



ICAEW



The 99.9%: small and medium-sized businesses

WHO ARE THEY AND WHAT DO THEY NEED?

ABOUT SMALL BUSINESS MATTERS

Small Business Matters is an ICAEW research report, the objectives of which are to:

- explore the diversity of the business community and better understand the need for business support that can be met by the valuable business-accountant relationship;
- provide meaningful insights to chartered accountants working with these businesses, many of whom are themselves small business owners and might not have the capacity to conduct in depth research for themselves; and
- make use of these insights to benefit society and the public interest.

We share our findings directly with businesses and chartered accountants, and engage them in the debate along with other stakeholders such as finance providers.

SEEKING AN ONGOING DIALOGUE

As well as the research activities ICAEW is looking to find new and innovative ways for chartered accountants to engage with business owners. We hope to provide a voice for businesses which might otherwise be overlooked, and to ensure that the best advice and support reaches those who need it, making the whole economy more resilient.

We welcome any input or suggestions to help identify how chartered accountants can best support businesses, and how businesses can get the most from their chartered accountants.

For more information or to get involved email angela.edwards@icaew.com or ruth.ward@icaew.com

Contents

Foreword	2
Executive summary	3
Background to this research	6
Summary findings: meet the businesses	8
SOLE TRADER: HAMID	9
MICRO BUSINESS: BRIGHTWEB	10
SMALL BUSINESS: SIGHTS2SEE	11
MEDIUM SIZED BUSINESS: PRINTSTYLES	13
Small business matters: next steps	15
Detailed results and data	16
CONTEXT: EXISTING RESEARCH A GROWTH AGENDA	16
FINDINGS FROM THE WHOLE POPULATION	18
TRENDS BETWEEN GROUPS	20
INSIGHTS BY INDUSTRY SECTOR	24
PROFILE: SOLE TRADER	27
PROFILE: MICRO BUSINESS	29
PROFILE: SMALL BUSINESS	31
PROFILE: MEDIUM BUSINESS	35
Appendix 1: what is a small or medium-sized business?	38
Appendix 2: questions and top-line data	39
Appendix 3: survey questions	43
Appendix 4: method note	45

Foreword

Big business may get more column inches, but small business is the engine of the economy. 99.9% of all companies registered at Companies House have under 250 employees, yet between them these companies employ 14.4m people.

Accountants are the number one advisers to small and medium-sized businesses

If small businesses are the engine, then chartered accountants are the mechanics that keep the engine ticking over smoothly.

At ICAEW we have long known that our members provide a vital source of support and advice to small and medium-sized businesses. This new research reveals just how important that relationship is: three quarters of these businesses have used an external accountant in the past year, and 48% name their accountant as their most trusted business adviser.

One thing that 99.9% of all UK companies have in common is that they are far more likely to turn to an accountant for help than to any other source of financial advice.

Small and medium-sized businesses should not be lumped together: they are different

Common sense tells us that a group consisting of 99.9% of all UK companies is not made up of clones. Many will be sole traders, individuals whose self-employment has been at the heart of the economic recovery. Some will be tiny start-ups with big plans. Others will be long-standing family firms, perhaps growing slowly and organically over time.

The needs and ambitions of these businesses are different, and this report shows just how different. Did you know only 48% of sole traders want to grow, compared to 79% of micros, 88% of small and 89% of medium-sized businesses?

Small Business Matters: what next?

This research gives a high-level look at the majority of UK companies and it challenges our perceptions of who they are and what they need, but it is only the first step. Over the second half of 2014 the ICAEW Small Business Matters team will be following up with a programme of in-depth interviews.

Understanding the needs of businesses is a core part of what it means to be an ICAEW Chartered Accountant. Researching and sharing these needs ensures that businesses of all kinds will continue to get the support they need to flourish into the future.



Michael Izza
Chief Executive Officer, ICAEW

Executive summary

SMALL BUSINESSES, BIG NEWS

Most businesses in the world are small. For each Microsoft or GlaxoSmithKline there are millions of local shops, internet start-ups, specialist manufacturers, doctors' and lawyers' practices, and so on. 99.9% of all 4.9m private enterprises in the United Kingdom are considered as small or medium by the UK government. These businesses play an important role in terms of employment, innovation and the economy generally, contributing to almost half of all private sector jobs.¹

The vast number of small and medium-sized enterprises in any economy also encompasses a diverse range of challenges. Owning and running a small organisation requires courage, dedication, and luck. It is perhaps unsurprising that so many small businesses fail within the first year following start-up. The resilience and durability of businesses is crucial and that is where the accountancy profession can play a significant supporting role.

Accountants are the most trusted and consulted advisers for businesses from sole traders up to medium-sized enterprises. They can be seen as the garage mechanics that keep the engine running with a range of crucial services.

Technological and regulatory changes, for example advances in off-the-shelf business systems software and the end of mandatory universal audit for UK companies, have given rise to changes in the relationship between businesses and accountants. Without an understanding of that relationship how can we be sure that chartered accountants are providing the best possible support to small and medium-sized businesses or that these businesses are getting the most out of their chartered accountants?

LEARNING FROM AND FOR BUSINESSES

500 incorporated businesses with 250 or fewer employees responded to ICAEW's Small Business Matters survey, conducted by IFF Research, contributing to a thorough investigation of their perception of the relationship between businesses and their accountants. Their responses have been extrapolated and, unless specified otherwise, every percentage given in this report relates to the entire relevant population of UK companies.

ICAEW (Institute of Chartered Accountants in England and Wales), members offer accountancy services as highly trained and regulated professionals. However, this study looks at the work of accountants from the perspective of businesses which do not always distinguish between professional and unqualified accountants. In order to build up a complete picture we have preferred to consider all external accountants, not just those who are members of a professional body.

Helping accountants help businesses now and in the future: Tomorrow's Practice

A good understanding of businesses is valuable in itself, and this research gives insights that can help everyone working with and for those with 250 or fewer employees. For the accountancy profession, this means thinking about the services that chartered accountants in practice offer to these small and medium-sized businesses.

ICAEW's Tomorrow's Practice project will be taking these questions on, along with considerations such as the impact of globalisation, economic change, and socio-environmental challenges. To learn more, or to get involved in the debate about the future for chartered accountants in practice, visit icaew.com/tomorrowspractice

ONE SIZE DOES NOT FIT ALL

There are significant differences between companies not just in size but from one industry sector to the next, and above all in attitudes to growth. This suggests that it is unhelpful to discuss and make policy for 'SMEs' as a single category. In particular, we found significant differences between sole traders and micro businesses, which are often classed together for regulatory purposes under both EU and UK law.

Of businesses with 250 or fewer employees 39% want to stay the same size over the next five years, and 33% want to grow significantly. Growth appetite is strongly correlated with business size. 48% of sole traders are looking to grow, compared to 89% of medium-sized businesses. There is also variation between industry sectors: just over half of the 'makers' (those in primary or manufacturing roles) would prefer to stay the same size, whereas the majority of businesses in all other sectors are looking to grow.

¹ Figures taken from *Small business and the UK economy*, Chris Rhodes and Matthew Ward, June 2014.

Three out of four businesses have used an external accountant in the past 12 months, but for those hoping to grow the figure rises to four out of every five.

The majority (54%) of small and medium-sized businesses have been trading for 15 years or more, and only 2% are currently in their first two years of trading. Slightly more have been trading for 5–10 years than have been trading for 10–15 years (19% compared to 15%). This suggests that support for start-up businesses, while crucial, is of direct assistance to a very small part of the economy at any given time. Support for older businesses would affect many more people, and could have a correspondingly significant impact on the economy.

A VITAL RELATIONSHIP

Businesses in all size bands overwhelmingly report an accountant as their most trusted business adviser. The larger a business, the more likely it is to say that a good relationship with an accountant adds value to the company. Appreciation for accountants is high across all categories with 72% seeing added value in the relationship, a strong indication of the importance of the role that the accountancy profession plays to help small and medium-sized businesses.

POPULAR AND UNPOPULAR SERVICES

The six most popular services obtained by small and medium businesses from external accountants in the past 12 months are: accounts preparation (65%), tax services (62%), bookkeeping (32%), audit (28%), business advice (25%), and a review of the financial statements (14%). The four least popular services, all obtained by 4%, were sustainability assurance, IT services, insolvency services, and payroll services.

Accounts preparation and bookkeeping are more popular with micro businesses than sole traders, and their popularity drops steeply as businesses grow larger. This is probably because of the development of in-house capacity as businesses grow.

Business advice is significantly more popular with larger organisations. Sole traders are far less likely to use external accountants for business advice than any other group, with only 20% doing so in the past 12 months. By contrast, half of all the medium businesses in the UK have obtained business advice from an accountant in the same period.

The bigger a business grows, the more likely it is to obtain an audit, even among the majority of businesses for which the audit is an entirely voluntary service. Just one in five sole traders say that they had an audit in the past 12 months, compared to two-fifths of micro businesses, just over half of small businesses, and over two-thirds of medium businesses.²

ATTITUDES TO AUDIT

Of the respondents, 26% feel that it would be better for the economy if businesses like them were required to have an audit. 50% disagree. However, these numbers vary significantly depending on the size of the business and correlate with whether they have had an audit in the past 12 months.

The larger a company is, and the more it wishes to grow in the next five years, the more it is likely to be in favour of mandatory audit for similar businesses.

Even among the smallest organisations there is a higher than expected level of appreciation for an audit. Nearly a quarter of small businesses feel that audit should be mandatory for businesses like them, while just over half disagree.

Although audit is not mandatory for small businesses, 57% say that they have had one in the past 12 months, and a further 30% have had a review of their financial statements. Perhaps it is not surprising then, that two-fifths of those in this size band feel it would be better if audit were mandatory for businesses like them and only 20% disagree.

² An audit is mandatory for those who meet the legal definition of a medium-sized incorporated company. In this survey, following common practice, we have defined business size by employee numbers alone. The medium business category therefore contains a significant percentage (about a third) of companies that are legally in a smaller category and for whom audit is therefore not mandatory.

If the definition of a small company in the UK is increased to the maximum set out under the 2013 EU Accounting Directive, only about 0.2% will be directly affected.³ As these form such a small part of the overall population surveyed it has not been possible to draw out more details about them, but as they are currently medium businesses we can infer some characteristics. They are likely to have a high growth appetite, a high appreciation for the services of accountants, and to believe that the economy as a whole would benefit from audit being mandatory for businesses like them.

CONCLUSION

The category of small and medium businesses is so broad that it is impossible to identify a typical company and its typical needs. Almost all, however, and particularly those seeking to grow, find that the services that accountants provide are valuable. A more nuanced view of these businesses will help accountants and policymakers alike better meet their needs and keep the engine of the economy ticking over.

The next step for the Small Business Matters research is to build on the segmentation of the market through the use of qualitative research methodologies. This next phase will provide rich data from small and medium business owners from each of the portrait types who will be encouraged to discuss their business support needs, motivations for seeking external support and relationship with external accountants.

³ The number is small enough to be distorted by sampling bias, so these extrapolations should be treated with due caution.

Background to this research

WHY RESEARCH SMALL BUSINESS MATTERS?

The question 'how can chartered accountants best support businesses?' is not new and it is unlikely to ever be finally resolved. Answers which make sense for one business or country may not be relevant for another, and answers which address current issues will be superseded by changing times and circumstances. Nevertheless, if we stop attempting to find the answers both businesses and chartered accountants will be poorer.

Small Business Matters is an ICAEW research programme. In order to do our part to help, we will share our findings directly with businesses and our members, and engage them in the debate along with other stakeholders such as finance providers.

Our aims for this first piece of research are to:

- examine the factors which influence the demand for accountancy services among small and medium-sized businesses in the UK, considering not just size but also industry, growth ambitions, and legal status (ie, which regulations apply under the criteria set by regulations); and
- develop an understanding of the market for accountancy services in order to support a second, in depth research stage in the second half of 2014.

This work will also support other ICAEW initiatives such as *Tomorrow's Practice*, which looks at the future of accountants in practice, the Business Advisory Service (BAS), which helps match businesses up to chartered accountants for free practical advisory sessions, and the *Business Finance Guide*, which provides a thorough reference and guide for businesses looking to raise finance.

UNDERSTANDING SMALL AND MEDIUM-SIZED BUSINESSES: MEETING THE CHALLENGE

There are 4.9m businesses in the United Kingdom, and 99.9% of them employ fewer than 250 people.⁴ Any statement about small and medium-sized businesses is therefore extremely broad brush. Research is also complicated by the need to identify an appropriate sample.

All incorporated businesses in the UK are registered at Companies' House, and required to provide certain information which is stored in a central database. However, smaller businesses are subject to light-touch regulation. They do not need to provide so much information, and many do not have to submit the information collected to the external scrutiny of a registered auditor.

Our first attempts to understand the different kinds of small businesses were carried out using data made available from the Companies' House database. The number of records made searching cumbersome. In order to consider any individual company it was necessary to obtain its most recent financial statements, and these gave limited information. It became clear that understanding businesses would best be achieved by contacting those businesses directly.

We put together a short list of nine questions which, together with base data, would allow us to explore the relationship between a business and their external accountant under a range of circumstances. These included not only the number of employees but also turnover and gross asset size, as well as appetite for growth and length of time in business.

In order to extrapolate the results to the whole of the UK, we commissioned IFF Research to select a sample of 500 businesses at random from the listings available at Companies' House. This sample included enough businesses at each size band to make sure that the results would be meaningful, and those results were then weighted to make sure that the percentages we derived would reflect the whole of the country. All the results in this report therefore relate to percentages of all businesses in the UK.⁵

The data collection phase took place in May and June 2014, and consisted of telephone interviews with each of the 500 businesses in the sample. Respondents were asked a series of screening questions to make sure they met the criteria for inclusion in the survey.

⁴ Statistics derived from the Office for National Statistics (ONS) and the UK government. Further details can be found in Appendix 1 to this report.

⁵ For more details on the methodology of this survey, please see Appendix 4 to this report.

