

# **Enterprise Britain: a modern approach to meeting the enterprise challenge**

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November 2002



HM TREASURY



small  
business  
service



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# Enterprise Britain: a modern approach to meeting the enterprise challenge

November 2002

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# FOREWORD

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Enterprise is the lifeblood of our economy - boosting productivity, creating employment and prosperity, and revitalising our communities. Our aim as a Government has been to change attitudes to enterprise - from the classroom to the boardroom - and to tackle the difficulties that we know entrepreneurs can face in starting and growing their businesses.

So we have lowered tax rates for small businesses and cut red tape by simplifying the tax system. New venture funds are improving access to finance across the regions, and the Enterprise Act will provide a competitive environment where successful businesses can thrive.

But we need to do more. Business start-up rates in the United States are almost twice as high as those in Britain. We do worse than many other OECD countries when it comes to female entrepreneurship. And across the UK, start-up rates in the best performing areas are ten times those of the worst, contributing to an enterprise gap in our inner cities of 88,000 companies, £5 billion in turnover and tens of thousands of jobs. We cannot close this gap overnight, nor can the Government do it alone - success also depends on the innovation and creativity of entrepreneurs themselves.

This paper sets out the measures that the Government is now putting in place to support entrepreneurs as they turn their ideas into start-up and growing businesses. The Small Business Service has an important role in achieving this. Our aim is to widen and deepen the enterprise culture in our country so that every woman and every man - regardless of background or circumstance - has the chance to go as far as their talents and potential will take them, so that enterprise is truly open to all.



The Chancellor of the Exchequer,  
Rt Hon Gordon Brown MP.



The Secretary of State for Trade and Industry,  
Rt Hon Patricia Hewitt MP.



# EXECUTIVE SUMMARY

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**E.1** For much of the twentieth century, economic forces and government policies gave priority to large-scale production. Small business was seen to be inefficient or unimportant in promoting economic growth and prosperity. But since the 1970s, the small business sector has experienced a marked resurgence. Today, small businesses and the entrepreneurial spirit that drives them lie at the heart of the Government's strategy to improve economic performance, by boosting productivity and increasing opportunity and prosperity throughout the UK.

**E.2** This paper explains why enterprise is central to the Government's approach to economic policy and to rebuilding communities, and sets out the principles that underlie a modern approach to enterprise policy. It also outlines the steps the Government is taking to ensure that the UK realises its full entrepreneurial potential, by:

- building a more enterprising society, in which all who have the initiative, skills and drive also have the opportunity to start and run a successful business;
- creating the best environment in the world to start and grow a business;
- tackling specific barriers that inhibit successful enterprise; and
- raising levels of enterprise in the UK's least prosperous communities, where these barriers are typically greatest.

**E.3** While the UK has become more enterprising since the 1970s, there remains a clear challenge. The UK has proportionately fewer entrepreneurs than the US and some European countries, business start-up rates vary widely across the UK, and evidence shows that the barriers to enterprise are greatest in the nation's least prosperous communities. Closing this enterprise gap will bring substantial benefits, by raising productivity and helping to build stronger and more sustainable communities.

## SMALL BUSINESS IN THE MODERN ECONOMY

**E.4** Small and medium sized enterprises<sup>1</sup> (SMEs) form a major part of our economy and our everyday lives. They employ over half the private sector workforce. They account for more than £1 trillion of private sector turnover. One in eight working people are self-employed.

**E.5** Impressive though these statistics are, this static analysis actually underplays the importance of SMEs within a dynamic economy. An increasing body of evidence shows that an active SME sector drives productivity growth by:

- making an important contribution to a process of '**productive churn**', by which more efficient businesses are established and grow, displacing the activities of their less productive competitors;
- providing a **competitive spur** to other businesses to improve efficiency and become more innovative; and
- contributing to productivity growth through its own **innovative activities**.

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<sup>1</sup> Where possible, the paper uses the EU definition of a SME: that is, fewer than 250 employees, and either annual turnover not exceeding €40 million or a balance sheet below €27 million.

**E.6** In addition, SMEs form part of the bedrock of local communities, contributing to both economic prosperity and social cohesion. SMEs provide the mechanism by which millions enter employment, realise their own potential, access the goods and services they need and play an active role in their local communities. Thriving small businesses provide greater diversity and so increase the resilience of local communities to economic downturns. Yet business formation rates in the UK's most enterprising communities are around ten times higher than in the least enterprising areas (see Chart 2.3).

### A MODERN APPROACH TO ENTERPRISE

**E.7** The importance of enterprise as a driver of productivity growth and employment does not necessitate general government measures to boost small businesses at the expense of larger ones: economies of scale still exist and, when exploited, increase productivity. Instead, the Government plays a particular role in promoting an enterprise society, creating the right environment for all businesses to thrive, and targeting specific market failures that hold back entrepreneurship and growth.

#### Enterprise Areas

**E.8** Recognising that the barriers to enterprise are particularly acute in disadvantaged communities, extra support is now being provided in two thousand Enterprise Areas – the most deprived communities across the UK – to sow the seeds of sustainable economic regeneration. The Government has already put in place a series of measures, such as stamp duty exemptions and investment incentives. The Government is now bringing forward the next stage of its strategy to ensure that enterprise can thrive right across the country. This strategy comprises increased assistance from the Inland Revenue, HM Customs and Excise and the Small Business Service, more flexible planning arrangements, new funding for business incubation projects and a series of Enterprise Shows.

#### Local and regional institutions

**E.9** At the local and regional level, the Government has introduced a range of institutional reforms to allow regionally balanced growth to be driven by the regions themselves. Regional Development Agencies (RDAs) and Local Strategic Partnerships are focusing on raising levels of enterprise in their communities in order to meet the objectives of Regional Economic Strategies and local Neighbourhood Renewal Strategies. It is estimated that local government and regional institutions have responsibility for almost a third of annual public expenditure on services for small business. The 2002 Spending Review provided RDAs with increased funding and flexibilities to equip them to take forward the enterprise agenda in partnership with local bodies.

