal Fund, or their equivalent funding while keeping in mind the need to publish the accompanying strategies for Wales-specific economic missions.

The administration of the National Wealth Fund in Wales should be developed through effective partnership between the British Business Bank and the Development Bank of Wales. The UK Government should work with Welsh Government around how bodies such as DBW can become a vehicle for Welsh-specific investment opportunities which focus on wealth creation.

We ask that the Department for Business and Trade and Treasury consider the importance of Food and Drink as a key sector in Wales, recognising that in 2023, Welsh food and drinks exports were worth over £800m to the Welsh and UK economies. It has a key role as an innovation sector in Wales and represents substantial potential future growth.

FSB Wales has noted the current classification of HS2 as an 'England & Wales' project, despite the lack of new infrastructure laid in Wales and a further loss of funding through a lower transport comparability factor. This impacts on consequential funding, such as from the new England-only 'pothole fund'. The Industrial Strategy must therefore provide evidence that UK Government is working to ensure that it is credibly addressing Wales's investment and growth needs.

**Scotland**
Joint working between the previous UK Government and the Scottish Government has at times proved difficult, thus holding back implementation of policy and actions which could deliver real benefit for small businesses in Scotland. Therefore, it is encouraging to see things getting off to a good start, with the new UK Government and Scottish Government quickly reaching an agreement regarding the location of GB Energy headquarters in Aberdeen. The UK Government introduced a Bill to establish GB Energy within its first 100 days, demonstrating their commitment to investment in Scotland. Existing Scottish Government strategies, including the National Strategy for Economic Transformation and National Strategy for Innovation, directly relate to some of the principles in the proposed Industrial Strategy – this highlights how important it is that the work of the UK and Scottish Governments is aligned, for the success of both.

**Northern Ireland**
We hope that the Department for Business and Trade and HM Treasury will work with the devolved government in Northern Ireland to ensure the Windsor Framework is viewed as an asset rather than deterrent for investors. The Framework if implemented more flexibly, could create unique and strategically beneficial opportunities – however, if it remains static it has the potential to do significant damage. The Industrial Strategy provides a platform for committing to review the approach.

Northern Ireland is the only part of the UK that shares a land border with an EU country; one in which the corporate tax rate is half that of the UK. Recognising this, the UK Government should consider the role of Corporation Tax in potentially driving - and, currently, hampering - growth in Northern Ireland. We can see the benefits of a competitive corporate tax regime in the Republic of Ireland, whose economy has realised record tax revenues as a result. The UK Government should expedite work with the Stormont Executive to find an innovative mechanism to fund the devolution of corporation tax powers so that Northern Ireland can cut the tax rate and play a leading part in attracting international investment to the UK.

## Partnerships

Question 30: *How can the **Industrial Strategy Council** best support the UK government to deliver and monitor the Industrial Strategy?*

It is vital that the Council provides clear accountability for delivery of the Strategy, to ensure that it continues to be targeted where it will have the greatest impact on growth. This is also key for ensuring that any unintended consequences are identified and assessed as soon as possible. Impact on the size, productivity and growth of SMEs should be key performance indicators measured by the Industrial Strategy Council. There should also be Small and Micro Business Impact Assessments for significant interventions. We may be able to support the Council's work by sharing our data to provide insight on specific points (for example, on barriers and incentives to small business uptake of AI, or impacts on bank loan applications). Thanks to our survey programme, FSB has data on SMEs going back a number of years. Our quarterly Small Business Index (SBI) looks at a range of factors influencing small business growth, from changes in revenues and employment to credit applications and rates offered. This sits alongside regular deep-dives into different policy areas, such as Skills, Net Zero and High Streets.

To provide this full accountability and prevent unforeseen consequences for SMEs, it is also important that the Council includes representation from those in the small business community, including FSB and other key stakeholders.

Question 31: *How should the Industrial Strategy Council interact with key non-government institutions and organisations?*

It will be vital that the Industrial Strategy Council talks to small businesses in supply chains rather than just primes. These is a layer of less visible SMEs in all of the eight priority sectors – failing to engage with them directly risks developing an incomplete picture of the policy impacts and missing out on opportunities to drive productivity and resilience through vital small businesses in supply chains. This engagement should include both working with industry-representative bodies such as FSB and engaging directly with small businesses themselves. See also Question 12 on gathering a complete picture of the economy using data.

Question 32: *How can the UK government improve the interface between the Industrial Strategy Council and government, business, local leaders and trade unions?*

Please see answers to Questions 30 and 31 on the importance of the Industrial Strategy Council engaging with small businesses.

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Interventions proposed in this response that would be particularly impactful for small business growth and investment include:

- Increase the number of businesses in the UK back up to 6 million
- Small business representation in the Industrial Strategy decision-making bodies
- Regulate personal guarantees as a barrier to investment
- Build resilient supply chains by flushing late payment out of the economy
- Commit to an SME spend target for the Industrial Strategy
- Transform planning policy with longer term strategy and lower barriers for SMEs

We look forward to working with the Government in the coming weeks and months to develop Sector Plans and the full Industrial Strategy.