USING COMPANIES' HOUSE DATA

All incorporated businesses in the UK must register with Companies' House, and it is this registration process which allows researchers to select large random samples of companies. The proportion of businesses which are incorporated in the UK is one of the highest in the world, with 3m registered as of July 2014.⁶ The results of this survey are therefore applicable to all incorporated companies in the UK, which have been taken as representative of the entire business population. Throughout this report, therefore, the terms 'business' and 'company' are used interchangeably.

Information collected and provided by Companies' House does not always indicate whether a company is part of a larger group. Companies in the sample therefore, may be subsidiaries. Given the size of the overall sample it is unlikely that this will have made any significant differences to the largest results, but it is worth bearing in mind particularly when considering smaller percentages.

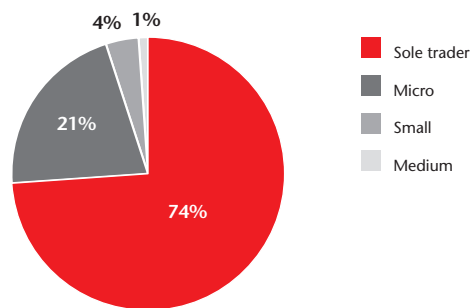
⁶ For more details on the Companies' House register, see www.companieshouse.gov.uk/about/statisticsAndSurveys.shtml

Summary results: meet the businesses

We've chosen two different ways to bring some nuance into the broad category 'small and medium-sized enterprises', which covers 99.9% of all businesses: size and industry. Each includes four categories.

The number of businesses in each size band varies dramatically. Most regulations and policy initiatives tend to draw distinctions along size lines, and many also elide sole traders and micro businesses, leading to a single category covering approximately 95% of all UK businesses.

Figure 1: Business size by employee numbers



Base: 500 respondents who took part in the telephone survey (May–June 2014).

The four industry sectors used in this analysis refer to four broad categorisations: primary/manufacturing/construction (the makers); transport/retail/distribution (the sharers); business services (the supporters); and services that are not business related (other services).

PROFILING SMALL AND MEDIUM-SIZED BUSINESSES

One purpose of this research is to equip accountants working in and with small businesses to better understand the characteristics and needs of their market. Accordingly we have developed a typology for typical small and medium-sized businesses, illustrated with fictional examples in the pen portraits below.

These portraits represent one typical set of characteristics for each size band, bringing the statistics to life. They should be regarded as a starting point for understanding how and why businesses might vary, not as a guide to what all or even most businesses will look like.

HAMID

Sole trader

The nature of the business

Hamid has a gift for event management. A few years back he quit his job, which had been about business support, and moved into organising private parties. He has no regrets about the move, or about finding himself as a sole trader in the loosely defined service sector. Many of the private parties that he organises are luxury or high-profile events and his turnover is nearly half a million pounds every year. On the other hand, his only business asset is one big van which he keeps in his own garage.

Like Hamid, 84% of those offering services that are not business related (other services) are sole traders, though they make up only a quarter (24%) of sole traders.

In terms of size, 91% of sole traders have turnover below £632k, and 89% have assets below £316k. That means that the vast majority of this group, like Hamid, would be classed as micro businesses.

Thinking about the future

Despite the huge success of his business over the past five years, Hamid is not interested in growing any larger. He already has as much work as he can handle and does not want to take time out of event organising to manage employees. Perhaps higher turnover would be nice but he has already more than tripled his income from his days on a salary.

Hamid is typical in being uncertain about the benefits of growth. Only 48% of sole traders want to grow in the next five years. Another 48% would prefer to stay the same size.

Like 20% of sole traders, he has been trading for 5–10 years. Whether he grows or not, he may well continue trading. 52% of sole traders have been trading for 15 or more years.

Assistance from a chartered accountant?

At first Hamid didn't even think about going to a chartered accountant, even to help with the incorporation process. After all, he found plenty of advice online and bought an off-the-shelf accounting software package to help keep track of his financial activity. After a successful first year, however, he could hardly bear to take the time out from the whirlwind of activity to get his head around the process of drawing up his first annual accounts.

70% of sole traders have used an external accountant in the past 12 months, again making Hamid typical. It is likely that about a third of his sole trader contacts have not done so and this is the highest percentage for any size band.

Hamid is unusual in that he did not use an accountant in his first year of trading.

What help and support looks like

Jenny, a chartered accountant, came to the rescue. Not only did she turn Hamid's digital records into a tidy set of financial statements but she also pointed out a couple of ways Hamid could take advantage of tax exemptions. Now Hamid has help every year with his accounts and tax returns and is particularly grateful that Jenny makes sure that he gets everything back to HMRC in time. Knowing that she is keeping track of the regulations for him lets him put all his energy into the work he loves.

The most frequently used accountancy services for sole traders are those that have benefitted Hamid: accounts preparation (60%) and tax advice (58%). If he does seek another service it is likely to be bookkeeping (28%), financial audit (23%) or business advice (20%).

70% of sole traders would agree with Hamid that a good relationship with their accountant adds value to their company.

Trust and value

Hamid has never specifically asked Jenny for advice, but she has explained several things to him over the years and he would have no hesitation in describing her as his most trusted source of business advice.

Only 20% of sole traders have commissioned their accountant to provide business advice in the past 12 months but 45% name their accountant as their most trusted business adviser. Hamid's sole trader friends are more likely than any other businesses to name themselves as their most trusted adviser.

BRIGHTWEB

Micro business

The nature of the business

Two sisters, May and Katy, set up BrightWeb together four years ago. Inspiration struck when Katy, who had just finished an arts degree, realised she could use her talent for web design. May brought programming skills and after a year or so of operating out of Katy's kitchen the pair felt confident enough to take out a loan, rent a small office and bring in a couple of assistants.

BrightWeb is providing business support services, the most common industry for micro businesses (36%).

30% of micro businesses have been trading for 10 years or less, with 16% at 5–10 years and 9%, like BrightWeb, at 3–5 yrs.

Thinking about the future

BrightWeb provides stylish content for business websites and Katy has expanded the design side to offer infographics as well. She and May are considering expanding again to support businesses using animations but this will need careful consideration. After all, their turnover is already nearly £1m a year and this could be badly hit if any of their three big clients felt neglected and went elsewhere.

BrightWeb's big customers bring in a higher than average turnover for a micro business, 75% of which had turnover below £632k in the past year. It is not alone, however, as 16% had turnover between £632k and £6.5m.

Most micro businesses are looking to grow over the next five years (79%) but half share Katy and May's caution and are only looking to grow a little.

Assistance from a chartered accountant?

At start-up Katy and May consulted an accountant for help incorporating their business. They did not feel he gave them much useful advice and did not follow up with any external accountancy services until looking for finance to expand a year later. A friend put them in touch with a more reliable chartered accountant, Kieran, who not only helped BrightWeb get the right information to the bank but also helped May get the internal accounting systems properly set up.

Katy and May are happy to outsource their accounts preparation to Kieran. He helps BrightWeb manage the annual budget, handles tax returns, and has also drawn up cash flow statements for the bank when necessary.

BrightWeb joined 90% of micro businesses in using the services of an accountant in the past year.

Like other micro businesses, BrightWeb has used a wider range of services than a sole trader is likely to. More than twice as many micro businesses than sole traders have obtained business advice from their external accountant in the past year (42% to 20%). Nearly twice as many have had similar help with their budget and/or cash flow statements (15% compared to 8%).

What help and support looks like

Having Kieran around has saved time for BrightWeb staff to focus on their core business and has brought peace of mind for May and Katy. Even if the bank were not asking for so much information, they have come to rely on Kieran's insight and would probably still ask for the same services.

BrightWeb's bank contacts did ask whether they would consider having an annual audit of their financial statements, but Kieran did not think it necessary. Katy is aware that at least one of her two main competitors has had an annual audit and is privately certain that it would be better all round if the other did as well – though the results might surprise HMRC. Overall, though, she does not think that audit should be mandatory for businesses like BrightWeb.

BrightWeb and its owners, like 78% of micro businesses, find that a good relationship with an accountant adds value. Like 87% of similar businesses, BrightWeb would continue to have services even if there were no requirement to do so.

Also, like the majority of businesses in this size band, BrightWeb do not have an audit. It is not surprising that Katy knows of a similar competitor who does have an audit, as 41% of micro businesses do.

Katy joins 39% of similar business owners in thinking that mandatory audit for those like her would not benefit the economy. Her concerns about the activity of some of her competitors may help to explain why 28% do think that mandatory audit would benefit everyone.

Trust and value

May would always say that Kieran was BrightWeb's most trusted business adviser. Katy would generally agree that he has been very helpful, but is also keenly aware of the help and support that she has had from the bank and from networking with similar businesses.

May is more representative of micro businesses, 54% of which name their accountant as their most trusted business adviser. 10%, like Katy, mention their business networks and another 6% name their bank adviser.

SIGHTS2SEE

Small business

The nature of the business

Sights2See had already been trading for eight years when Idris joined the company six years ago. It is a small organisation specialising in sourcing new and interesting gifts for shops in a range of tourist hotspots in the South West. A team of seven buyers select the goods which are delivered to the shops by the four distributors in their branded vans.

Idris has a background in IT and systems support but he also takes day-to-day responsibility for the company's finances. He isn't sure how much Sights2See owns but wouldn't be surprised if it came to nearly £1m by now. Turnover has held steady at around £3.5m for the past couple of years.

Just over a quarter of small businesses are, like Sights2See, sharers in distribution or retail.

15% have been trading between 10 and 15 years. Soon Sights2See will join the majority, 62%, which have been trading for more than 15 years.

Idris is not alone in his uncertainty about gross assets. 17% of small businesses report uncertainty about their gross assets and a further 9% are similarly uncertain about their turnover.

Most of those which are certain (65%) have turnover between £632k and £6.4m, and 77% have gross assets below £3.25m. Idris' guess would therefore put Sights2See in the middle of the pack.

Thinking about the future

Idris and his assistants provide central office support for Fatima, the founder of Sights2See, who handles most of the sales work herself. Fatima has ambitious plans for growth and has begun negotiating to buy a selection of the tourist shops that Sights2See currently supply.

Like 88% of small businesses, Sights2See intends to grow over the next five years. 47% of small businesses share Fatima's ambitions and want to grow a lot.

Assistance from a chartered accountant?

Sights2See has good internal accounting systems and Idris is confident that he and his team can handle the company's bookkeeping and is fairly sure of his ground when it comes to preparing the annual accounts.

In order to be absolutely sure, Idris has asked Sights2See's preferred firm of chartered accountants, Adding and Uscott, to carry out a review of the financial statements every year for the past four years. These reviews have also come in handy to reassure the bank.

Small businesses like Sights2See are more likely than any other group to have used an external accountant, with 91% having done so in the past 12 months.

The range of services obtained by businesses like Sights2See is different from those used by sole traders and micro businesses.

Where 46% of micro businesses used an external accountant for bookkeeping, and 81% used an external accountant for accounts preparation, the relevant percentages of small businesses are 29% and 65% respectively.

What help and support looks like

This year, given Fatima's plans for growth, Adding and Uscott have suggested that Sights2See might want to have a full audit. The extra scrutiny would not only give peace of mind but could help Sights2See raise finance for its expansion. Adding and Uscott have also noted that, if the expansion goes ahead, it is likely that Sights2See will be large enough to be subject to mandatory audit from next year.

Idris is considering the idea. On the whole, he would be more comfortable if every business like Sights2See had to have an audit. He doesn't like to think that less scrupulous competitors might avoid scrutiny and he knows that many of his business contacts feel the same way.

Nearly a third of small businesses (30%), like Sights2See, use an external accountant to review their financial statements. 57% have obtained an audit, even though the majority of small businesses (by employee numbers) are exempt from the requirement.

If Idris does agree to an audit for Sights2See next year, he will join 46% of businesses of a similar size which would still use an audit even if it were not mandatory. He is already one of 43% who agree that an audit for businesses like theirs would benefit the whole of the economy. Only 20% of small businesses disagree.

Trust and value

Sights2See receives support from the bank, from a firm of solicitors, and has even had input from a business consultant over the past year. However, Idris would not hesitate to say that Adding and Uscott are the most trusted of all these advisers.

At his previous place of work the relationship with the accountants had completely broken down. The trouble was that the accountants showed no real understanding of the business and their suggestions were often out of place.

5% of small businesses consider a consultant to be their most trusted business adviser, 6% mention the bank, and 6% a solicitor or lawyer. A solid 58% however, would agree with Idris that their accountant is their most trusted adviser.

Like Sights2See, 76% of small businesses would agree that a good relationship with their accountant adds value to their company. 5%, like Idris' previous place of work, would disagree. Of these a third mention cost, a third mention a lack of understanding, and a third mention poor communication as the barrier to value.

PRINTSTYLES

Medium business

The nature of the business

Printstyles has been trading for nearly 50 years. Founded by John Cranton, it is now managed by his granddaughter Adele who still considers it to be a family business.

John's original interest was in fine papermaking, using a water powered mill. Over the years Printstyles has expanded to design and make a range of different luxury stationary products at two factory sites in the UK, as well as importing high-quality ranges from overseas.

Adele has only recently taken over as CEO of Printstyles, and she is keen to expand. A potential third factory site has been identified and she is considering plans to introduce an 'economy' range of simple but high-quality products to expand Printstyles' market share.

Only 1% of all UK companies with 250 employees are medium sized and of these over a quarter (28%) are, like Printstyles, makers in some form of primary industry or manufacturing.

Like Printstyles, 72% of medium businesses have been trading for more than 15 years, and nearly half (48%) are looking to grow a lot over the next five years. A minority of similar businesses, 10%, would prefer to stay the same size. The pattern of growth intentions is similar to that of small businesses, and it is notable that in both cases there is a core of businesses whose ambitions don't necessarily take the form of further growth in the next five years.

Thinking about the future

Between the factory sites, the plant and machinery, and the expensive materials required, Printstyles have gross assets worth just under £5m. Turnover has been growing slowly over the past five years and in the past financial year was £9.4m. The company is currently cash rich, and Adele's growth plans could be largely carried out without further external finance.

Printstyles' auditors, JBT, have mentioned to Adele's finance team that the company may be considered small if some expected changes to the Companies' Act are put through in 2015. If Adele's growth plans go ahead, however, this is unlikely.

