

Covid-19 and small business: A discussion paper

Financial Inclusion Commission and Money Advice Trust
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Executive summary

The coronavirus pandemic has served to accelerate the problems faced by small businesses: getting insurance for income continuity; accessing affordable credit; digital access; late payments and payment deferrals. Small businesses are operating in a more uncertain economic landscape.

Urgent intervention is needed to assist this hugely important sector of the UK economy to recover, innovate, create jobs and employment, and rebuild in a financially resilient way.

We believe that small businesses need:

1. Swift action with either insurance or assurance of help from Government to deal with the interruptions that they will see in the years to come.
2. Action to strengthen the Prompt Payment Code further, to introduce fines for persistent late payers, and to review the use of statutory interest on late payments.
3. Help to defer repayment of government-backed loans, where needed, without increasing their debt and more accessible, affordable credit.
4. A collaborative approach by the regulators, requiring the industry to guarantee access to and acceptance of cash, and provide the regulatory framework to enable effective collaboration as well as requiring payment providers to implement Request to Pay and auto-enrol customers.
5. Further support to ensure digital access and better digital banking and payments products which meet these needs, at costs affordable for small businesses.
6. Support and training to help small businesses adapt to the increasing digitisation of the economy and assistance to train and upskill the workforce and contribute to job creation.
7. A fundamental review of how small businesses and the self-employed are taxed with a view to achieving a system which does not lead to significant costs for small businesses.
8. A sustainable long-term pension solution with ways of providing adequate advice and of engaging small businesses and the self-employed in planning their financial future.

Introduction

There are millions more people facing economic hardship as a result of the Covid-19 pandemic. We tend to think of these as being individuals losing jobs or contracts, having work hours cut and facing difficulties with rent and mortgage payment. However, small businesses have been severely impacted by the crisis.

In 2019 there were 5.82 million small businesses (with 0 to 49 employees). They make up 99.3% of the UK's total business population (5.9 million).¹

By June nearly 80% of those businesses, including sole-traders and freelancers, had seen a negative revenue impact from Covid-19.² While the extent of the impact varies between sector and region, despite Government assistance more than half of SMEs (small and medium sized enterprises) say they may be out of business by April 2021.³ This is deeply worrying as SMEs employ around 44% of the UK work force. Ensuring these vital contributors are financially resilient and adequately supported is crucial to the UK economy.

Research conducted by Money Advice Trust, the charity that runs Business Debtline, in May this year provides a snapshot of the impact of the Covid-19 pandemic on Business Debtline callers as the crisis continued to unfold.⁴ A survey of callers to the advice service revealed that a third of respondents had experienced a drop in business income highlighting the significant impact this crisis has had on people in self-employment. In addition, half of respondents reported that they had already used their savings to help cope with the income loss caused by the pandemic.

This has a significant impact on households as small business owners are also more likely to run business and household finances from the same accounts, so if the business runs into financial difficulty household bills are likely to be affected too. Indeed, almost half of respondents to the Trust's survey of callers reported that they had already fallen behind on their household bills, and half also reported being behind on their credit card payments.

Small business owners, and in particular those working as freelance contractors or in the gig economy, are likely to earn less for the same work done by their employed counterparts. Also, households with self-employed and gig workers have on average worse future prospects than households generally, when controlling for other factors including income.⁵ As a result, they are less able to save, to afford insurance such as income protection insurance, and to plan for retirement. There is clearly a need to work towards greater financial resilience among this significant and important part of the population.

Insurance

The crisis has demonstrated the importance of insurance for small businesses to help protect against substantial shocks. However, just four in ten businesses operate with insurance in their first three

¹ Department for Business, Energy and Industrial Strategy, *National Statistics: Business population estimates for the UK and regions: 2019 statistical release*, January 2020. Available at: <https://www.gov.uk/government/publications/business-population-estimates-2019/business-population-estimates-for-the-uk-and-regions-2019-statistical-release>

² McKinsey and Company, *How the Covid-19 crisis is affecting UK small and medium-size enterprises*, June 2020. Available at: <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/how-the-covid-19-crisis-is-affecting-uk-small-and-medium-size-enterprises>

³ Ibid.

⁴ Money Advice Trust, *At the Business End: A spotlight briefing on the impact of Covid-19 on Business Debtline clients*, August 2020. Available at:

<http://www.moneyadvicetrust.org/researchpolicy/research/Documents/At%20the%20business%20end%20briefing%20on%20the%20impact%20of%20Covid%2019%20on%20Business%20Debtline%20clients.pdf>

⁵ Standard Life Foundation, *Coronavirus financial impact tracker: Key findings from a national survey*, June 2020. Available at: https://www.standardlifefoundation.org.uk/__data/assets/pdf_file/0010/61120/SLF-JUNE-2020-COVID-19-Tracker.pdf

years.⁶ Small businesses struggle to access insurance for a number of reasons, including cost, lack of awareness about insurance needs, and complexity of products. There is a need to redesign the products on offer to fit the needs of small businesses better.