#### The Small Business Service

**E.10** The Small Business Service (SBS) was set up in 2000 to drive progress towards the Government's aim to make the UK the best place in the world to start and grow a business. Following the joint SBS/ HM Treasury *Cross-Cutting Review of Government Services for Small Business*,<sup>2</sup> the SBS has developed a framework for taking forward government policy towards small business, focused around seven core themes (see Box 2.1). The role of the SBS has been re-focused and enhanced. In particular, it will:

- be a **centre of expertise** for government on small business issues;
- develop **innovative new approaches** to meeting the needs of small business through better policy and high-quality services; and
- be an **engine for change**, demonstrating what can be done, measuring progress against outcomes in the marketplace, and taking action at national, regional and local levels.

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<sup>2</sup> [www.sbs.gov.uk/crosscutting](http://www.sbs.gov.uk/crosscutting).

## CREATING THE RIGHT ENVIRONMENT FOR BUSINESS

**Promoting an enterprise society** **E.II** Without changing social attitudes to enterprise, the UK will never be able to narrow the enterprise gap with more entrepreneurial countries, despite the other policy measures that have been put in place. Relative to the USA and some European countries, people in the UK tend to be less inclined to enterprise, less aware of the opportunities to participate in the enterprise economy and less confident of their ability to start up and run their own business. Changing attitudes to enterprise starts in the nation's schools. To that end, the Government will provide an additional £60 million funding by 2005-06 to ensure that every young person leaves school with some experience of enterprise. This will be particularly beneficial in the two thousand Enterprise Areas, where young people tend to have less contact with successful small businesses.

**Macroeconomic conditions** **E.I2** Macroeconomic instability in the past created difficult conditions for businesses of all sizes, but smaller firms were particularly vulnerable to sharp fluctuations of output and demand. In 1997, the Government moved quickly to establish a new macroeconomic framework, giving the Bank of England independence to set interest rates and establishing tough fiscal rules. As a result, greater stability of demand, along with lower inflation and interest rates, are now contributing to lower SME failure rates and higher investment.

**Rewarding enterprise** **E.I3** Despite the improved macroeconomic climate, setting up a business remains an intrinsically risky proposition – more than one third of new businesses survive less than three years. To encourage enterprise, the potential rewards need to be commensurate with the greater risks that entrepreneurs take. To achieve this, the Government has acted to reduce the small companies' rate of corporation tax by 4 percentage points, and has cut the starting rate to zero. 150,000 small businesses no longer pay corporation tax. Progressive reforms to capital gains tax (CGT) since 1997 mean that the UK now offers one of the most favourable CGT regimes in the world.<sup>3</sup>

**E.I4** It is impossible to eliminate business risks, and not all individuals will be willing or able to bear these uncertainties. But an appropriate balance between risk and reward can help more people to feel able to manage the risk of starting a business. The Enterprise Act modernises the rules for insolvency to reduce the cost and stigma of honest business failure, helping to address a concern that has dissuaded many potential entrepreneurs in the past.

**Promoting competition** **E.I5** To ensure that small businesses can compete fairly in all markets, the Enterprise Act also greatly strengthens the UK competition regime, including the introduction of tough new criminal penalties for those engaging in cartels. Radical reforms have given the Office of Fair Trading a new role to scrutinise new and existing regulations, and to point out any anti-competitive effects that they may have.

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<sup>3</sup> Andersen/ Growth Plus (2002).

**Regulatory reform** **E.16** Effective and efficient business regulation plays a vital role in correcting market failures, promoting fairness and ensuring public safety. Unnecessary or poorly implemented regulation, however, can stifle valuable enterprise activity. International comparisons consistently show that the UK has one of the most entrepreneur-friendly regulatory environments in the world.<sup>4</sup> Nevertheless, the Government recognises that more could be done, particularly to reduce the burden on smaller businesses. Recent measures include the optional flat rate VAT scheme, already available to more than 500,000 businesses, enabling them to cut their compliance costs by up to £1,000 per year, and extensions to the VAT annual accounting scheme. To ensure that regulations are communicated to businesses as effectively as possible, the Government will launch a new *Start-Up Guide* in spring 2003, to set out clearly what is required to start up a business and what support is available. New planning reforms will allow local authorities to cut red tape for new and expanding businesses by removing the need to apply for planning permission in designated Business Planning Zones.

### TACKLING SPECIFIC MARKET FAILURES

**Improving access to finance** **E.17** New businesses requiring start-up funding and smaller businesses with strong growth potential face particular problems in accessing appropriate finance. To improve access to debt finance for businesses with limited collateral, eligibility for the Small Firms' Loan Guarantee Scheme will be extended from April 2003 to include the retail and catering sectors. To address the shortage of equity finance for individual investments below £500,000, government-supported Regional Venture Capital Funds will invest up to £270 million in SMEs across the nine English regions. Seven of the funds are now up and running, and the remainder are due to be launched by the end of the financial year. In addition, through the Community Investment Tax Credit and the Bridges Community Development Venture Fund, the Government has created new opportunities and incentives for capital markets to provide finance to businesses in deprived areas, where accessing finance is particularly difficult. On the demand side, pilots are now up and running to improve the 'investment readiness' of small businesses seeking risk capital.

**Raising standards of business advice** **E.18** SMEs can obtain business advice from a variety of external sources, but often lack awareness of the opportunities available. To widen access to business support, the Government has restructured and relaunched the national network of Business Link operators. It is also driving up standards through business performance reviews for poor performers, a Business Link University to share best practice, and a new performance regime which will enforce contracts more effectively. The Small Business Service is working with RDAs in the North West, West Midlands and East Midlands to set up regional pilots of RDA-led management and coordination of Business Link operators. These will better integrate business support with Regional Economic Strategies and join up delivery at the local and regional levels. The Government has also committed a further £50 million to the Phoenix Fund, which supports organisations that deliver business support services in disadvantaged areas and for under-represented groups, including women and ethnic minorities.

**Training and skills** **E.19** The ability to recruit and retain a workforce with the appropriate skills is a key determinant of business success and productivity growth. The Government has put in place a series of measures to support employers in training their staff, recognising the particular difficulties that SMEs face due to the day-to-day pressures of running their business. For example, Employer Training Pilots are currently allowing businesses in six areas to access free training, information and advice and are providing subsidies to meet the costs of staff taking time off to gain basic skills or to progress to a Level 2 qualification, with higher rates paid for SMEs. The Government has also allocated an extra £30 million to support more small firms working with the Investors in People standard, and is piloting a Small Firms Development Account which includes a financial package to support workforce development.

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<sup>4</sup> Andersen/ Growth Plus (2002).