Printstyles' turnover is near the middle of the range for medium businesses. 44% reported turnover below £6.5m in the past year, and 42% reported turnover above £10m. Unlike Printstyles, however, 53% report gross assets below £3.26m.

If the size categories change to match those in the 2013 EU Accounting Directive, Printstyles may be considered a small business on both turnover (like 54% of those with 50–250 employees) and on gross assets (like 60% of those with 50–250 employees). This could make Printstyles one of the 0.2% of businesses for whom the changes could lead to deregulation.

Assistance from an accountant?

JBT carry out the legally required audit of Printstyles' financial statements and have done so for several years now. Over time, a range of other external accountancy services have also been provided by a different team working out of a different JBT office.

Accounts preparation and bookkeeping are entirely handled by Printstyles' own internal accountants. JBT have been most useful in the areas of business advice and support with specific questions on tax, legal, and pensions-related issues.

87% of medium businesses used an external accountant in the past year, lower than the 91% of small businesses. These definitely include all of those which (like Printstyles) meet the legal, as well as the employee numbers, criteria for this category and are therefore subject to a mandatory audit.

Businesses like Printstyles are more likely to have obtained business advice than any other size band, with 50% having done so in the past year. They are also more likely than small businesses to have support on tax (71% compared to 67%), legal matters (15% compared to 10%) and on pensions (28% compared to 16%).

What help and support looks like

The audit team are entirely separate from the other JBT staff who support Printstyles, to maintain their independence. Adele is glad to know that Printstyles has this regular check-up by external financial experts and knowing that the audit is mandatory gives her comfort about other similar businesses, including her competitors.

70% of medium businesses, like Printstyles, had an audit in the past 12 months. 63% would agree with Adele that it is better for the economy to have mandatory audit for businesses like them, and only 12% would disagree.

Trust and value

Although she has only recently been promoted to CEO, Adele has worked at Printstyles for her entire adult life. In that time she has come to truly appreciate the support and advice provided by the external accountants – both JBT and the previous firm, Farnleys.

Both Adele and Printstyles' finance team would not hesitate to say that JBT was their most trusted source of business advice, though Adele's second-in-command, James, would maintain that he trusted the company's lawyers more.

Like Printstyles, 76% of medium businesses find that a good relationship with their accountant adds value to their company. Of the 9% that disagree, none consider the barrier to be cost: more than half say it is a lack of understanding, a third have in-house expertise and do not rely on external accountants, and the rest say the barrier is time.

58% of medium businesses regard their accountant as their most trusted source of business advice. 16%, though, would agree with James and name their lawyers or solicitors instead.

Small business matters: next steps

In its initial phase, the Small Business Matters research has shed new light on the complex nature of business with 250 or fewer employees. In order to make the best use of this work, the next step is to engage more deeply with small businesses and begin to answer some of the 'why?' questions with qualitative research and deeper engagement. This second phase will be focused on two main themes emerging from the research, chosen because of the opportunities provided by each to meet three key objectives.

SMALL BUSINESS MATTERS OBJECTIVES

- To explore the diversity of the business community and better understand the need for business support that can be met by the valuable business–accountant relationship.
- To provide meaningful insights to chartered accountants working with these businesses, many of whom are small business owners and might not have the capacity to conduct in-depth research for themselves.
- To make use of these insights to benefit society and the public interest.

SUSTAINABILITY AND GROWTH

While there has been much political emphasis on encouraging small businesses to grow, understanding the types of support required by established businesses to sustain themselves is no less important. The 39% of businesses which would prefer to stay the same size over the next five years also need support and until now have been largely invisible in the public policy arena. A key question for the sustainability and growth theme is: how do the needs of those which are looking to remain the same size differ from the needs of those which have a desire to grow?

GETTING THE RIGHT SERVICES

Both chartered accountants and businesses would benefit from an understanding of which services are most valuable in different circumstances, and why. This is a vast potential area for investigation and it will have many answers, all of which will change over time. The challenge is, therefore, for Small Business Matters to provide insights which have ongoing relevance and to engage all the interested groups in an ongoing, mutually supporting dialogue. Questions include: What are the trigger points or factors which influence the use of accountancy services? Why are some businesses choosing one service over another? For example, what makes sustainability assurance popular with small businesses, or IT services with makers? Are there any other services which businesses would like to see their accountants offer?

SEEKING AN ONGOING DIALOGUE

As well as the research activities ICAEW is looking to find new and innovative ways for chartered accountants to engage with business owners. We hope to provide a voice for businesses which might otherwise be overlooked and to ensure that the best advice and support reaches those who need it, making the whole economy more resilient.

We welcome any input or suggestions to help identify how chartered accountants can best support businesses and how businesses can get the most out of their accountants.

Contact angela.edwards@icaew.com or ruth.ward@icaew.com for more information or to get involved.

Detailed results and data

INTRODUCTION

In order to keep this research relevant to the debate, we have chosen to develop our most in-depth profiles on the basis of the four size categories. Before doing so, however, we take a look at the context including the most relevant existing research, consider findings across the whole population of businesses covered by this research, and detour briefly to consider how businesses vary between industry sectors. Finally, we sum up with a section which brings together comparisons between businesses in various size groups, to ensure that any wider trends have been captured.

CONTEXT: EXISTING RESEARCH AND A GROWTH AGENDA

Government initiative

A raft of measures have been introduced by the UK government to recognise, investigate, and promote the role of businesses with 250 or fewer employees as the engine of the economy. In his 2013 report, *Growing Your Business*, Lord Young lists eight schemes from the Supporting Small Business Charter, from funding support such as start-up loans and SME growth loans, to the use of the Government's mystery shopper initiative to hold contractors responsible for their behaviour towards businesses.⁷

In a report prepared for a government with a focus on economic growth, it is hardly surprising that Lord Young emphasises initiatives that are designed primarily to support those small businesses that are actively seeking to grow. However, 'there will always be 'lifestyle firms' with little or no growth ambition, as the *Growing Your Business* report itself states in an aside.

It is worth bearing in mind that businesses classed as micro, small, or medium sized make up 99.9% of all UK businesses, and employed 14.42m people in 2013.⁸ This amounts to nearly half (48%) of the total employed population of the country, which in mid-2013 was recorded at 29.84m.⁹

Expecting growth, or hoping to grow?

ICAEW's UK Enterprise Survey Report for 2013 asked all businesses about their predicted turnover growth over the next 12 months. 69% were predicting growth, with 18% predicting growth of 10% or more. However, micro businesses had a more varied outlook. 22% predicted growth of 10% or more, but 35% did not expect any growth and 15% expected their turnover to shrink over the next 12 months.

Anticipated growth is an indicator of a businesses' attitude to growth, but not a substitute measure. The Small Business Matters survey asked businesses about their hopes for the next five years, in order to consider the link between growth appetite and the use of accountancy services.

Although we have found a significant correlation between those with growth ambitions and those who value and use external accountants, it is worth noting that a substantial number of businesses have no desire to grow over the next five years. These businesses, including more than half of the UK's sole traders, are all but invisible in current policymaking. While they might not contribute to the growth agenda, they do make a significant contribution to employment and to the resilience of the economy as a whole.

What can the accountant-business relationship contribute?

Chartered accountants provide support and advice for all small businesses, and we have specifically asked businesses about their growth ambitions in order to better understand the relationship between growth and support. When it comes to businesses that are looking to grow, there is already evidence that a good relationship with an accountant can be an important factor in business success.

Businesses that use external advice are more likely to be able to access finance.¹⁰ The Department for Business, Innovation and Skills (BIS) found in 2012 that accountants were the most commonly used source of external advice for businesses with fewer than 250 employees. BIS found that only 2% of small and medium-sized enterprises had sought advice specifically on the subject of raising finance, and that of these 60% had sought that advice from their accountant (21% had gone to a bank, and only 7% to a specialist financial adviser). However, 39% of those in England and Wales had sought more general business advice from an accountant over the same time period.

⁷ *Growing Your Business*, Lord Young, 2013, pp3–4.

⁸ *Small business and the UK economy*, Chris Rhodes and Matthew Ward, June 2014.

⁹ *Labour Market Statistics*, September 2013, Office for National Statistics (ONS).

¹⁰ *How SME owners' characteristics influence external advice and access to finance*, J. M. Scott and D. Irwin, 2007.

The role of accountants

Accountants have been supporting businesses in a variety of ways, both internally and externally, for centuries. The majority of accountancy firms, like the majority of businesses, are themselves small.¹¹ Whether internal or external, a chartered accountant is likely to be the first port of call for business advice. When asked to name their chief source of business advice, 39% of UK small businesses named their accountant, more than twice as many as mentioned any other source.¹²

The relationship between chartered accountants and businesses has never been a static one. Accountancy is a technology and, like all technology, it is liable to change and develop over time. Other factors such as regulations, information technology, and the changing economy have also had an impact.

Recent changes have had a profound effect on this relationship. In the past businesses would beat their own path to accountancy practices due to the need to comply with statutory audit and tax requirements. Very often the trust and communication channels established by these services would lead to chartered accountants providing further support, where appropriate. Universal mandatory audit ensured that all companies encountered a professional accountant at least once a year, and deregulation in this and other areas has created an environment where the majority of accountancy services are optional for small businesses. The arrival of sophisticated accounting software has simplified many of the routine tasks that might previously have been referred to an accountant, though computers have not yet developed the skills and judgement that a human expert builds over years of experience.

When a relationship has been shaped by the existence of regulation over many years, both sides may come to take it for granted. Chartered accountants do not need to consider whether or not, for example, a company should have an audit when statutory audits are mandatory. A business owner who has benefitted from the regular health check provided by an auditor may not realise that potential issues are no longer being identified at an early stage once that regular audit is no longer there.

A sea change: audit exemption in the UK

The UK has transitioned from a universal audit requirement for incorporated companies, still active in the early 1990s, to exempting all small and micro businesses from audit. This can be contrasted with the United States, where there has never been a universal audit requirement. In some other jurisdictions the removal of mandatory statutory audit has been accompanied by the introduction of an alternative mandatory service for exempt organisations. For example, in both Denmark many audit exempt organisations are required to have a review engagement instead. In the UK this approach has been taken with charities, many of which are required to have an independent examination if they do not have an audit, but no mandatory alternative has been introduced for small businesses. Most chartered accountants in practice therefore already have to judge the best advice to give to businesses in this situation.

The 2013 EU Accounting Directive raised the thresholds by which an EU Member State can define a small business. Implementation of the directive is still in process in the UK, and in our research we have given particular attention to the question of what this could mean for the relationship between businesses and their accountants. We have found that only 0.2% of UK companies are likely to find their status changed even under the greatest possible increase in the threshold.

The research presented in this report is an investigation of the current state of the relationship between accountants and small businesses. The services provided by chartered accountants must meet real needs if the profession is to be relevant, and businesses need to understand how to make the most out of the relationship with a chartered accountant if they are to develop the resilience to thrive.

¹¹ The UK Office for National Statistics (ONS) found 36,015 enterprises engaged in accounting, bookkeeping, and auditing activities in the UK in 2013. Compare this with the Accountancy Age list of 100 top firms in 2013 (www.accountancyage.com/static/top50-this-year), among whom the last 20 have fewer than 10 partners, and it is clear that the size profile of accountancy firms is similar to that of enterprise as a whole, with a few big organisations and a myriad of small firms.

¹² UK Department of Business, Innovation and Skills, Small Business Survey, 2012.

Findings from the whole population

When considering findings across the whole population of businesses in the UK it is important not to fall into the trap of assuming that all of these enterprises are the same. Attitudes to growth, to financial management, and to the value of the relationship with an accountant are very different from one group to the next. The habit of referring to this vast range of companies as one group, perhaps by the initials SMEs (small and medium-sized enterprises) and acting as though one size fits all – whether in policy, regulation, or market identity – is bound to be misleading.

With that caveat, here are some observations drawn from the findings of our research on the whole population, constituting the 99.9% of UK businesses that would not be described as ‘large’.

TO GROW OR NOT TO GROW

Far from all hoping to be ‘the next Facebook’, UK businesses are divided on their attitude to growth. A third do want to see their company grow a little over the next five years, and a further 23% would like to see it grow a lot. That only amounts to 56% who want to grow at all, however, and of the remainder a solid 39% would definitely prefer to remain the same size.

It would be a mistake to assume that those who do not want to grow do not have aims for their business. Perhaps some would prefer to focus on quality, or on the social impact of their operations, rather than on increasing the scope of their activity.

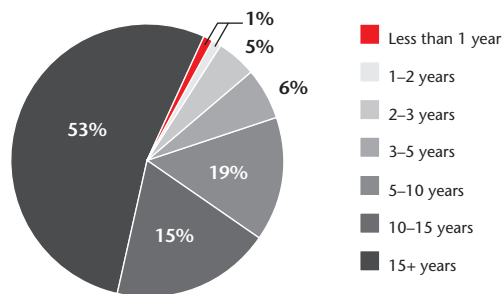
There could also be excellent reasons for keeping a business small. A sole trader might prefer to contract their services to larger organisations than to add an employee and complicate their own arrangements, for example. Or a small family-owned and -run factory might be kept to a size which the owners are comfortable with to avoid diluting control.

It would also be a mistake to discount businesses which do not seek to grow. All of these businesses, growing or not, would prefer to survive and thrive. Their resilience is the resilience of the economy as a whole and is of vital importance to the millions of people they employ.

LONGEVITY AS A GENERAL RULE

The first hurdle for any new business is to survive its early years, and the number of start-ups that fail naturally draws attention to this exciting and difficult period in the life of a business. However, successful businesses of any size tend to survive for a number of years. This means that the average age of a business employing 250 or fewer employees is over 15 years.