For those who can afford insurance, this crisis has revealed that the levels and nature of insurance products are not always suitable. Many businesses and freelancers have found their business continuity insurance has not provided them with the support they need. Flood Re provisions don't apply to small business for example. This is vital for small businesses who are less able to save and afford insurance such as income protection insurance. New research from McKinsey shows a third of the 500 small business owners surveyed said they were likely to stop paying for business interruption cover in the wake of the growing controversy over whether the policies will pay out for coronavirus losses.⁷ Judgement in an FCA test case heard by the courts in July is due to be handed down on Tuesday 15th September and will provide guidance on the interpretation of policy wording.

Businesses need swift action with either insurance or assurance of help from Government to deal with the interruptions that they will see in the years to come. Even with a vaccine there will be waves of this virus to deal with for many years and small firms are unable to carry that risk.

Late Payments and Deferrals

The ongoing problem of late payments to small businesses has been exacerbated during the Covid-19 pandemic. Research published by the Federation of Small Businesses (June 2020) shows that around two-thirds of SMEs in the UK have been hit by late or frozen payments in the wake of the outbreak.⁸

Late payments can have serious consequences for small businesses. In a survey of Business Debtline clients affected by the issue, 41% said they spent more than a tenth of their working time chasing late payments. Furthermore, 75% reported that late payments have affected the viability of their business, and 83% said it had contributed to their financial problems. The impact isn't limited to people's business: 87% said late payments had a negative impact on their personal wellbeing.⁹

There is significant concern that the issue of late payments is hampering economic recovery and tackling this crucial issue is a matter of urgency. In June 2019 the Minister for Small Business announced a series of measures including the transfer of responsibility for the voluntary Prompt Payment Code to the Small Business Commissioner, and a new consultation on strengthening the Commissioner's powers – a commitment the Chancellor reiterated in the Budget earlier this year. Action to strengthen the Prompt Payment Code further, introduce fines for persistent late payers, and review the use of statutory interest on late payments to improve payment practices are all

⁶ Owen Gough, *Rise of the uninsured economy? Startups boom but lack basic financial protection*, August 2017. Available at; <https://smallbusiness.co.uk/rise-uninsured-economy-start-ups-2540285/>

⁷ Financial Times, *UK companies to sun business interruption insurance*, May 2020. Available at; <https://www.ft.com/content/ba7b8321-73a0-442d-ac85-74ad09019223>

⁸ Federation of Small Businesses, *Late again: How the coronavirus pandemic is impacting payment terms for small firms*, June 2020. Available at; <https://www.fsb.org.uk/resources-page/23bn-late-payment-crisis-deepens-through-lockdown-new-report-finds.html>

⁹ Money Advice Trust, *Business as Usual: A spotlight briefing on late payments and their impact on small business owners in financial difficulty*, February 2020. Available at; <http://www.moneyadvice.org/researchpolicy/research/Documents/Money%20Advice%20Trust%20Business%20as%20Usual%20briefing%20Feb%202020.pdf>

options that could be considered as part of the Government's efforts to support small businesses in the wake of Covid-19.

Credit

A recent Simply Business survey found that the Covid-19 pandemic has cost the average small business in the UK more than £11,000.¹⁰

All too often those small business owners who should have access to affordable credit haven't been able to borrow. The Covid-19 crisis has pushed many into using Government loans. There is a concern that small businesses will struggle to repay these loans. Research from the Money Advice Trust found that half of respondents to a survey of recent Business Debtline callers at the height of the pandemic in May reported falling behind on business bills as a result of the impact of Covid-19 - 48% of respondents were unclear about how to get their finances back on track following the outbreak. Small businesses need further clarity to combat the confusion around the rules governing the Government's business support schemes and what is available to them. There is no 'one size fits all' for small businesses. The arts, entertainment and recreation sectors are calling for additional support, and we believe that a sector by sector approach would help small businesses more effectively.

The scale of the unsustainable debt arising from Covid-19 is a major concern, especially when Bounce Back Loans guarantees begin to be called in. In the case of Government-backed loans to small businesses, it is vital that there are clear and consistent rules in place governing their collection in order to ensure that small businesses are treated fairly by lenders.