**Innovation and R&D** **E.20** SMEs often face acute barriers to innovation, both in meeting up-front costs and in appropriating all the benefits that accrue. Recognising this, the Government has introduced a tax credit to support innovation among SMEs, providing cash support worth up to 24 per cent of R&D expenditure. In addition, building upon the 10 per cent real annual increase in the science budget announced in the 2002 Spending Review, the Government is working to strengthen the links between universities and enterprise, to support SME innovation and to encourage commercial exploitation of research. The Higher Education Innovation Fund will be increased to £90 million per year by 2005-06, to support a range of knowledge transfer activities of benefit to SMEs, such as equity funding for university spin-out companies and promotion of enterprise skills among science and technology students.

### THE GOVERNMENT'S VISION

**E.21** The Government's vision is that anybody with the talent, potential and drive to succeed in business should have the opportunity and the necessary support to do so, regardless of their background. Entrepreneurs and small business owners themselves are the most important agents in achieving this vision. The Government has an important role in creating a fertile business environment, addressing market failures and ensuring that, where it comes into contact with future entrepreneurs and existing businesses, it helps rather than hinders them. This role is all the more important in deprived areas, where barriers to enterprise are often more acute than elsewhere. Measures already put in place and new developments announced in this Pre-Budget Report are important steps towards attaining this goal, and the policy framework currently being developed by the SBS will drive forward improvements in policy and service delivery across government.

**Table E.1: Government measures to support enterprise (shaded entries will particularly benefit businesses in the Enterprise Areas)**

Event	To provide ...	the Government has ...	and it will ...
<b>Starting a business</b>	better awareness of enterprise opportunities, and of how to start a new business	<ul style="list-style-type: none"> <li>allocated additional resources to the Department for Education and Skills to ensure that every child has experience of enterprise by the time they leave school, in line with the recommendations of the Davies review of enterprise and the economy in education (<a href="http://www.daviesreview.org">www.daviesreview.org</a>)</li> </ul>	<ul style="list-style-type: none"> <li>make available a <i>Start-Up Guide</i> for new businesses from spring 2003</li> </ul>
	more flexible, affordable premises for new enterprises	<ul style="list-style-type: none"> <li>established the Business Incubation Fund, encouraging investment in incubator workspace for start-up firms (<a href="http://www.sbs.gov.uk/services/businessincubationfund.php">www.sbs.gov.uk/services/businessincubationfund.php</a>)</li> </ul>	<ul style="list-style-type: none"> <li>run Enterprise Shows, bringing together government and private sector service providers for the benefit of potential and new entrepreneurs</li> </ul>
	a stable economic environment, to enable firms to plan ahead and invest with confidence	<ul style="list-style-type: none"> <li>introduced a new framework for macroeconomic policy (<a href="http://www.hm-treasury.gov.uk/Documents/LUK_Economy">www.hm-treasury.gov.uk/Documents/LUK_Economy</a>), which has delivered the lowest interest rates and the longest period of sustained low inflation since the 1960s</li> </ul>	<ul style="list-style-type: none"> <li>provide new grants from the Business Incubation Fund to cover the costs of feasibility studies for incubators, with higher levels of funding in disadvantaged areas</li> </ul>
	a fair tax system that rewards successful enterprise	<ul style="list-style-type: none"> <li>reduced the starting rate of corporation tax to zero from April 2002 so that 150,000 small firms no longer pay corporation tax, and cut the small companies' rate from 23p in 1997 to 19p from April 2002 (<a href="http://www.inlandrevenue.gov.uk/ctsa">www.inlandrevenue.gov.uk/ctsa</a>)</li> </ul>	<ul style="list-style-type: none"> <li>exempt all commercial property transactions in the Enterprise Areas from stamp duty, irrespective of value, subject to state aids approval</li> </ul>
	help reducing the cost of managing VAT	<ul style="list-style-type: none"> <li>maintained the highest VAT registration threshold in the EU</li> <li>introduced an optional VAT flat rate scheme, allowing firms to reduce their compliance costs by up to £1,000 a year (<a href="http://www.hmce.gov.uk/forms/notices/733.htm">www.hmce.gov.uk/forms/notices/733.htm</a>)</li> <li>doubled the turnover ceiling for businesses wishing to use the VAT annual accounting scheme (<a href="http://www.hmce.gov.uk/forms/notices/732.htm">www.hmce.gov.uk/forms/notices/732.htm</a>)</li> </ul>	<ul style="list-style-type: none"> <li>consider further steps that might be taken to reform and modernise the corporation tax regime</li> </ul>
	fairer rates for smaller businesses	<ul style="list-style-type: none"> <li>established the Small Business Service to improve delivery of, and information on, government services for small businesses (<a href="http://www.sbs.gov.uk">www.sbs.gov.uk</a>)</li> </ul>	<ul style="list-style-type: none"> <li>examine how HM Customs and Excise can enhance and target more effectively their support services in disadvantaged communities, particularly with regard to VAT</li> </ul>
	easier ways of dealing with government	<ul style="list-style-type: none"> <li>put in place Public Service Agreement floor targets for key public services (health, education, crime, employment, housing), which set out how outcomes will improve in the most deprived neighbourhoods (<a href="http://www.hm-treasury.gov.uk/Spending_Review/spend_sr02/psa">www.hm-treasury.gov.uk/Spending_Review/spend_sr02/psa</a>)</li> </ul>	<ul style="list-style-type: none"> <li>introduce legislation for rates relief of up to 50 per cent for single-property small businesses</li> <li>improve the cohesion and quality of electronic delivery of government services by developing a single web portal for small business by summer 2003</li> </ul>
	an improved environment for businesses to start and grow, narrowing the gap between the most deprived areas and the rest of the country		<ul style="list-style-type: none"> <li>meet the strengthened PSA floor targets set in the 2002 Spending Review for the most deprived neighbourhoods</li> <li>increase the Neighbourhood Renewal Fund by £125 million to £525 million by 2005-06</li> </ul>

**Table E.1 (continued): Government measures to support enterprise (shaded entries will particularly benefit businesses in the Enterprise Areas)**