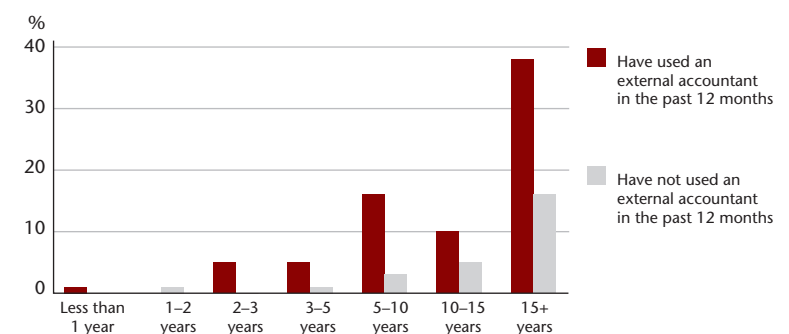
Figure 2: Length of time trading, all UK companies with 250 or fewer employees



Base: 500 respondents who took part in the telephone survey (May–June 2014).

The 1% of businesses in their first year of trading all reported that they had used an external accountant in the past 12 months. The majority of those in their second year had not done so, suggesting that use of an external accountant is associated with the moment of start-up for new businesses.

Figure 3: Use of external accountants by length of time trading



Base: 500 respondents who took part in the telephone survey (May–June 2014).

MAKING USE OF AN EXTERNAL ACCOUNTANT

Three quarters of all businesses covered by this research have used an external accountant in the past 12 months. The most popular services were accounts preparation and tax services, with bookkeeping, audit, and business advice coming next. See figure 4 opposite.

The use of most of these services in fact varied significantly from one sector to the next but one common factor which holds true is that most businesses would still obtain a similar profile of services even if none of them was mandatory.

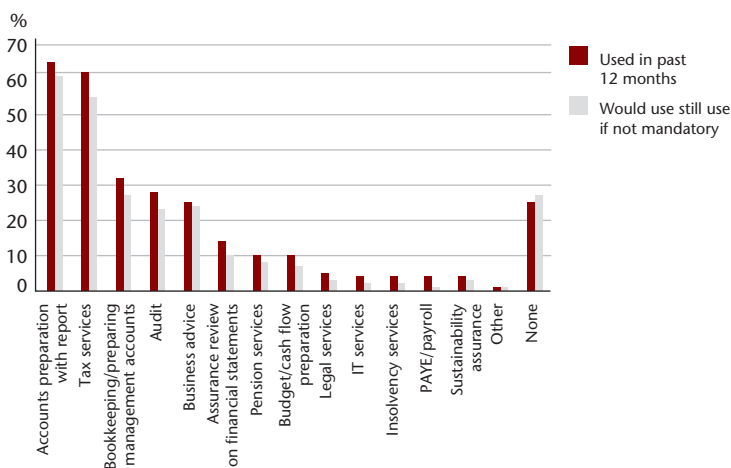
Nearly half of those who asked an external accountant to prepare a budget or cash flow in the past 12 months had been trading for 5–10 years (47%). None of those who sought business advice did so in their first year, only 8% of those who did so had 3–5 years' trading, and 58% had been trading for 15 years or more.

A general observation is that, for most services, businesses were more likely to report that they had obtained them in the past year when they had been trading for 5–10 years or for 15 years or more, with a slight lull in between.

In practice this means that although only 19% of businesses have been trading for 5–10 years, 22% of those which had obtained accounts preparation were in this category, as were 27% of those which had obtained bookkeeping services, 47% of those which had obtained budget or cash flow preparation, 20% of those who had obtained business advice, and 36% of those who had obtained legal services.

By contrast, 15% of businesses have been trading for 10–15 years but these account for only 14% of those which had obtained accounts preparation, 11% of those who had obtained bookkeeping services, 14% of those which had obtained budget or cash flow preparation, 12% of those which had obtained business advice, and 4% of those which had obtained legal services.

Figure 4: Use of external accountancy services, entire population



Base: 500 respondents who took part in the telephone survey (May–June 2014).

Those which have been trading for over 15 years make up 54% of the total, and account for 50% of those which had obtained accounts preparation, 40% of those which had obtained bookkeeping services, 27% of those which had obtained budget or cash flow preparation, 58% of those which had obtained business advice, and 39% of those which had obtained legal services.

Just over a quarter of all businesses agree that the economy as a whole would benefit if those similar to them were subject to mandatory audit. Half of businesses disagree. Length of time trading does not seem to have any significant correlation with these opinions. However, attitudes to audit were extremely variable by size and also appear to correlate strongly with attitudes to growth. The variations, and what they might mean, are discussed in detail later in this report.

A GOOD RELATIONSHIP

Nearly half of all businesses (49%) strongly agree that a good relationship with an accountant adds value to their company, and 72% agree either slightly or strongly. This result is fairly consistent across different sizes of business, though the barriers to value mentioned by the 16% which disagree do vary from one size band to another.

Nearly half of all businesses (48%) say that their accountant is their most trusted business adviser. This increases to more than half for businesses larger than sole traders, who are more likely to say that they are their own most trusted adviser or to turn to business networks.

Trends between groups

When considering each size band separately it is possible to lose sight of the overall comparison by size from one end of the market to the other. Some patterns do emerge when businesses of different sizes are considered together.

GROWTH

When attitudes to growth are directly compared between businesses it is plain to see how different sole traders are from all other categories of business. It is also clear that the appetite for growth is greater in larger businesses. This may be because those businesses that have a high appetite for growth are more likely to take on employees until they reach the medium-sized business category.

Even among medium businesses, however, there is still a non-negligible minority of those who would prefer to stay the same size over the next few years. The characteristics of those businesses, and their needs and preferences, are a topic of interest for future research. See figure 5 opposite.

LENGTH OF TIME TRADING

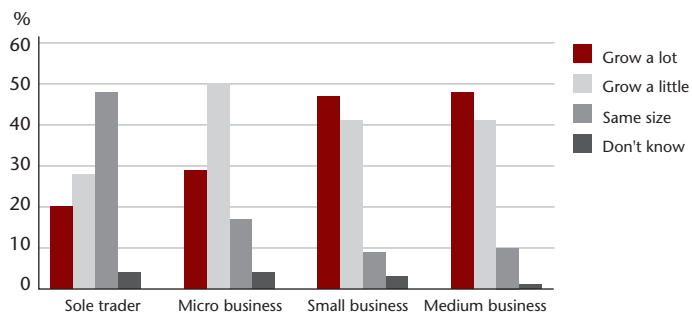
Most businesses, of whatever size, have been trading for some time; the majority have been trading for 15 years or more. There is a slight correlation between size and length of time trading (ie, 52% of sole traders have been trading for 15 years or more, compared to 72% of medium businesses), but otherwise the size bands share the same basic pattern of trading. See figure 6 opposite.

USE OF AN EXTERNAL ACCOUNTANT

This graph shows the extent to which businesses of all sizes make use of an external accountant. It is not clear from our initial research whether businesses discern consciously between professional and unqualified accountants, or how informed businesses are about the quality of the services they receive.

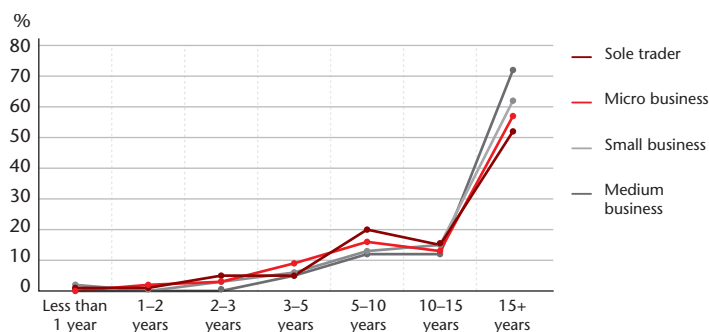
Accountants, like other professional advisers such as doctors or engineers, have an advantage in terms of expertise which could make it difficult for those using their services to judge their skill level. This is another area for further consideration during future research. See figure 7 opposite.

Figure 5: Attitudes to growth varying by size



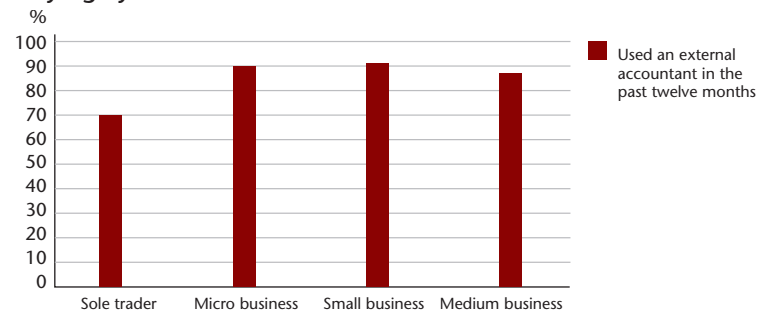
Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Figure 6: Length of time trading by size of business



Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Figure 7: Use of an external accountant in the past 12 months varying by size



Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

WHICH SERVICES?

Three different trends emerge from a look at the use of the seven most popular external accountancy services by companies of different sizes.

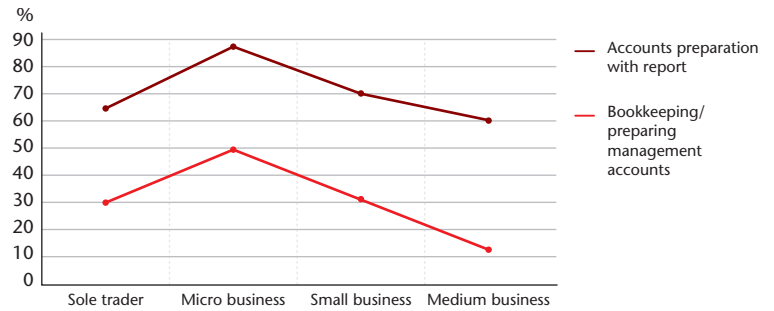
Two services, accounts preparation and bookkeeping or preparing management accounts, peak with micro businesses and drop off as businesses grow larger. Preparation of financial information is an activity which one would expect to see brought in house as an organisation grows.

Employees of a business with direct access to the systems throughout the year are well placed to prepare accounts, and additional comfort could be found in the increasing likelihood that a larger business will have an audit or a review.

Four services, tax services, business advice, assurance review, and pension services, all become more popular as businesses get larger. With the exclusion of sole traders, however, the increase in popularity becomes less steep for all four of these services.

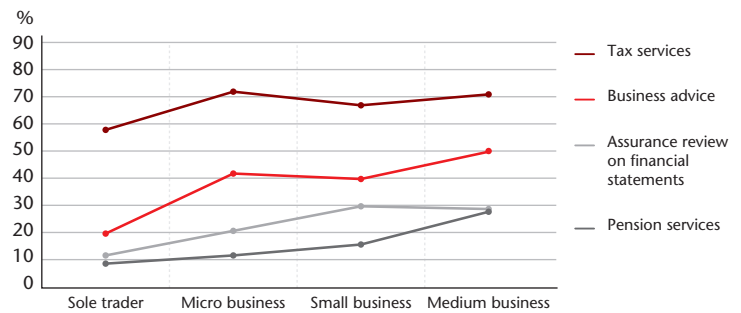
Audit alone increases sharply in popularity with a consistency across all four size groups, and therefore correlates most strongly with growth in the size of a company. See figures 8, 9 and 10 opposite.

Figure 8: Services used by size trend 1: peaking early



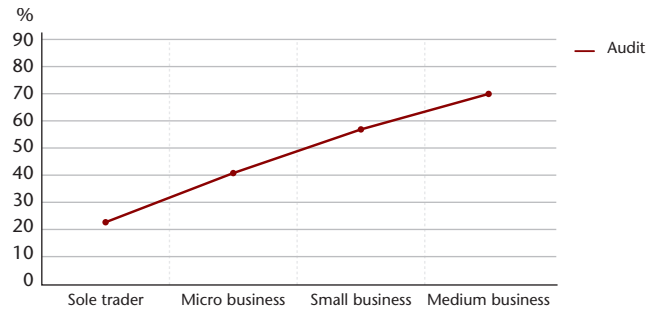
Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Figure 9: Services used by size trend 3: slow overall increase



Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Figure 10: Services by size trend 3: steady increase with clear correlation to business size



Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

IF NOTHING WAS MANDATORY...

The difference between a sole trader and a business involving more than one person is marked, here as elsewhere. See figure 11 opposite.

The most interesting thing about figure 9 on page 21 is how similar the numbers are to those for the services that businesses already obtain from an external accountant, shown in figures 5–7 on page 20. Although all services have dropped off by around 10% we can still see that accounts preparation and tax services are most important to sole traders and micro businesses, and that financial audit and business advice become increasingly important as businesses grow.

Accountancy is often seen as a profession driven by businesses' need to comply with external pressures, but these patterns show that businesses would voluntarily choose to obtain much the same range of services as they do now even if there were no external pressures.

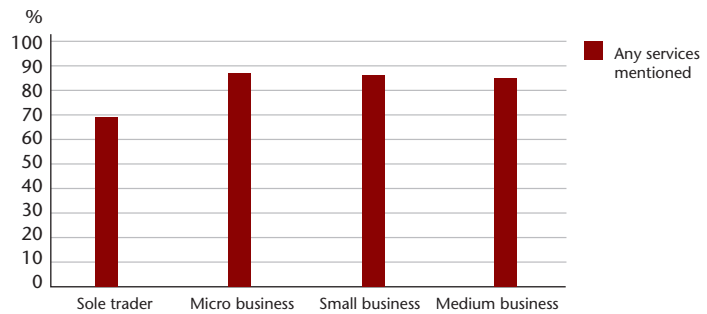
As well as being given a list of (in total) 13 different services to consider, businesses were also asked if they would choose to obtain other services. 2% of micro businesses, 2% of small businesses, and 4% of medium-sized businesses said yes. Investigating what businesses think these other services might be will form part of further Small Business Matters research, and these questions will be considered by ICAEW's Tomorrow's Practice project which asks accountants where they think the future of their profession will take them. See figure 12 opposite.

VIEWS ON AUDIT

Sole traders and micro businesses say that it would not be better for the economy if companies of their size were subject to mandatory audit. These attitudes change sharply as businesses grow in size, however.