There are several possible solutions to tackle this mountain of debt, such as extending the maturity of these loans with the Government paying the 2.5% interest in the meantime or transforming these loans into tax contingent liabilities that only have to be repaid when certain cash flow or profit margins are reached. Small businesses in particular require support in repaying these loans and there is a case for help for small businesses to defer repayment of loans without increasing the debt. In the longer-term, we believe small businesses should have better access to affordable credit.

Cash and Payments

Access to cash and cash acceptance both remain fundamentally important for small and micro-businesses and self-employed people, particularly in areas with low digital and/or financial inclusion. Doing so requires not only being able to accept cash payments, but also the facility to bank cash quickly and efficiently to minimise the cost of cash transactions. Whilst payment habits have changed towards more digital methods during Covid-19, cash usage figures show that ATM withdrawals have been steadily rising again.¹¹ We welcome the announcement from the FCA on the new steps firms should take when considering closing bank branches or ATMs. However, there is more to be done to ensure that the access and usage of cash is safeguarded. The regulator needs to

¹⁰ Simply business, *Small businesses and Covid-19: how has your area been impacted*, June 2020. Available at; <https://www.simplybusiness.co.uk/knowledge/articles/2020/06/covid-19-and-small-business-how-has-your-area-been-impacted/>

¹¹ LINK, *ATM cash use rising again as retail and hospitality reopen*, July 2020. Available at; <https://www.link.co.uk/about/news/link-atm-cash-use-rising-again-as-retail-and-hospitality-reopen/>

take a collaborative approach, requiring the industry to work together to guarantee access to and acceptance of cash, and provide the regulatory framework to enable effective collaboration.

Small businesses also need to be able to track their own invoices, and ideally manage their cash flow through having greater flexibility and control when paying their suppliers. The recently introduced Request to Pay is a voluntary service. The main retail banks need to implement it and offer it to their customers, including small businesses and consumers for its economic benefits to be realised. The PSR needs to consider requiring payment providers to implement Request to Pay and auto-enrol customers to enable critical mass to be achieved quickly.

Digital access

The issues of access to financial services created by bank branch closures, fewer free to use ATMs in some areas and the shift of financial services online have been accelerated by Covid-19 and continue to disproportionately impact people who are least able to deal with them. This is a concern for small businesses as digital and financial exclusion intersects. Further support for small businesses around ensuring accessibility to financial services is key to promoting financial resilience, especially as the country begins to emerge from the pandemic.

Internet connection is essential to carry out business in the new environment, providing the key to accessing cash, banking and financial services, funding through Local Authority schemes, business advice, transport and skills. A lack of access to any of, or a combination of any of, these could result in financial exclusion. As the Government begins to extend tax digitisation to businesses below the VAT threshold of £85,000 from April 2023 this becomes ever more important.

Although 90 per cent of UK adults use the internet, this figure drops among many of the groups much more likely to be financially excluded. ONS data shows that women and people aged over 65 are less likely to use the internet. There are high levels of online banking among younger generations (93 per cent for 25 to 34 year olds), but among 65-74 year olds and 75-79 year olds, it is 47 and 23 per cent respectively.¹² Ofcom data shows that while 90% of UK adults used the internet in 2018, this falls to 67% among people with a disability.¹³ This is important in the current environment, where banking and financial transactions are almost exclusively taking place online.

This is clearly a problem for SMEs. A recent report by the Entrepreneurs Network and Xero stated that more than a third of UK SMEs have very low levels of digital adoption.¹⁴ In a survey of Business Debtline clients, a quarter (26%) said they use mobile apps including banking apps and a quarter (25%) said they use e-banking, with 10% using online accounting. However, over half didn't use any of these (53%). Of those who didn't use digital technologies, 1 in 5 (18%) said they lacked the skills to use them. There is a need for further support for SME's to ensure digital access, beyond the infrastructure. There is a need for better digital banking and payments products which meet these needs, at costs affordable for small businesses. However, even with access, 11.9 million people in

¹² ONS, *Internet banking by age group*, September 2018. Available at: <https://www.ons.gov.uk/peoplepopulationandcommunity/householdcharacteristics/homeinternetandsocialmediausage/ahd0cs/009078internetbankingbyagegroup2018>

¹³ Ofcom, *Access and inclusion in 2018: Consumers experiences in communications markets*, January 2019. Available at: https://www.ofcom.org.uk/__data/assets/pdf_file/0018/132912/Access-and-Inclusion-report-2018.pdf

¹⁴ Xero, *Xero calls on UK Small Business Minister for digital campaign to accelerate SME recovery*, July 2020. Available at: <https://www.xero.com/blog/2020/07/xero-calls-on-uk-small-business-minister-for-digital-campaign-to-accelerate-sme-recovery/>

the UK do not have the necessary digital and business skills. Setting up business accounts can be daunting and all too often small business owners use their personal accounts. Digital upskilling will play a significant role in helping small businesses adapt to the current landscape.