Event	To provide ...	the Government has ...	and it will ...
<b>Trading (continued)</b>	government regulation that is fair and proportionate, with impacts on small firms fully considered	<ul style="list-style-type: none"> <li>put in place systems such as Regulatory Impact Assessments and the Ministerial Panel of Regulatory Accountability (<a href="http://www.cabinet-office.gov.uk/regulation/scrutiny">www.cabinet-office.gov.uk/regulation/scrutiny</a>)</li> <li>introduced a package of over 260 deregulatory measures (<a href="http://www.cabinet-office.gov.uk/regulation/actionplan">www.cabinet-office.gov.uk/regulation/actionplan</a>)</li> <li>established the Small Business Service, to ensure small business interests are considered fully in development and delivery of policy (<a href="http://www.sbs.gov.uk">www.sbs.gov.uk</a>)</li> </ul>	<ul style="list-style-type: none"> <li>improve communication and enforcement of regulatory requirements</li> <li>ensure more effective consultation on new regulations, through small firms impact assessments</li> <li>consult on common dates for employment law changes</li> </ul>
	measures to stamp out unfair competition	<ul style="list-style-type: none"> <li>strengthened the competition framework through the Enterprise Act, which gives full independence and new powers to competition authorities and brings in tough new penalties for those who engage in cartels (<a href="http://www.dti.gov.uk/ccp/topics2/ukcompref.htm">www.dti.gov.uk/ccp/topics2/ukcompref.htm</a>)</li> </ul>	
	improved competition in the market for banking services	<ul style="list-style-type: none"> <li>accepted in full the findings and recommendations of the independent Competition Commission following its investigation into the supply of banking services to SMEs (<a href="http://www.competition-commission.org.uk/pressreleases/15-02.htm">www.competition-commission.org.uk/pressreleases/15-02.htm</a>)</li> </ul>	
	help coping with late payment by creditors	<ul style="list-style-type: none"> <li>provided a statutory right for small firms to claim interest for the late payment of commercial debts (<a href="http://www.sbs.gov.uk/finance/latepayments.php">www.sbs.gov.uk/finance/latepayments.php</a>)</li> </ul>	
	fairer results for creditors of insolvent companies	<ul style="list-style-type: none"> <li>introduced reforms in the Enterprise Act to ensure that the corporate insolvency process is always handled in the interests of all creditors, to abolish Crown Preference and to provide for full distribution of interest on insolvent estates, providing an extra £110 million a year for creditors (<a href="http://www.insolvency.gov.uk/reform.htm">www.insolvency.gov.uk/reform.htm</a>)</li> </ul>	
<b>Growing</b>	access to high-quality external advice and support	<ul style="list-style-type: none"> <li>re-franchised the national Business Links network, leading to strong growth in usage (<a href="http://www.businesslink.org">www.businesslink.org</a>; <a href="http://www.sbs.gov.uk/partners/#local">www.sbs.gov.uk/partners/#local</a>)</li> </ul>	<ul style="list-style-type: none"> <li>pilot Regional Development Agency led management and coordination of business support, to enhance performance and promote better integration with Regional Economic Strategies</li> </ul>
	help and advice on expanding into overseas markets	<ul style="list-style-type: none"> <li>introduced the £96 million Phoenix Fund, which has already supported 150 projects involving specialist business support organisations in disadvantaged communities (<a href="http://www.sbs.gov.uk/phoenix">www.sbs.gov.uk/phoenix</a>)</li> <li>provided support through British Trade International, which last year helped around 28,000 UK businesses take steps towards export success (<a href="http://www.tradepartners.gov.uk">www.tradepartners.gov.uk</a>)</li> </ul>	<ul style="list-style-type: none"> <li>extend the Phoenix Fund with a further £50 million over 2004-05 and 2005-06</li> </ul>
	role models for growth firms in disadvantaged communities	<ul style="list-style-type: none"> <li>supported the Inner City 100 project (<a href="http://www.theinnercity100.org">www.theinnercity100.org</a>), which aims to publicise entrepreneurial role models in disadvantaged communities, by focusing on the fastest-growing 100 businesses in inner cities around the country</li> </ul>	
	increased government recognition of the needs of small businesses in disadvantaged areas	<ul style="list-style-type: none"> <li>set a Public Service Agreement target for the DTI to deliver “more enterprise in disadvantaged communities” (<a href="http://www.hm-treasury.gov.uk/Spending_Review/spend_sr02/psa/spend_sr02_psadi.cfm">www.hm-treasury.gov.uk/Spending_Review/spend_sr02/psa/spend_sr02_psadi.cfm</a>), providing a strong incentive to ensure that mainstream services for business – including Business Links – serve deprived areas as effectively as others</li> </ul>	

**Table E.1 (continued): Government measures to support enterprise (shaded entries will particularly benefit businesses in the Enterprise Areas)**