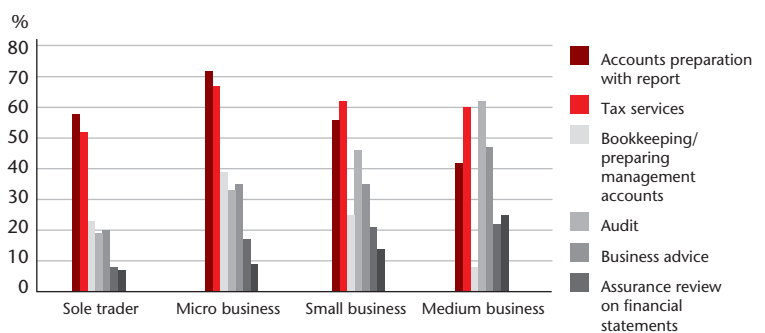
A useful confirmation can be seen in the correlation between growth attitudes and attitudes to mandatory audit. There is also a correlation between those who have an audit and those who indicate that they believe that mandatory audit would be valuable to the economy. See figure 13 opposite.

Figure 11: Percentage who would use any external services from an accountant if none were mandatory, by size band



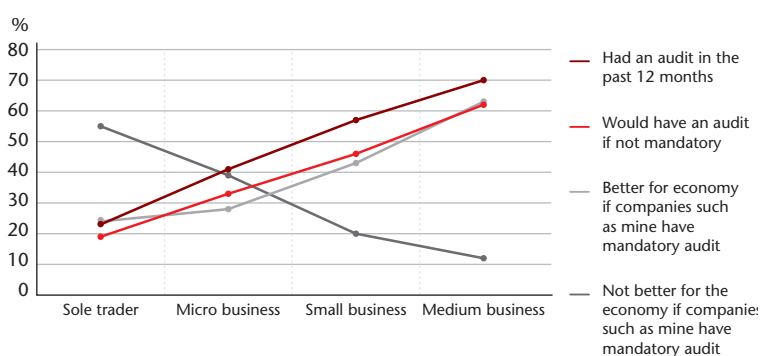
Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Figure 12: Businesses which would still use the seven most popular services, by size band



Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Figure 13: Attitudes to audit, varying by size



Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

The larger a company is, and the more it wishes to grow in the next five years, the more likely it is to see a benefit to the economy from mandatory audit for similar businesses. Although half of companies overall do not see a benefit, these are mostly sole traders and micro businesses.

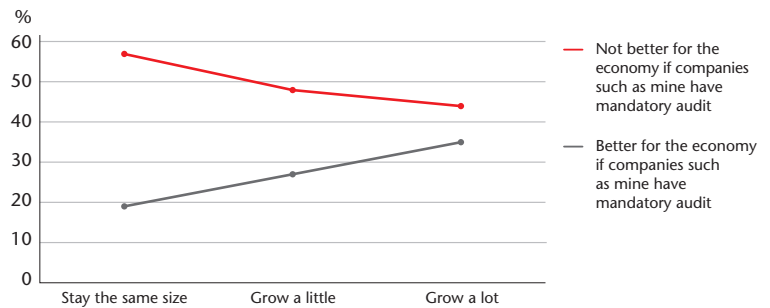
This suggests that the optimum level for an audit exemption threshold, as far as companies are concerned, falls somewhere between micro and small businesses. See figure 14 opposite.

MOST TRUSTED BUSINESS ADVISER

Businesses in all size bands overwhelmingly consider their accountant to be their most trusted business adviser. Other professional advisers such as lawyers or consultants are most likely to be the most trusted adviser to medium-sized businesses, with sole traders far less likely to consider any single external source of advice as their most trusted.

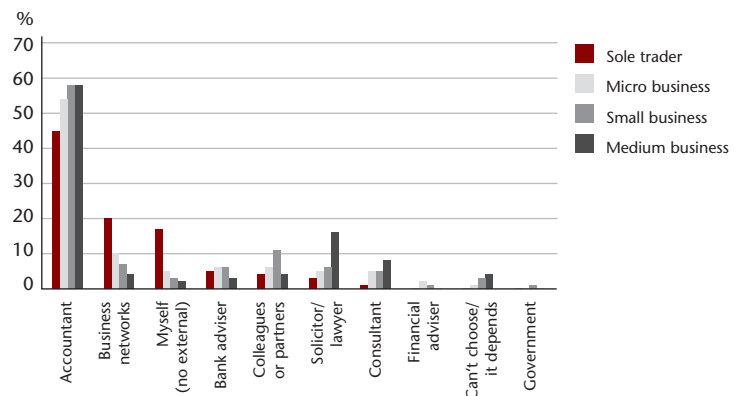
This comparison emphasises the importance of the accountant–business relationship. If an accountant is the most trusted adviser for most businesses, then accountants have a high degree of power to influence business activity across the country. They also have a corresponding responsibility to meet business needs and to help businesses to flourish. See figure 15 opposite.

Figure 14: Attitudes to mandatory audit, by attitudes to growth



Bases: all respondents wishing to stay the same size (100, weighted base 196), all respondents wishing to grow a little (211, weighted base 167), and all respondents wishing to grow a lot (174, weighted base 117) who took part in the telephone survey (May–June 2014).

Figure 15: Most trusted business adviser, varying by size

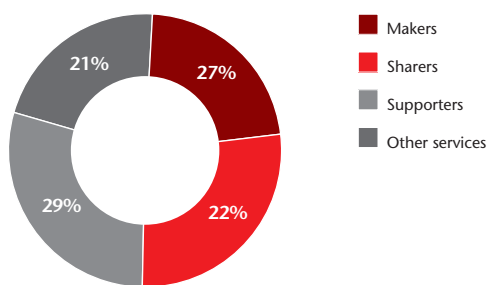


Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Insights by industry sector

The four sectors used in this analysis refer to four broad categorisations: Primary/manufacturing/construction (the makers); transport/retail/distribution (the sharers); business services (the supporters); and services to private individuals rather than businesses (other services).

Figure 16: All businesses by industry sector*



Base: 500 respondents who took part in the telephone survey (May–June 2014).

*Due to rounding up percentages may not add to 100.

Our research has shown that roughly a quarter of businesses fall into each category and that this only changes slightly from one size band to the next. Sole traders are the most evenly distributed, and in the other three size bands the number of businesses acting as supporters is closer to a third, with the number offering other services reduced to between 13% and 15%.

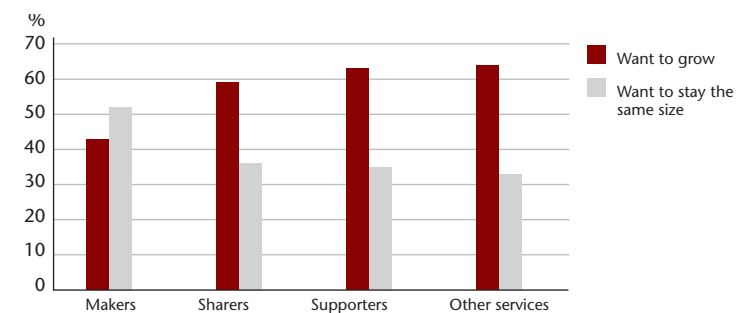
Although businesses in each industry sector are fairly evenly distributed in terms of employee numbers, those in other services tend to be smaller in terms of turnover (92% had less than £632k in the last financial year) and in terms of gross assets (90% had less than £316k at their last balance sheet date).¹³

GROWING A BUSINESS?

There are dramatic differences between industry sectors in terms of attitudes to growth. More than half of the makers (those in primary or manufacturing roles) want to stay the same size rather than to grow. The greatest appetite for growth is seen in other services, even though these businesses are represented most heavily in the sole trader category. Sole traders in general (as discussed later in this report) have the lowest appetite for growth of any size group.

Other services is a broad category for those who do not fit into the three more traditional roles of businesses, and this set of correlations suggests that these include the most ambitious companies. The fact that fewer of these businesses can be found in the bigger size bands suggests that providing other services also puts a business into a more risky or challenging environment.

Figure 17: Attitudes to growth in different industry sectors



Bases: all makers respondents (115, weighted base 137), all sharers respondents (107, weighted base 112), all supporters respondents (136, weighted base 144), and all other services respondents (142, weighted base 107) who took part in the telephone survey (May–June 2014).

Another intriguing contrast is shown by the makers, who have a lower appetite for growth but are more likely to have used the services of an accountant in the past year (87% have done so, compared to 82% of sharers, 67% of supporters, and 62% of those offering other services). As Figure 5 shows, those businesses looking to stay the same size in general are less likely to have used an accountant in the past 12 months than those which are looking to grow.

This suggests that the nature of a primary sector business such as manufacturing or construction makes accountancy services more valuable in this context. One possibly telling indicator is that makers were far more likely to obtain IT services from their accountant than any other group (9% as opposed to 1% of sharers, 3% of supporters and 2% of those offering other services). See figure 18 on page 25.

¹³ Turnover is the amount of income received by a business during a period (in this case a full financial year) before any expenses are deducted. Gross assets is the total of all the assets owned by a business at a certain date (in this case at the last balance sheet date) before any liabilities are deducted. These figures give a measure of the size of the business and the extent of its activities, but are not a measure of its profitability.

THE RIGHT SERVICE IN THE RIGHT PLACE

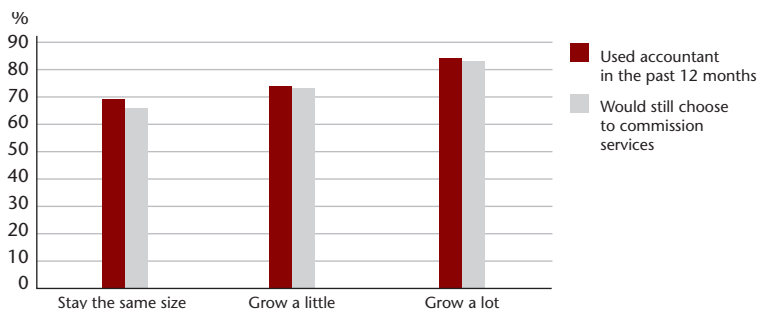
Although the same five services are used by the majority of businesses in each of the four industry sectors, differences can be seen between the level of popularity of each service across the sectors. Supporters and those providing other services are overall less likely to use an external accountant for any of these services, though they show more interest in business advice than makers do. Sharers are more likely to look for bookkeeping, audit, and business advice than any other group.

The question of why businesses choose to obtain accountancy services is outside the scope of this initial quantitative research but will be considered in future Small Businesses Matters qualitative work. See figure 19 opposite.

AUDIT AS A MANDATORY SERVICE

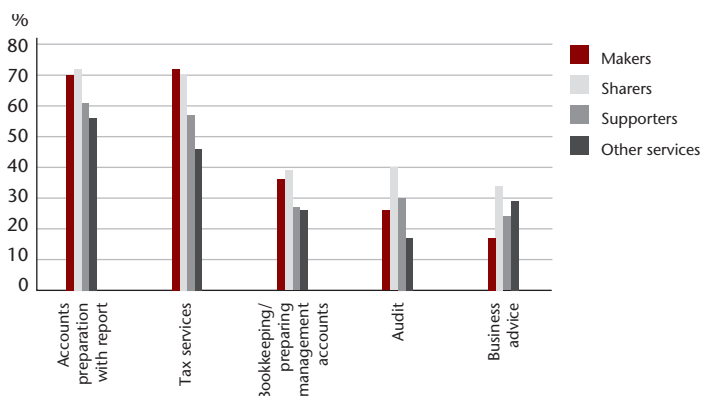
The attitudes of industry sectors to whether it would benefit the economy if audit were mandatory generally did not vary. Roughly a quarter of businesses from each of the four sectors agreed, with the highest level of agreement coming from the makers (29%). Just over half of makers, supporters, and those providing other services disagreed (53%, 54%, and 56% respectively), with an outlier result from sharers only 35% of whom disagreed. It seems that those in retail and distribution are more ambivalent on the subject of mandatory audit than others.

Figure 18: Use of external accountant by companies with different growth attitudes



Bases: all respondents wishing to stay the same size (100, weighted base 196), all respondents wishing to grow a little (211, weighted base 167), and all respondents wishing to grow a lot (174, weighted base 117) who took part in the telephone survey (May–June 2014).

Figure 19: The most popular services obtained from an external accountant by businesses in different industry sectors



Bases: all makers respondents (115, weighted base 137), all sharers respondents (107, weighted base 112), all supporters respondents (136, weighted base 144), and all other services respondents (142, weighted base 107) who took part in the telephone survey (May–June 2014).

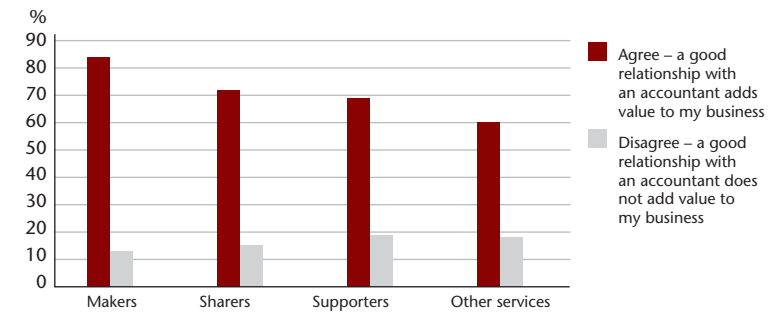
VALUING THE RELATIONSHIP

Makers are more likely than businesses in any other sector to agree that a good relationship with an accountant adds value to their business. Of those who disagree, both sharers and supporters say that cost is the chief barrier, while those offering other services are evenly split between cost and time. See figure 20.

In terms of their most trusted business adviser, businesses in different sectors are generally in agreement. It is, however, interesting to note that supporters are less likely to say they are their own advisers and more likely to go to a solicitor or lawyer. This is natural considering the liability issues that could arise for those providing support to other businesses.