Reskilling post-Covid

There is also a need for wider reskilling of the small business workforce to help businesses adapt to the economic landscape post-Covid. Beyond support and training to help small businesses adjust to the increasing digitisation of the economy, they need assistance to help train the workforce and thus contribute to job creation.

However, there are concerns that small businesses have been forgotten by Government schemes to assist with this important task. The Kickstart scheme is in effect only available to firms taking on thirty or more young people. This fails to serve the needs of small businesses whilst supporting big businesses who are more able to carry the financial costs of reskilling young people. Furthermore, small businesses face uncertainty about how to access this support, with reports that intermediaries have not yet been appointed for those businesses taking on fewer than thirty workers. This severely disadvantages small businesses who need young and diverse thinking and those who are able to innovate and create jobs. Without Government support, those businesses are unlikely to have the resources to hire and therefore are unable to contribute to job creation and economic recovery.

Tax

There is a need for a fundamental review of how small businesses and the self-employed are taxed. The tax system does not reflect the current working climate, and the pandemic has exacerbated this disparity. The tax system causes uncertainty and problems which lead to significant costs for small businesses. For example, there are around 350,000 duplicate employment records, and around 5% of returns are received late.¹⁵ HMRC's data shows that more than 70% of small businesses use a tax agent to help them with their tax compliance. The system needs to be simplified to reflect the fluidity of the modern workplace better. The Office of Tax Simplification has called for the government to develop and offer a package of start-up guidance and digital options such as templates to help small companies prepare accounts and tax returns.¹⁶ This would be an important first step.

Any changes to the wider tax system should treat small businesses fairly. There appears to be a perception that small businesses don't pay as much tax as they should. Past research has shown that small business people earned around ten percent less than they would have done if they were employed to do the same work. At the same time, they carry all the risk. As small businesses continue to struggle in the wake of the coronavirus pandemic, reviewing this disparity and the levels at which small businesses are taxed is important to help the sector recover. The recent Treasury Select Committee inquiry into tax reform is a welcome step in this process, alongside HM Treasury's review of business rates. However, there is a lack of understanding of small business and the self-employed and we are concerned that tax reform will create a system that is even more onerous for

¹⁵ Office of Tax Simplification, *Simplifying everyday tax for smaller businesses*, May 2019. Available at; <https://www.gov.uk/government/publications/simplifying-everyday-tax-for-smaller-businesses>

¹⁶ Ibid.

small business owners. We need a better understanding of the vital part small businesses play, and the amount they contribute financially to UK PLC and to their local communities.

Pensions

Small business owners and self-employed people are less likely to save for retirement. A 2015 report by the Resolution Foundation concluded that as few as 27% of self-employed individuals were putting money into a pension, down from 33% only a few years earlier. This compared to more than 50% of employees.¹⁷

This is backed up by statistics from the Wealth and Assets Survey which shows that only 23% of self-employed people intend to rely on a personal pension in retirement. A further 23% expect to rely on the state pension, 12% on personal savings and investments and only 6% on the proceeds from selling their business.¹⁸

There is a danger that reliance on the state pension may lead to financial exclusion and poverty in retirement. The current pension landscape is complicated, small business people aren't aware of the level of the state pension support they can expect in retirement and there is a lack of engagement by small business people with retirement planning. There are options such as personal pensions and lifetime ISA's but we need to look for a sustainable long-term solution, ways of providing adequate advice and of engaging small businesses and the self-employed to generate a step change in the way that they save for their future.

Conclusion

The coronavirus pandemic has served to accelerate the problems faced by small businesses: obtaining insurance for income continuity; accessing affordable credit; digital access; payment deferrals. Small businesses are operating in a more uncertain economic landscape.

There are still a number of problems which have yet to be quantified: to what extent are small businesses handing back premises to landlords, or trapped in tenancy agreements for workspace which is no longer affordable? Given the acceleration towards use of digital technology, changing demands of customers, and the desire for more flexibility for employees in terms of working environment will small businesses find the skills they need to rebuild?

Small business and household finances are often inextricably intertwined. If the business fails, the household will face significant hardship. While Government loans have helped many small businesses stay afloat, significant numbers won't be able to repay when the time comes. How many will be negatively impacted? The Money Advice Trust will be publishing further research on the impact of Covid-19 on small business owners later in the Autumn.

¹⁷ The Resolution Foundation, The self-employed and pensions, May 2015. Available at; <https://www.resolutionfoundation.org/app/uploads/2015/05/Self-employment-and-pensions.pdf>

¹⁸ M. Taylor, Good Work - The Taylor Review of Modern Working Practices, July 2017. Available at; https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf

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