Event	To provide ...	the Government has ... and it will ...
<b>Investing</b>	improved access to finance	<ul style="list-style-type: none"> <li>ensure that the remaining two Regional Venture Capital Funds are fully operational by April 2003, making available up to £270 million for investment in smaller companies with growth potential</li> <li>launch Early Growth Funding programmes across England, working alongside business angel networks</li> <li>extend eligibility for the Small Firms' Loan Guarantee Scheme from April 2003 to include the retail and catering sectors, which are strongly represented in less prosperous areas</li> </ul>
	<ul style="list-style-type: none"> <li>help developing attractive investment propositions</li> <li>improved incentives for those investing in enterprise</li> </ul>	<ul style="list-style-type: none"> <li>launched Regional Venture Capital Funds in seven of the English regions, three of which have made their first investments (<a href="http://www.dti.gov.uk/sbs/ef">www.dti.gov.uk/sbs/ef</a>)</li> <li>provided £20 million cornerstone investment in the £106 million UK High Technology Fund, which has already invested at least £35 million in 69 - technology based businesses (<a href="http://www.dti.gov.uk/sbs/ef">www.dti.gov.uk/sbs/ef</a>)</li> <li>provided guarantees under the Small Firms' Loan Guarantee Scheme (<a href="http://www.sbs.gov.uk/sf/gs">www.sbs.gov.uk/sf/gs</a>), supporting bank loans worth over £250 million and benefiting around 4,200 small businesses a year</li> <li>launched the Bridges Community Development Venture Fund – a £40 million fund which invests in businesses in the most deprived areas in England (<a href="http://www.bridgesventures.com">www.bridgesventures.com</a>)</li> <li>established pilot projects to improve 'investment readiness' among small firms seeking external finance (<a href="http://www.sbs.gov.uk/press/news70.php">www.sbs.gov.uk/press/news70.php</a>)</li> <li>reformed capital gains tax and introduced a taper relief, cutting the effective rate to just 10 per cent for business assets held for over two years (<a href="http://www.inlandrevenue.gov.uk/cgt">www.inlandrevenue.gov.uk/cgt</a>)</li> <li>enhanced the Enterprise Investment Scheme and Venture Capital Trust tax incentive schemes to encourage further equity investment (<a href="http://www.inlandrevenue.gov.uk/news/budgetreleases/revbn1b.doc">www.inlandrevenue.gov.uk/news/budgetreleases/revbn1b.doc</a>)</li> <li>introduced a new Community Investment Tax Credit to promote enterprise and wealth creation in under-invested communities (<a href="http://www.sbs.gov.uk/finance/citc.php">www.sbs.gov.uk/finance/citc.php</a>)</li> </ul>
	<ul style="list-style-type: none"> <li>better incentives and support for investment and for business research and development (R&amp;D)</li> </ul>	<ul style="list-style-type: none"> <li>take further steps to promote awareness and understanding of the R&amp;D tax credits amongst businesses, and consider options for legislative change to keep them current and improve their operation</li> <li>increase the science budgets of DTI and DfES by £1 1/4 billion by 2005-06, compared with 2002-03</li> <li>work to strengthen the links between universities and enterprise, to support SME innovation and encourage commercial exploitation of research</li> <li>raise funding for the Higher Education Innovation Fund to £90 million a year by 2005-06</li> </ul>
<b>Planning</b>	<ul style="list-style-type: none"> <li>a simpler planning regime</li> <li>financial incentives to encourage regeneration</li> </ul>	<ul style="list-style-type: none"> <li>introduce legislation for Business Planning Zones, which will provide a more flexible planning regime for businesses located in designated hi-tech clusters or disadvantaged communities</li> <li>introduce a tax incentive to encourage donations towards the running costs of Urban Regeneration Companies</li> </ul>

**Table E.1 (continued): Government measures to support enterprise (shaded entries will particularly benefit businesses in the Enterprise Areas)**

Event	To provide ...	the Government has ...	and it will ...
<b>Employing</b>	improved skills levels throughout the labour market	<ul style="list-style-type: none"> <li>raised standards and announced increased funding across the board for education (<a href="http://www.hm-treasury.gov.uk/Spending_Review/spend_sr02/report/spend_sr02_repchap06.cfm">www.hm-treasury.gov.uk/Spending_Review/spend_sr02/report/spend_sr02_repchap06.cfm</a>)</li> <li>launched the Skills for Life strategy to help adults improve their basic skills (<a href="http://www.dfes.gov.uk/readwriteplus">www.dfes.gov.uk/readwriteplus</a>)</li> </ul>	<ul style="list-style-type: none"> <li>provide Education Maintenance Allowances of up to £1,500 a year for young people from low-income families from September 2004, helping to overcome barriers to learning amongst over-16s</li> <li>pilot joint working by Regional Development Agencies and Learning and Skills Councils on regional skills, to enhance performance and promote better integration with Regional Economic Strategies</li> </ul>
	an education system that prepares young people to enter the world of business	<ul style="list-style-type: none"> <li>developed a new approach to 14–19 education, emphasising the importance of vocational qualifications, and created new vocational GCSEs and A levels</li> <li>expanded and improved the Modern Apprenticeship system (<a href="http://www.realworkrealpay.co.uk">www.realworkrealpay.co.uk</a>)</li> <li>improved the work permit system, introduced the Highly Skilled Migrant Programme and made it easier for employers to fill vacancies in shortage occupations through work permits (<a href="http://www.workpermits.gov.uk">www.workpermits.gov.uk</a>)</li> <li>established the Enterprise Management Incentive (EMI) scheme, to help smaller companies compete in the job market and motivate key personnel, and doubled the size limit for companies qualifying for EMI (<a href="http://www.inlandrevenue.gov.uk/shareschemes">www.inlandrevenue.gov.uk/shareschemes</a>)</li> </ul>	<ul style="list-style-type: none"> <li>shortly publish its full response to the Davies review of enterprise and the economy in education</li> <li>announce ambitious new targets for vocational pathways, including Modern Apprenticeships</li> <li>continue to improve the service offered by Work Permits UK and the Highly Skilled Migrant Programme</li> <li>introduce statutory tax deductions for the cost of delivering share options</li> </ul>
	help recruiting and retaining key staff	<ul style="list-style-type: none"> <li>announced an annual 4.7 per cent real terms funding increase for DTI's employment relations agencies from 2002–03 to 2005–06</li> <li>announced reforms to reduce the burden of payroll administration, following the recommendations of the Carter Review (<a href="http://www.ir.gov.uk/pbr2001/carter_review.pdf">www.ir.gov.uk/pbr2001/carter_review.pdf</a>), with incentives for small employers to file payroll returns online from 2004–05</li> </ul>	<ul style="list-style-type: none"> <li>expand the capacity of the ACAS helpline, and increase the volume of face-to-face advice given to small firms by ACAS</li> <li>launch and market the online filing programme nationally, in time for the first incentive payments in 2004–05</li> </ul>
	advice on employment-related matters		<ul style="list-style-type: none"> <li>deliver a special package of Inland Revenue support for employers in disadvantaged communities, including a higher profile for Business Support Teams</li> </ul>
	greater enterprise opportunity for those on the New Deal	<ul style="list-style-type: none"> <li>introduced the New Deal self-employment option, which eases the transition from benefits to self-employment (<a href="http://www.newdeal.gov.uk/english/self_employment">www.newdeal.gov.uk/english/self_employment</a>)</li> <li>established new Employer Training Pilots in six areas across the country, focusing on lower-skilled adults (<a href="http://www.lsc.gov.uk/news_docs/Employer_Training.pdf">www.lsc.gov.uk/news_docs/Employer_Training.pdf</a>)</li> <li>launched a Small Firm Development Account pilot (<a href="http://www.enterpriseforum.co.uk/sfda.asp">www.enterpriseforum.co.uk/sfda.asp</a>)</li> </ul>	<ul style="list-style-type: none"> <li>extend access to New Deal support, including for self-employment, in pilots of a more intensive approach to tackling worklessness in the most disadvantaged areas</li> <li>continue to explore policy measures to increase demand for training, and to improve the way in which training is supplied</li> <li>publish a Skills Strategy next year, setting out how the Government will achieve its target to reduce the number of adults lacking the equivalent of five good GCSEs by 40 per cent by 2010</li> </ul>
<b>Training</b>	support to provide training to employees	<ul style="list-style-type: none"> <li>announced additional funding of £30 million to encourage small organisations to reach the Investors in People standard (<a href="http://www.iipuk.co.uk">www.iipuk.co.uk</a>)</li> </ul>	
	improved management skills	<ul style="list-style-type: none"> <li>established New Entrepreneur Scholarships, currently supporting 400 scholars in deprived areas (<a href="http://www.rcu.gov.uk/abi/results/abi_result.asp?searchID=51">www.rcu.gov.uk/abi/results/abi_result.asp?searchID=51</a>)</li> </ul>	<ul style="list-style-type: none"> <li>work to improve the quality of management and leadership across the UK, building on the report of the Council for Excellence in Management and Leadership</li> </ul>