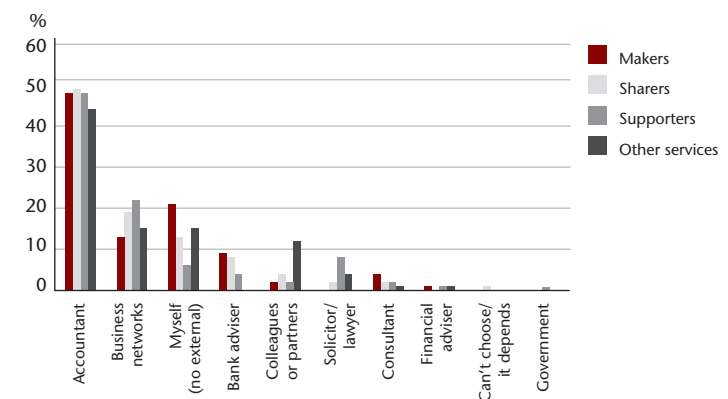
Those in other services are more likely to rely on their own advice, or to turn to colleagues or partners. This fits with the idea of a small atypical or innovative business whose owners might feel that traditional sources of advice are less likely to meet their needs. See figure 21 opposite.

Figure 20: Value of the relationship with an external accountant by sector



Bases: all makers respondents (115, weighted base 137), all sharers respondents (107, weighted base 112), all supporters respondents (136, weighted base 144), and all other services respondents (142, weighted base 107) who took part in the telephone survey (May–June 2014).

Figure 21: Most trusted business advisers by industry sector

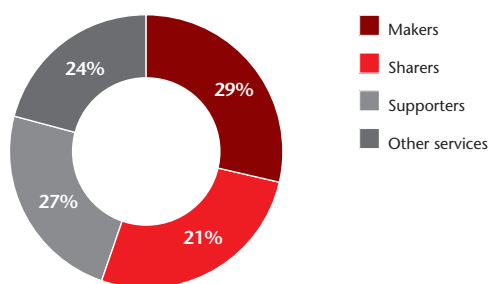


Bases: all makers respondents (115, weighted base 137), all sharers respondents (107, weighted base 112), all supporters respondents (136, weighted base 144), and all other services respondents (142, weighted base 107) who took part in the telephone survey (May–June 2014).

Profile: sole trader

Nearly three-quarters of all enterprises in the UK are sole traders and they are spread fairly evenly across the four industry sectors. These are individuals who have incorporated their activities to form single-person companies, though as this category includes contractors they may not always be working alone.

Figure 22: Sole traders by industry sector*



Base: all sole trader respondents (100, weighted base 372) who took part in the telephone survey (May–June 2014).

*Due to rounding up percentages may not add to 100.

AMBIVALENT ABOUT GROWTH

A typical sole trader is likely to have turnover of less than £632k (reported by 91%) and gross assets below £316k (reported by 89%). Legally speaking, this means that the sole trader will almost always be a micro business. A very few report turnover between £632k and £6.5m (3%), and the same percentage report gross assets in the £316k to £3.25m band.¹⁴ Any sole trader with both high turnover and high gross assets would fall into the legal definition of a small company, and would be subject to further reporting and accounting requirements.

Of all the groups surveyed, sole traders are most ambivalent in their attitudes to growth. Fewer than half expressed any desire to grow at all over the next five years (48%). Of those, 28% said that they wanted to grow a little and only 20% wanted to grow a lot. Another 48% were certain that they would prefer to stay the same size.

A VALUED, VOLUNTARY RELATIONSHIP

Only 70% of sole traders had used the services of an external accountant in the past 12 months but when asked what they would do if there was no mandatory requirement, 69% would still obtain external accountancy services. The difference of only 1% is the smallest of any size segment and compares to a reduction of 3% for micro businesses, 5% for small businesses and 2% for medium-sized businesses.

In other words, although many sole traders do not have an active relationship with an accountant, those that do value it highly – in fact, the percentage saying that a good relationship with an accountant adds value to their business was also 70%. This is in spite of a higher percentage of sole traders mentioning cost as a barrier to value than any other size band (13%, compared to 3% of micros, 2% of small companies, and no medium companies). As deregulation moves accountancy services for larger businesses from a mandatory to a voluntary footing, the strength of the relationship between sole traders and their accountants could be seen as an encouraging sign of things to come.

PRACTICAL HELP

The most frequently used services in the past 12 months were accounts preparation (60%), tax services (58%) and bookkeeping (28%).

No sole traders are legally required to have an audit but 23% have had one in the past 12 months and 19% would still have one if there were no mandatory requirements at all (some mandatory requirements may derive from sources other than the law eg, a condition on a bank covenant). 24% feel that it would be better for the economy as a whole if audit was mandatory for companies like theirs, while 55% disagree.

A FORTRESS MENTALITY?

When asked to name their most trusted business adviser, just under half of sole traders mention their accountant (45%). This is significantly lower than for any other size band, and is accompanied by a higher number of sole traders citing themselves, or saying that they use no external advisers (17%, as opposed to 5% of micros, 3% of small businesses, and 2% of medium businesses).

¹⁴When asking retailers about their gross assets and turnover we made use of the broad bands which form the thresholds of different business sizes in the UK Companies' Act.

Only a fifth had obtained business advice from an accountant in the past 12 months, a similar percentage to the number seeking to grow a lot in the next five years. This suggests either that many of those who regard their accountant as their most trusted business adviser have not sought advice recently.

This could be taken as evidence of the fortress mentality first identified in small businesses by Curran and Blackburn in 1994 but it is worth noting that 20% of sole traders rely on their business networks as their most trusted source of advice (as opposed to 10% of micros, 7% of small businesses, and 4% of medium businesses).¹⁵

Scepticism about the advice provided by business professionals such as accountants may be combined with concerns about the cost of that advice, leading sole traders more than any other group to rely on networking with their peers.

It seems likely, given how many more sole traders regard their accountant as their most trusted adviser than say they have obtained advisory services, that they have received that advice as an informal addition to another service such as accounts preparation.

Given the possibility of a range of informal sources of advice being available to sole traders, it may be that there is not so much a fortress mentality as a canny use of resources.

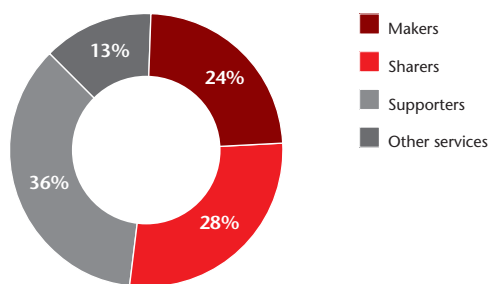
¹⁵ *Small firms and local economic networks: the death of the local economy?* James Curran and Robert Blackburn, 1994.

Profile: micro businesses

Just over a fifth of all UK companies employ between 1 and 9 people. These enterprises have moved onto a different footing from that of a sole trader, as bringing in even one new employee has doubled their workforce.

Micro businesses are more likely to be found in business support roles than in any other industry sector, and slightly more likely to be sharers (that is, in transport, retail or distribution).

Figure 23: Micro businesses by industry sector*



Base: all micro business respondents (150, weighted base 107) who took part in the telephone survey (May–June 2014).

*Due to rounding up percentages may not add to 100.

ONLY SLIGHTLY BIGGER THAN SOLE TRADERS, BUT LOOKING TO GROW

91% of micro businesses reported turnover below £6.5m in the last 12 months, with most of those (75% of the total) falling below £632k. 68% report gross assets below £316k and a further 15% had gross assets between £316k and £3.25m.

This is one of the places where the use of employee numbers to assess company sizes (as per most government statistics) does not reflect the legal status of the businesses. Any of these businesses with both more than £632k turnover and more than £316k gross assets is legally a small business, subject to different regulations under UK and EU law.

Given the potential for increased complexity as new employees are brought in, it is perhaps not surprising that 1% reported turnover between £6.5m and £9.9m, and a further 1% reported turnover between £10m and £25.9m.

Half of micro businesses want to grow a little in the next five years, and 29% want to grow a lot. Only 17% would prefer to stay the same size, compared to 48% of sole traders. This indicates that once a company has taken the first step towards expanding its workforce, it is likely to be enthused about growth even if on average it does not already fall into a larger size band than most sole traders.

LESS LIKELY TO GO IT ALONE

Although subject to no more accounting and auditing requirements than sole traders, micro businesses were significantly more likely to have obtained external accountancy services. 90% had done so in the past year, and in many cases services had been used by twice as many micro businesses as sole traders.

The big two services for businesses of all size are accounts preparation and tax services, and 81% and 72% respectively of micro businesses used these. This represents (narrowly) the highest take up for both services of any size group. Micro businesses are also more likely to use an external accountant for bookkeeping or management accounts preparation than any other group (46%, compared to 28% for sole traders, 29% for small businesses, and 12% for medium businesses).

These patterns indicate that, for a growing enterprise employing fewer than 10 people, basic business support is increasingly necessary and is likely to be obtained externally due to a lack of in-house accountancy expertise.

A RANGE OF USES FOR AN EXTERNAL ACCOUNTANT

Across a whole range of other services, micro businesses are nearly twice as likely to use an external accountant than sole traders. This difference arises even though they are subject to exactly the same light-touch regulations as sole traders and are already exempt from many requirements. Almost all of these services are being obtained on a voluntary basis.

Services which micro businesses are far more likely to obtain than sole traders include business advice (42% compared to 20%), assurance review of financial statements (21% compared to 12%), budget or cash flow preparation (15% compared to 8%) and PAYE or payroll services (6% compared to 3%). Perhaps the starkest difference is with sustainability assurance, obtained by 10% of micro businesses compared to only 2% of sole traders.

The same pattern holds true for audit. Although similarly not required by law to have an audit, 41% of micro businesses obtained one in the past 12 months.

It is likely that this difference is partly driven by other external requirements (contract terms or bank covenants), as only 33% of micro businesses would obtain an audit if they did not have to. Nevertheless, 28% still say that it would benefit the economy if businesses like them did have to have an audit and only 39% disagree. See figure 24.

THE ACCOUNTANT'S PERSPECTIVE

Chartered accountants may be wrong to worry that deregulation will reduce the demand for their services, given the enthusiasm of micro businesses for so many different services on a voluntary basis.

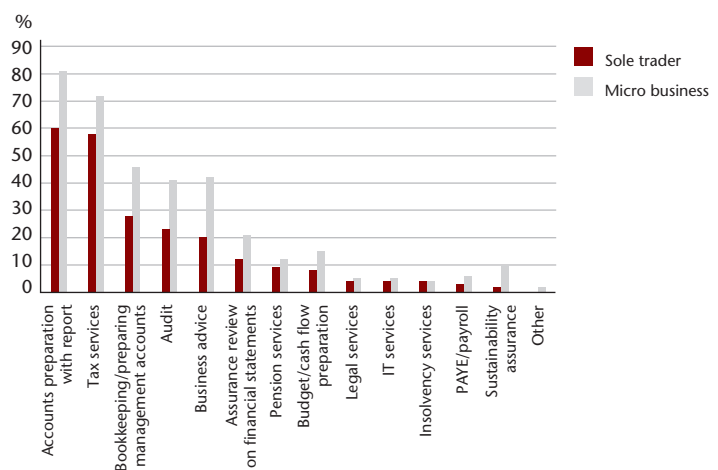
It might be more appropriate to worry about quality. Where services are unregulated, the providers of those services are also not subject to regulation. 'Accountant', unlike 'doctor', is not a protected term and chartered accountants compete with those with little training or quality control. Only 3% of small businesses regard cost as a barrier to getting value from the relationship with their accountant. Whether this means that businesses are getting value for money depends largely on how well equipped and supported they are to assess the quality of the services they receive. It may be a good sign, therefore, that they are very likely to appreciate the work that external accountants do.

APPRECIATION FOR THE ASSISTANCE

87% of micro businesses list one or more services which they would still obtain from an external accountant even if there was no mandatory requirement to do so, and 78% say that a good relationship with their accountant adds value. Both of these percentages are higher than for any other size group.

Micro businesses are far less likely than sole traders to rely on themselves as their most trusted business adviser (5% compared to 17%) and half as likely to turn to business networks. The majority of the difference is accounted for by their higher appreciation for their external accountants, named as the most trusted adviser by 54%.

Figure 24: Comparing sole trader and micro business use of external accountants in the past 12 months



Bases: all sole trader respondents (100, weighted base 372), and all micro business respondents (150, weighted base 107) who took part in the telephone survey (May–June 2014).

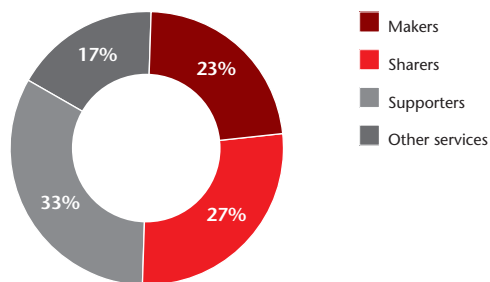
A CATEGORICAL ERROR?

Sole traders and micro businesses may be a similar size but have significantly different attitudes to growth, to how to manage their activities, and to regulation such as the audit requirement. Despite this they are lumped together in a single category for the purposes of both UK and wider EU legislation.

Given the huge number of enterprises that fall into these two groups, and the notable differences between them, it would be sensible to treat them as different legal categories as well. A healthy economy needs flourishing sole traders as well as fast-growing micro businesses, and should respect the varying needs and ambitions of both.

Profile: small businesses

Figure 25: Small businesses by industry sector



Base: all small business respondents (150, weighted base 19) who took part in the telephone survey (May–June 2014).

WHAT'S IN A NAME?

In terms of employee numbers a small business is defined as one with between 10 and 50 employees and by this definition only 4% of UK businesses can be considered small. The term 'small businesses' is, of course, more widely used and variously defined, often to include sole traders and micro businesses.

The 2013 EU Accounting Directive allows Member States to revise their legal definition of a small business upwards. When determining the size of a business for legal purposes, however, turnover and gross assets are considered as well as employee numbers. The EU changes, even if the highest possible definition is applied, will affect only turnover and gross assets and will not change the small business band of 10 to 50 employees.

A fifth of businesses with 10 to 50 employees have turnover below £632k a year but the majority (65%) have turnover between £632k and £6.4m. The majority (77%) have gross assets below £3.25m, with a further 2% between £3.26m and £4.9m, 2% between £5m and £12.9m, and 2% greater than £12.9m. This contrasts strongly with sole traders and micro businesses, none of which report gross assets above £3.26m.

Currently (before the implementation of the 2013 EU Accounting Directive) £6.5m is the upper limit on turnover for the UK Companies Act definition of a small business. The 7% of businesses with 10 to 50 employees reporting turnover greater than £6.5m may still be classed as small, however, as they only need to meet two of the three criteria (employee numbers, turnover, and gross assets) in order to meet the legal requirements.

Given the number of variables to take into account when determining the legal size of a business, and the uncertainty posed by the potential changes, it is a matter of concern that small businesses are more likely than any other group to say that they don't know what their turnover was for the last financial year (9%) or that they don't know what their gross assets were at their last balance sheet date (17%). Chartered accountants working with businesses in this group should bear in mind that an increase in size might outpace the development of an internal finance function, and be ready to help businesses understand the implications of their size and activity.

CHANGES: THE IMPACT OF THE 2013 EU ACCOUNTING DIRECTIVE

If a business falls below the lower limits of two of the three criteria, it is considered to be a micro business. It must fall below the upper limits of at least two of the three criteria or it will be considered a medium-sized business. See table 1.

This arrangement is designed to give a more nuanced understanding of what defines business size than simply looking at employment numbers. It does, however, lead to some interesting anomalies.

For example, out of our sample of 500 businesses there were 274 which fell below the lower limits of two of the three criteria in table 2 on page 38 and are therefore legally considered to be micro businesses. Three of these reported that they had between 50 and 250 employees, yet because they meet the turnover and gross assets criteria they are subject to the same light-touch legislation as any sole trader. Interestingly, though the numbers are too small for this to be extrapolated across the entire UK business population, all three of these are services organisations (two supporters and one other services).

Table 1: The potential change in the legal definition of a small company

Criteria	Current 'small business' levels	Potential new 'small business' levels
Employee numbers	Between 10 and 50	Between 10 and 50
Turnover	More than £632k and less than £6.5m	More than £632k and less than £10.3m
Gross assets	More than £316k and less than £3.26m	More than £316k and less than £5.1m

Another population of interest is the businesses which are currently classed as medium but which would be small under the upper limits permitted by the 2013 EU Accounting Directive. It appears that only about 0.2% of UK businesses will be affected, so few that it is impossible to draw any further conclusions about the population with any confidence.

It should be noted that even 0.2% of UK companies amounts to nearly 7,000 individual companies, and that if these businesses had employee numbers around the boundary between the small and medium definitions (ie, around 50 employees each), that could mean hundreds of thousands of people directly affected. These are rough estimates, however, and should be treated with caution. During the next stage of research undertaken by Small Business Matters we intend to undertake qualitative work to gain a better understanding of who these businesses are and what the impact of any change could be.

FULL STEAM AHEAD...

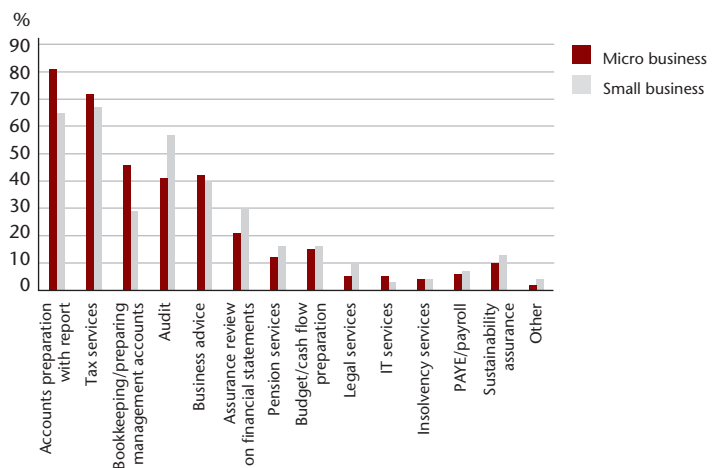
There may not be many businesses with 10 to 50 employees, but as a group they are all keen to expand. Over the next five years 88% are seeking to grow, and for the first time in this group we encounter more businesses seeking to grow a lot (47%) than to grow a little (41%). Only about a tenth of small businesses are content to stay the same size.

...AND LOOKING FOR SUPPORT

91% of small businesses used an external accountant in the past 12 months, higher than any other group. The profile of these services is as different from that of a micro business as a micro business is different from a sole trader. See figure 26.

The biggest variance between micro and small businesses is seen in the area of bookkeeping or preparing management accounts, a service used by 46% and 29% respectively. The simplest explanation for this difference is that small businesses are more likely to do all of their own bookkeeping in-house, and less likely therefore to need the services of an external accountant.

Figure 26: Comparing micro business and small business use of an external accountant in the past 12 months



Bases: all sole trader respondents (100, weighted base 372), all micro business respondents (150, weighted base 107), all small business respondents (150, weighted base 19), and all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Similarly, only 65% of small businesses used an external accountant to prepare their annual accounts, compared to 81% of micro businesses. On the other hand, a small business was more likely to ask an external accountant for an audit (57% compared to 41% at a micro business). The two might well be connected, as preparing a set of financial statements can be seen as compromising the independence which is necessary for an external audit to add value.

Both small and micro businesses, if they meet the full Companies Act requirements for those definitions, are exempt from mandatory audit in the UK. Why, then, are small businesses so much more likely to obtain an audit? It is worth noting as well that more small businesses have used an external accountant to obtain an assurance review of their financial statements, a less intensive option perhaps than a full audit but still a service offering the same kind of value.

There are a number of factors which can influence a company's decision to have an audit or a review engagement, both internal and external to the business. See figure 27 opposite.

The longer a business has been in existence, and the larger it grows, the more likely it is that management will gain comfort from external scrutiny. An audit or review engagement provides assurance by exposing the mechanisms of financial reporting within that company to the view of an external expert.

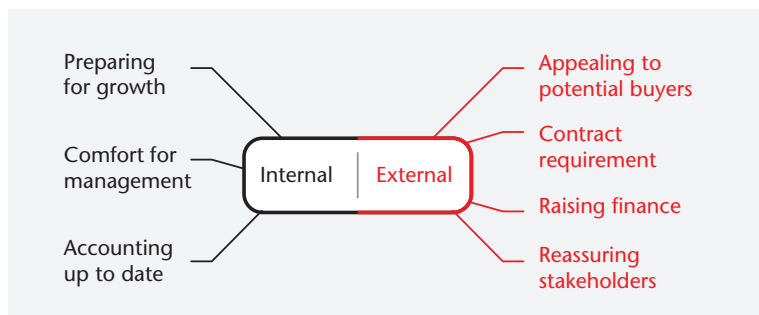
A business which is looking to grow, as 88% of small businesses are, is more likely to be considering the perspective of external stakeholders such as lenders and investors. Bank loans may come with covenants requiring an audit, or an investor may want to see several years' worth of audited accounts before committing.

46% of small businesses would still have an audit (down from 57%) and 21% would still have a review engagement (down from 30%) if it were not required of them. Given that neither of these services is required by law of small businesses, it is reasonable to conclude that 11% of those who have an audit and 9% of those who have a review engagement are doing so primarily for external stakeholders. The remainder are presumably meeting a mixture of internal and external needs.

A THREE-LINE WHIP?

Over two-fifths (43%) of small businesses feel that it would be better for the economy as a whole if businesses like them were subject to a mandatory audit requirement. This is of particular interest as this group is the most recent to have been exempted from mandatory audit. Only one-fifth (20%) actively disagree that a mandatory audit would be better, with the remaining two-fifths of small businesses undecided.

Figure 27: Factors influencing a company's decision to have an audit or review engagement¹⁶



Across all UK companies covered by this research (that is, all but the largest 0.1%) just over a quarter think that it would be better if audit were mandatory for those like them, and only half disagree. The majority of those which disagree are, like the majority of businesses in the country, sole traders. Medium-sized businesses are even more likely to approve of mandatory audit for those like them, with 63% agreeing and only 12% disagreeing.

It might seem counter-intuitive that, in this one area at least, a large number of businesses are keen to see more rather than less regulation. Across the whole sample, those who already obtain an audit or a review engagement are likely to agree (43% and 47% respectively) rather than disagree (30% in both cases) that it would be better if audit were mandatory for those similar to them. This suggests that one reason for supporting mandatory audit might be that a business which already uses the service, or a similar one, anticipates benefits from a more universal service, perhaps in terms of choice of providers or competitive pricing.

Another possibility is that businesses would feel more confident about their peer-to-peer activity, such as lending or extending credit terms, if they knew that all of their peers were subject to a high level of external scrutiny.

As well as engaging in more complex peer-to-peer networks, larger businesses might simply see more of the value of audit because of their increased complexity and more engaged external stakeholders, and believe that the economy as a whole would benefit from this value being more widely shared.

The advantages and disadvantages of a voluntary service as opposed to a compliance driven one will be an area of investigation for further Small Business Matters research.

¹⁶ List of factors developed following ICAEW's Assurance Review Roundtable, held in the first half of 2013.

REVIEWING THE TROOPS?

It is interesting to note the high percentage of businesses, 30%, that have had a review of their financial statements. If these are businesses which have not had an audit (and it is difficult to see why a business would need an independent review as well as an independent audit) then overall 87% of small businesses have had either an audit or a review engagement.

This is a higher total than would be expected based on the relatively small number of chartered accountants who have reported that they have carried out a review engagement in accordance with the appropriate technical and quality standards. This is an unregulated area and it is likely that many of these engagements are carried out by unqualified accountants who may not be applying the highest level of technical expertise and quality control.

Another possibility is that businesses are reporting informal or unofficial review engagements, which do not lead to a report that can be shared with external stakeholders, as part of this total. This could mean that, despite valuing a review service, businesses are unaware of their options and may not have obtained the best possible service to meet their needs.

VALUING THE SERVICE

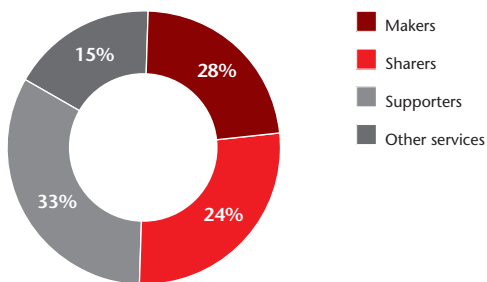
Just over three quarters of small businesses (76%) agree that a good relationship with an external accountant adds value to their business and only 5% disagree (others are ambivalent). Those that disagree are divided on the subject of what barrier prevents value from being added, with a third (2% of all small businesses) mentioning cost, a third mentioning a poor understanding of the business, and a third mentioning a poor ability to communicate key findings. This range of reasons suggests higher expectations of accountants from this group than from sole traders or micro businesses.

58% of small businesses name their accountant as their most trusted business adviser, more than sole traders (45%) and micro businesses (54%). Only 3% would consider themselves for the role, but 11% mention colleagues or business partners, suggesting that as the business grows so does confidence in in-house expertise.

Other small businesses are divided between trusting business networks (7%), a bank adviser (6%), a solicitor or lawyer (6%), and a consultant (5%). The fact that accountants are seen as trusted advisers by far and away the majority, despite the wide range of sources of support, is a strong indication of the importance of external accountants to small businesses.

Profile: medium businesses

Figure 28: Medium-sized businesses by industry sector



Base: all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Only 1% of UK companies have between 50 and 250 employees and it is likely that some of those fall below the gross assets and turnover thresholds which must also be taken into account when considering whether a business is legally defined as medium.

Though there are not so many medium businesses as small businesses, and far fewer of either than there are micro businesses or sole traders, 1% of all 4.9m non-large businesses in the UK still amounts to 30,000 companies. Our base sample included enough of these businesses to ensure that the results would be statistically significant, even though the percentages look very small when weighted to reflect the actual make-up of the UK's business population.

ASSESSED BY SIZE

39% of businesses with medium-band employee numbers (50 to 250) had turnover in the last financial year between £632k and £6.4m, the band which is currently legally assigned to small businesses. If the upper threshold of what counts as a small business is increased to £10m turnover, then the majority (54%) of companies regarded as medium sized in most BIS figures will have turnover below the small business threshold. 53% already report gross assets below the £3.26m upper threshold for a small business, and that would increase to two-thirds if the upper threshold for a small business is increased to £5m gross assets.

These results would suggest that the proposed increases under the 2013 EU Accounting Directive would result in a very large number, perhaps most, of medium-sized businesses being redefined as small. However, under both existing and new legislation, a company only needs to meet two of three criteria in order to be placed in any given size band.

When the question is adjusted to take into account this complex flexibility, we found that only 0.2% of companies might be moved from the medium to the small size band. As only 1% of companies are medium, this is still about a fifth of that number.

The reason that the percentage of companies potentially transitioning is not higher might well be that many of those counted as medium sized by employee numbers are already small by the other two criteria of turnover and gross assets. In other words, more companies are already subject to small business deregulation than most figures used by government to discuss policy would suggest.

A GROWING CONCERN

Nearly half of medium-sized businesses (48%) say that they want to grow a lot over the next five years. Most of the remainder (41%) are looking to grow a little, and only 10% would prefer to remain the same size. This is a higher appetite for growth than any other size group shows. It seems highly likely that most of those companies which have already reached 50 to 250 employees have grown significantly to do so, so that medium-sized companies have effectively self-selected for a high growth appetite.

THE USE OF EXPERTS

With more employees, it is only to be expected that companies in this band would tend to have more in-house financial expertise than those in smaller bands. This may be why the percentage of those obtaining external accountancy services in the past 12 months, 87%, is slightly lower than the 91% of small businesses. Similarly, the fact that only 56% of medium businesses used external accountants to prepare their accounts and only 12% made use of bookkeeping or management accounts preparation suggests that medium businesses are more likely to have brought these elements of their financial management in-house.

By contrast, half of all medium businesses have sought business advice from their accountant, compared to only 20% of sole traders and 42% and 40% of micro and small businesses respectively. They are also more likely to have obtained tax services and legal services from an accountant than small businesses (71% compared to 67% and 15% compared to 10% respectively) and, perhaps to be expected from organisations with more employees, are nearly twice as likely to have obtained pension services (28% compared to 16%).