# INTRODUCTION

**1.1** Entrepreneurship may be defined as the mindset and process by which an individual or group identifies and successfully exploits a new idea or opportunity. It requires creativity, ambition, independence and the willingness to bear the inevitable risks involved. Enterprising behaviour may be found in organisations of all sizes, in both private and public sectors; indeed, it is critical to the task of modernising public services.

**1.2** This paper focuses on two particular forms of enterprise: the creation of new businesses, and enterprising behaviour within existing small and medium-sized firms. The remainder of this chapter sets the scene for current policies, briefly outlining the evolution of the SME sector, and government strategies towards it, over the past century.

**1.3** Chapter 2 sets out the foundations of a modern approach to enterprise, which recognises its important contribution to productivity growth and to generating sustainable new prosperity in the UK's disadvantaged communities. It identifies significant scope to raise levels of enterprise across the UK, but especially within disadvantaged communities, and outlines the principles that underlie the Government's approach to meeting this challenge. It also explains the role of the Small Business Service and the policy framework it has developed to drive forward better policy and service delivery for small business.

**1.4** Chapter 3 considers the importance of social attitudes to, and awareness of, enterprise, and sets out the ways in which the Government is seeking to build a more enterprising society. It examines various features of the business environment that affect the performance of all firms, but especially SMEs, and details the steps the Government has taken to improve that environment, particularly within the UK's most disadvantaged communities.

**1.5** While the Government's approach to enterprise policy is based around the free functioning of markets, it also recognises that market failures can stifle enterprising behaviour. Chapter 4 argues that these failures are often most acute in the UK's least prosperous communities, and summarises the measures the Government is taking to address these failures.

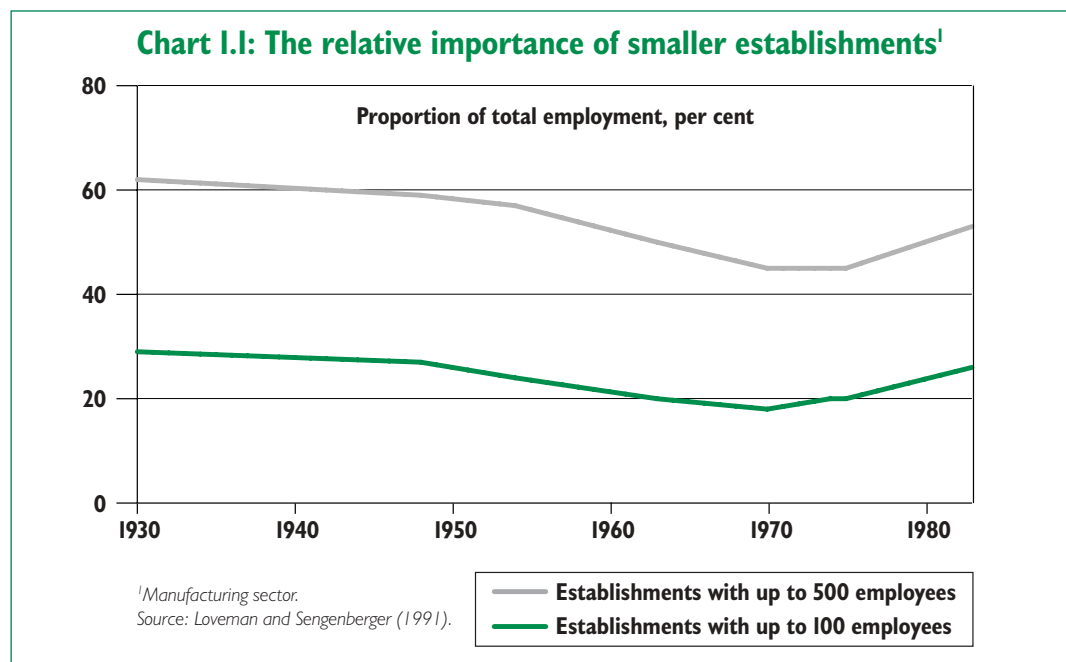
**1.6** The Government recognises that the renewal of deprived neighbourhoods must involve a strong economic dimension, but that the barriers to enterprise in these communities are often particularly severe. Promoting enterprise in disadvantaged areas therefore forms an integral part of the strategy set out in this paper. The measures the Government has put in place to achieve this – including those announced in the Pre-Budget Report – are concentrated in two thousand Enterprise Areas, the two thousand most deprived communities across the UK. These measures are summarised in Table E.1 and Chapter 2, and are set out in more detail in Chapters 3 and 4. They include specific steps to provide extra support and advice, to improve access to finance, and to facilitate planning and access to suitable business premises.

## ENTERPRISE IN THE TWENTIETH CENTURY

### 1900-1970: enterprise in decline

**1.7** For much of the twentieth century, production in the UK and across the industrialised world became increasingly concentrated in large-scale plants and organisations. This trend was primarily driven by new opportunities for producers to exploit economies of scale, based around the principles of Henry Ford’s pioneering model of mass production. In the UK, successive governments became active participants in this drive towards large-scale production, with industrial policy promoting consolidation and mergers during the 1960s and 1970s.<sup>2</sup>

**1.8** Small businesses were viewed as having limited potential to contribute to economic growth, and their share of total employment fell progressively (see Chart 1.1). At the start of the 1970s, the Bolton Committee report on small firms found that “the small firm sector is in a state of long-term decline, both in size and in its share of economic activity”.<sup>3</sup>



### The rise of the enterprise economy

**1.9** Since the 1970s, increasing globalisation has gone hand-in-hand with a resurgence in small business activity. In the UK, SMEs became the principal engine of employment growth in the 1970s<sup>4</sup> and, since 1980, the total stock of SMEs has increased from around 2<sup>1</sup>/<sub>2</sub> million to 3<sup>3</sup>/<sub>4</sub> million today. During the late 1990s, SMEs accounted for over half of all job creation in expanding firms, and new firms established during the period had provided 2.3 million new jobs by 1999 – over 85 per cent of which were in SMEs.<sup>5</sup>

**1.10** The resurgence of the small business sector can partly be attributed to the changing economic environment. The relative growth of the service sector, where products are often supplied at a more local level and where large-scale activity may offer more limited economies, was undoubtedly a contributing factor, reinforced by a progressive shift in consumer demand from standardised to more specialised goods. However, smaller businesses have also become more prominent *within* the manufacturing sector, suggesting that the sectoral shift towards service sector output provides only part of the explanation.<sup>6</sup>

<sup>2</sup> Owen (1999).

<sup>3</sup> Bolton (1971).

<sup>4</sup> Loveman and Sengenberger (1991).

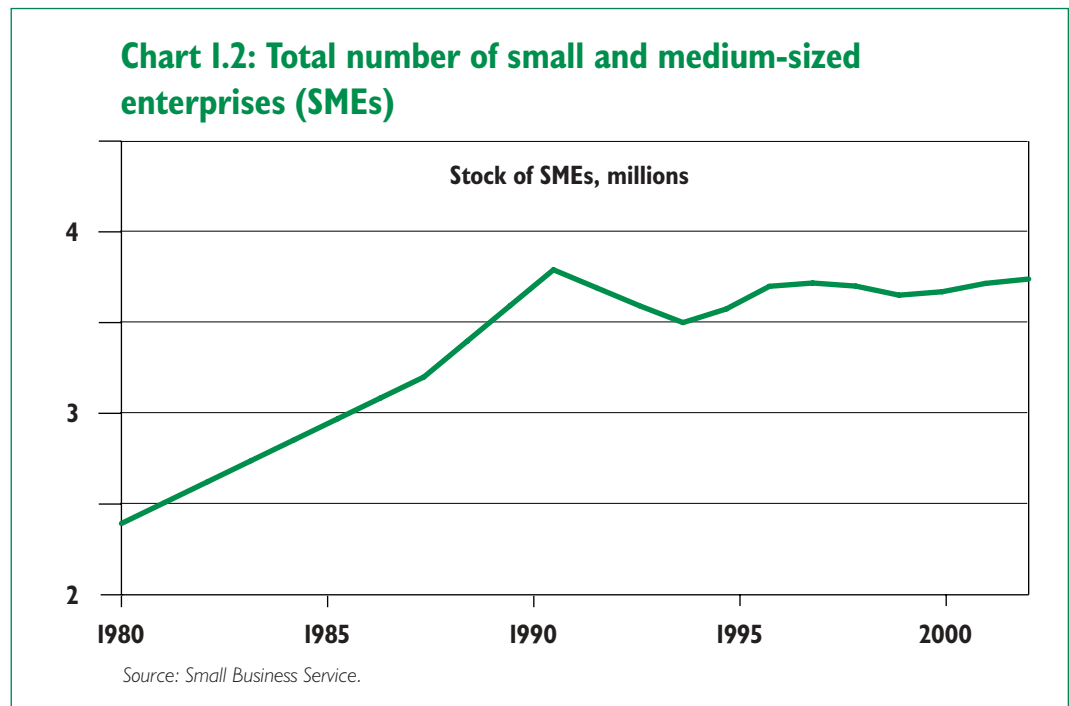
<sup>5</sup> Dale and Morgan (2001).

<sup>6</sup> Storey (1994).

**I.II** The increasing affordability and diffusion of new technologies is likely to have enhanced the competitiveness of smaller enterprises. The advance of ‘light’ industries using plastics and electronic devices, rather than steel and hydraulic or mechanical technologies, was beginning to make small-scale operation more economic by the start of the 1970s;<sup>7</sup> more recently, advances in computer-based technology have further improved the relative quality and flexibility of small-scale production.

**I.I2** Significant structural changes in the UK economy in the 1970s and 1980s also helped to shift the balance in favour of smaller businesses. Some large companies were hampered by rigid organisational structures, and so were poorly placed to cope with disturbances such as rising oil prices and significant labour market unrest in the 1970s. By contrast, many smaller enterprises possessed the flexibility needed to adapt to changing conditions, for example by applying newer, less energy-intensive production techniques.<sup>8</sup>

**I.I3** Increased domestic and international competition provided a further spur to smaller business, encouraging firms to specialise in those core activities where they had greatest competitive advantage.<sup>9</sup> Sub-contracting became increasingly prevalent in the UK during the 1980s, making a significant contribution to the growth of the small firm sector.<sup>10</sup>



<sup>7</sup> Boswell (1973).

<sup>8</sup> Traù (2000).