It is less easy to understand why a medium-sized business is less likely to have obtained sustainability assurance than either a small business or a micro business (6% compared to 13% and 10%). Does this mean that medium businesses are more confident in their own sustainability processes and internal controls? There is no obvious reason why sustainability should be less important to a business with more employees but perhaps this is another area where increased size means increased in-house expertise.

AUDIT: UNIVERSAL COVERAGE?

All businesses defined as medium under the UK Companies Act are required to have an audit every year. The fact that only 70% of businesses with 50 to 250 employees report that they have had an audit in the past 12 months is another indication, therefore, that this category includes a significant minority of businesses which are, legally speaking, small and exempt from audit.

Some of those audits are likely to be taking place on a voluntary basis at organisations which do not legally require them, making it hard to estimate exactly how many of the businesses in this category do meet the legal criteria for a medium-sized business. Given this conclusion, it is interesting that 29% of businesses in this category report that they had a review engagement of their financial statements in the past year. As discussed under the small business category, it is difficult to see why any organisation which had had the thorough scrutiny of an audit would choose to have an external review of their financial statements as well. This strongly suggests that 99% of medium businesses had assurance over their financial statements either in the form of an audit or of a review.

With such high numbers seeking assurance over their financial statements, it is hardly surprising that 63% of medium businesses think that mandatory audit for organisations like them benefits the economy. Only 12% disagreed, continuing the pattern seen across other groups: the larger a business and the higher its growth appetite, the more it is likely to see value in mandatory audit for similar organisations.

IN AN IDEAL WORLD...

85% of medium-sized businesses would use an external accountant for one or more services even if there was no mandatory requirement to do so, only slightly fewer than have made use of an external accountant in the past 12 months (87%).

The most popular service on a voluntary basis would be an audit (62%), followed by tax (60%) and business advice (47%). This range of preferred services is different from that of small businesses, most of which would choose to obtain tax services followed by accountants preparation and then audit. Both sole traders and micro businesses were most likely to choose accounts preparation, followed by tax services and then by bookkeeping or management accounts preparation.

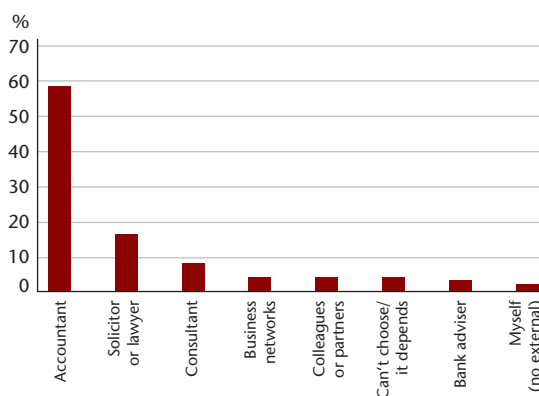
Business advice is clearly more important for a medium-sized business than for any other and it is striking how much more important an audit appears to be to larger, growth-ambitious organisations. Both of these services require a high level of judgement on the part of an accountant and in both cases an external view can provide independence which is difficult to replicate inside a business. This may explain why over half of those medium businesses which say that a relationship with an accountant does not add value to their company see a poor understanding of their business as the chief reason.

TRUST AND VALUE

Over three-quarters (76%) of medium-sized businesses agree that a good relationship with a chartered accountant adds value to their company, any only 9% disagree. Those who disagree do not see cost as a barrier. Over half refer to a poor understanding of their business, and a third say that in-house expertise makes an external expert less relevant. The remainder are more concerned about time than anything else. This indicates that quality and efficiency are the chief interests for medium-sized businesses.

Given that medium-sized businesses have high expectations of their accountants it is reassuring that 58% would still consider their accountant their most trusted business adviser. Other professional advisers are more important to businesses in this size band than they are to smaller organisations, with 16% mentioning a solicitor or lawyer (compare to 6% of small businesses) and 8% mentioning a consultant (5% of small businesses). In spite of having more in house expertise, medium-sized businesses are less likely than those in any other category to consider themselves or their colleagues as their most trusted business adviser. See figure 29 opposite.

Figure 29: Medium-sized companies' most trusted business advisers



Base: all medium business respondents (100, weighted base 3) who took part in the telephone survey (May–June 2014).

Appendix 1: what is a small or medium-sized business?

There is no single agreement on what should be defined as a micro, small, or medium-sized business. The definitions used in regulation are not necessarily the same as those applied in official statistics, and neither are really comparable to the way that the term is used in casual conversation. For example, statistics used by the UK's Office for National Statistics (ONS), and by most government departments in the country, would consider a business with 50 or fewer employees to be small. If that business had a significant property portfolio worth £4m and an annual turnover of £15m, then it would be treated as a medium-sized business under the regulations set out in the UK Companies' Act. To the casual observer, it might be considered a fairly large concern.

For the sake of simplicity in this report all business sizes follow the employee number categories preferred by the ONS and other UK government departments, unless stated otherwise.

Table 2: ONS business sizes

Number of employees	Size of business	Number of businesses (thousands) ¹⁷	Percentage of total UK businesses
0 – 9	Micro business	4,671	95.4%
10–49	Small business	186	3.8%
50–249	Medium-sized business	30	0.6%
0–249	Total excluding large businesses	4,889	99.9%
250+	Large	6	0.1%
All	Total including large businesses	4,895	100%

There are around 3m active companies registered at Companies' House as being incorporated in the UK as at July 2014. This is the population from which the Small Business Matters survey is taken.

¹⁷ Department for Business, Innovation and Skills, 2013 data.

Appendix 2: data tables top line results

Large companies (ie, those employing more than 250 people) have been omitted from this survey. As they make up only 0.1% of all companies, the analysis below is valid for 99.9% of all UK enterprises.

Q1 AND Q2: SIZE OF COMPANIES

Table 3: Question 1 – Turnover in the last financial year

Turnover	% of UK companies
£632k or less	84%
£632k to £6.4m	9%
£6.5m to £9.9m	–
£10m to £25.9m	1%
£25.9m or more	–
Don't know	6%

Table 4: Question 2 – Gross assets at the last balance sheet date*

Gross assets	% of UK companies
£316k or less	84%
£316k to £3.25m	7%
£3.26m to £4.9m	–
£5m to £12.9m	–
£12.9m or more	–
Don't know	10%

*Due to rounding up percentages may not add to 100.

Q3: ATTITUDES TO GROWTH

Table 5: Question 3 – Attitudes to growth*

Thinking of the next five years, I would like my company to...	% of UK companies
Stay the same size	39%
Grow a little	33%
Grow a lot	23%
Don't know	4%

*Due to rounding up percentages may not add to 100.

Q4: USE OF EXTERNAL ACCOUNTANTS

Table 6: Question 4 – Use of external accountants

Use of an external accountant in the past 12 months	% of UK companies
Yes	75%
No	25%

Q5 AND Q6: PREFERRED SERVICES

Q5 and Q6 were only asked of the 75% of respondents who answered 'yes' to Q4. The results here are given as a percentage of the whole population.

Table 7: Question 5 – Services used in the past 12 months

What service have you obtained from an accountant?	% of UK companies
Accounts preparation with a report	65%
Tax services	62%
Bookkeeping and/or preparing management accounts	32%
Financial audit	28%
Business advice	25%
An assurance review of your financial statements	14%
Pension services	10%
Budget and/or cash flow preparation	10%
Legal services	5%
Sustainability assurance	4%
IT services	4%
Insolvency services	4%
PAYE/Payroll	4%
Other	1%
None (ie, answered 'No' to Q4)	25%

Table 8: Question 6 – If not mandatory, then what?

If there was no mandatory requirement to fulfil any of these tasks, which would you still choose to commission from an external accountant?	% of UK companies	Variance from Q5
Accounts preparation with a report	61%	-4
Tax services	55%	-7
Bookkeeping and/or preparing management accounts	27%	-5
Financial audit	23%	-5
Business advice	24%	-1
An assurance review of your financial statements	10%	-4
Pension services	8%	-2
Budget and/or cash flow preparation	7%	-3
Legal services	3%	-2
Sustainability assurance	2%	-2
IT services	2%	-2
Insolvency services	1%	-3
PAYE/Payroll	3%	-1
Other	1%	-

If there was no mandatory requirement to fulfil any of these tasks, which would you still choose to commission from an external accountant?	% of UK companies	Variance from Q5
None	2%	N/A
N/A (answered 'No' to Q4)	25%	–

Q7A: MANDATORY AUDIT?

The full phrasing of this question was: 'On balance, it would be better for the UK economy if it was mandatory for companies such as mine to be audited.'

Table 9: Question 7a – Should audit be mandatory?*

Companies such as mine should be audited. Do you...?	% of UK companies
Strongly agree	12%
Slightly agree	14%
Neither agree nor disagree	18%
Slightly disagree	11%
Strongly disagree	39%
Don't know	7%

*Due to rounding up percentages may not add to 100.

In total, 26% agreed and 50% disagreed. The remaining 24% neither agreed nor disagreed, or didn't know.

Q7B, Q8 AND Q9: THE ACCOUNTANT–BUSINESS RELATIONSHIP

Table 10: Question 7b – Added value

A good relationship with an external accountant adds value to my company. Do you...?	% of UK companies
Strongly agree	49%
Slightly agree	23%
Neither agree nor disagree	11%
Slightly disagree	8%
Strongly disagree	8%
Don't know	1%

In total, 72% agreed and 16% disagreed. The remaining 12% neither agreed nor disagreed, or didn't know.

Only those who disagreed with Q7b were asked Q8, what is the most significant factor that prevents external accountants from adding value to their company?

Table 11: Question 8 – Barriers to added value

The most significant factor preventing added value	% of those who disagreed with Q7	% of UK companies
Cost	62%	10%
Time	10%	2%

The most significant factor preventing added value	% of those who disagreed with Q7	% of UK companies
Poor ability to communicate	1%	0.2%
Poor understanding of my business	5%	1%
Other (not specified)	4%	1%
Other (specified that an accountant was not needed due to in-house expertise)	6%	1%
Don't know	5%	1%

Base: 81 respondents who disagreed with Q7B answered Q8. Some noteworthy correlations:

- Of the 81 respondents who disagreed with the statement 'A good relationship with an external accountant adds value to my company', only 26% had used an external accountant in the past 12 months.
- The 51 respondents who mentioned cost as the most significant barrier were most likely to be looking to stay the same size (41%), or to grow only a little (35%).
- The 51 respondents who mentioned cost as the most significant barrier were also most likely to have obtained accounts preparation (29%) or tax services (27%) in the past 12 months. The majority (71%), however, had not obtained any accountancy services at all.
- 26% of the 81 respondents who disagreed with the statement 'A good relationship with an external accountant adds value to my company' stated that they would still commission service(s) from an external accountant even if they were not mandatory.

Table 12: Question 9 – Most trusted business adviser*

Who (apart from family) would you say is your most trusted business adviser?	% of UK companies
Accountant	48%
Business networks	17%
Other (specified no external advisers)	14%
Bank adviser	6%
Other (colleagues/partners)	4%
Solicitor/lawyer	3%
Consultant	2%
Don't know	5%

*Due to rounding percentages may not add to 100.

Appendix 3: survey questions

THINKING OF THE COMPANY YOU CURRENTLY WORK FOR...

- 1** For the most recent complete financial year, which of the following best describes your approximate total turnover?
Please select the most relevant from these options I am going to read:
- Less than £632,000
 - £632,000 to £6.4m
 - £6.5m to £9.9m
 - £10m to £25.9m
 - Greater than £25.9m
 - Don't know
- 2** At your most recent balance sheet date, which of these statements I am going to read best describes your approximate gross assets? (NB gross assets are the sum of total assets on your balance sheet before the deduction of any liabilities.)
- Less than £316,000
 - £316,000 to £3.25million
 - £3.26 m to £4.9 m
 - £5 m to £12.9 m
 - Greater than £12.9 m
 - Don't know
- 3** Looking ahead to the next five years, which of these statements best describes your attitude to growth?
- I would like my company to grow a little
 - I would like my company to grow a lot
 - I would like my company to remain the same size
 - Don't know
- 4** Has your company used the services of an external accountant during the past 12 months?
- Yes
 - No
 - Don't know
- 5** FOR THOSE WHO SAY YES – And what services have you received from an external accountant during the past 12 months?
Please select all that apply.
- Accounts preparation with a report
 - Bookkeeping and/or preparing management accounts
 - Budget and/or cash flow preparation
 - Financial audit
 - An assurance review on your financial statements
 - Sustainability assurance
 - Insolvency services
 - Tax services
 - IT services
 - Legal services
 - Pension services
 - Business advice
 - Other services (please specify)
- 6** FOR ALL ANSWERING Q5 – Imagining if there is no mandatory requirement to fulfil any of the tasks I read out – which of the following services, if any, would you still choose to commission from an external accountant?

Relay list of services respondent has cited at Q5

7 How much do you agree or disagree with the following statements where 1 = strongly disagree and 5 = strongly agree

- a. On balance, it would be better for the UK economy if it was mandatory for companies such as mine to be audited.
- b. A good relationship with an external accountant adds value to my company.

8 IF DISAGREE with statement 'B' – The most significant factor that prevents external accountants from adding value to my company is (select one):

- Cost
- Time
- Poor ability to communicate key points
- Poor understanding of my business
- Other (please specify)

9 Thinking about people (other than family) who might provide your company with business advice and support, who would you say is your most trusted business adviser?

Prompted single-choice: interviewer to read list below

- Accountant
- Consultant
- Bank adviser
- Business networks
- Solicitor/lawyer
- Other (please specify)

Appendix 4: method note

ICAEW commissioned IFF Research to carry out 500 telephone interviews via their Small Business Omnibus Survey with a nationally representative sample of small and medium-sized businesses within the UK.

Fieldwork was conducted during May–June, 2014, using the set of questions and instructions supplied in Appendix 3 to this report.

All survey data has been weighted using population data to ensure results are nationally representative of the small and medium-sized business market in the UK.

All data analysis has been conducted by ICAEW.

Both ICAEW and IFF Research adhere to the Market Research Society (MRS) code of conduct.

ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession.

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