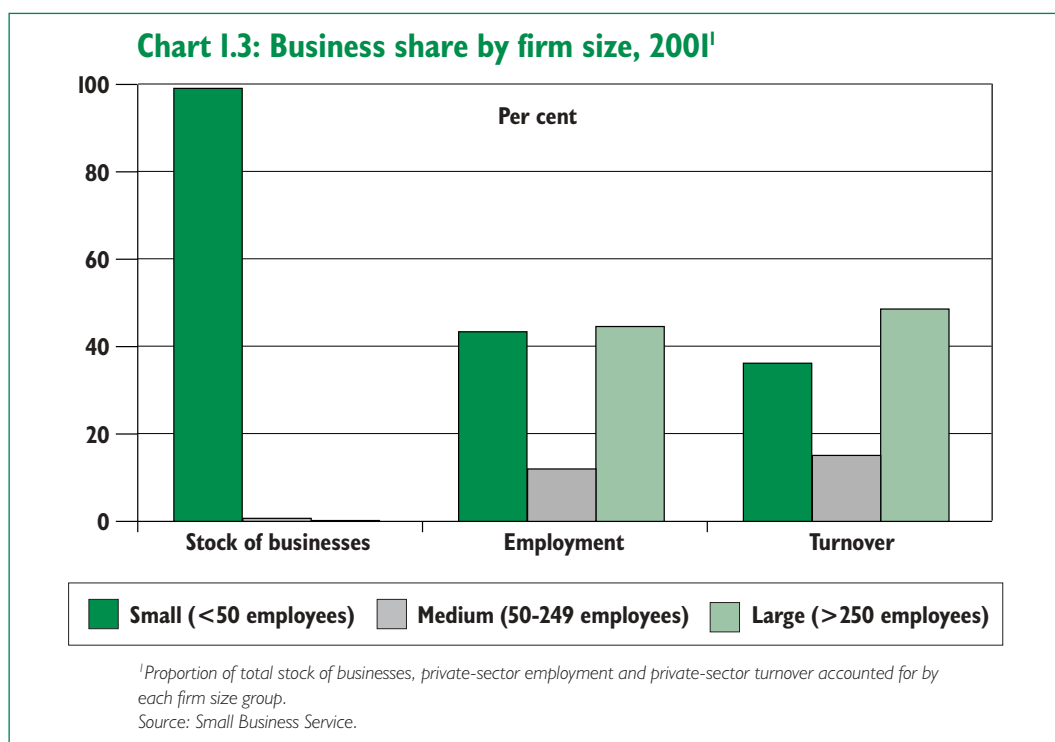
<sup>9</sup> Traù (2001).

<sup>10</sup> Greenhalgh and Gregory (2000).

**I.14** Government policy also began actively to promote small business in the 1980s. Deregulation has helped to raise competition by eliminating entry barriers and reducing transaction costs, and policies began to emphasise the potential benefits of building an enterprise culture. However, small business formation was encouraged principally as a solution to high levels of unemployment,<sup>11</sup> and government policy only partially addressed the particular obstacles and challenges facing potential entrepreneurs and existing SMEs with growth potential. Enterprise continued to be constrained by damaging economic volatility, and the need to equip potential entrepreneurs with appropriate skills and support received only limited recognition.<sup>12</sup> As a result, new firm formation remained concentrated in the UK's faster growing regions.<sup>13</sup> Nevertheless, the acceptance and encouragement of enterprise as a contributor to economic success was a significant turnaround in policy.

### THE SME SECTOR TODAY

**I.15** SMEs today make a substantial contribution to the UK economy. There are currently some 3<sup>3</sup>/<sub>4</sub> million SMEs in the UK: almost 200,000 more than at the start of 1994, when directly comparable data were first collected. Collectively, these firms account for over 55 per cent of private-sector employment, and over 50 per cent of private-sector turnover. The vast majority of SMEs may be classified as 'small', with more than 99 per cent employing fewer than 50 staff; many of these are sole traders.



**I.16** SMEs make an important contribution to output and employment in virtually all industry sectors, though activity in certain sectors is particularly concentrated amongst smaller enterprises. For example, SMEs account for more than 85 per cent of all employment in the construction industry, with employment concentrated in enterprises with fewer than ten employees, whereas larger firms are relatively more important in manufacturing and some service sectors.

<sup>11</sup> Storey (1994).

<sup>12</sup> Greene (2002).

<sup>13</sup> Keeble and Walker (1994).

**I.17** SMEs also vary greatly in their motivations and objectives. Many are ‘lifestyle’ businesses, established by individuals seeking the freedom and challenge associated with running a small business,<sup>14</sup> but whose main objective is to make a comfortable living rather than to achieve significant business growth. Survey evidence suggests that only around one fifth of SMEs aim to generate substantial growth.<sup>15</sup> As the next chapter makes clear, it is this latter group which exerts the greatest competitive threat to other firms, and therefore makes a particularly important contribution to economy-wide productivity growth.<sup>16</sup> By concentrating on obstacles to growth, the Government’s policies are targeted towards those SMEs with the greatest productivity potential.

**I.18** Whilst SMEs collectively make a substantial contribution to employment in the UK, they are, on average, less productive than larger firms. Of course, this comparison masks a substantial divergence in productivity levels between individual firms and across industries. Some industries offer substantial scope to exploit economies of scale, so that larger firms enjoy a significant productivity advantage, whereas other activities are more suited to small-scale production.

**I.19** More importantly, a focus on this *static* analysis of small-firm productivity fails to capture the important role of enterprising SMEs in driving productivity growth and in building sustainable communities in a *dynamic* economy. Chapter 2 outlines the evidence that underpins the inclusion of enterprise as one of the five key drivers of productivity growth, and sets out the Government’s role in promoting a more dynamic SME sector throughout the country, particularly in disadvantaged areas.

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<sup>14</sup> Small Business Service (2002a).

<sup>15</sup> Cosh and Hughes (2000).

<sup>16</sup> Scarpetta *et al.* (2002).



# 2

## A MODERN APPROACH TO ENTERPRISE POLICY

**2.1** A modern approach to enterprise policy should acknowledge not only the substantial contribution of SMEs to employment and output, but also their vital role as dynamic ‘agents of change’ within the economy. Enterprise lies at the heart of the Government’s strategy to narrow the UK’s long-standing productivity gap with other major economies, and enterprising SMEs contribute materially to economic prosperity and social well-being within local communities.

### ENTERPRISE AND THE PRODUCTIVITY CHALLENGE

#### Narrowing the productivity gap

**2.2** *Productivity in the UK: The Evidence and the Government’s Approach*<sup>1</sup> showed that the UK faces a significant and long-standing productivity gap with its major competitors. In 2001, the labour productivity gap with the US was 38 per cent; the gaps with France and Germany were 15 and 9 per cent respectively.<sup>2</sup> Raising levels of productivity in the UK is crucial to delivering higher living standards and greater prosperity for all.

**2.3** There are two elements of the Government’s strategy to narrow the productivity gap over the long term: first, locking in the platform of **economic stability** which has been established under the new macroeconomic framework; and second, putting in place a series of **microeconomic reforms** based around five priority areas, or ‘drivers’ of productivity growth. The recognition of enterprise as one of these five key drivers marks a crucial step in the transformation of government policy towards small business.

#### Enterprise and productivity

**2.4** Among major industrialised economies, the level of entrepreneurship is positively correlated with both the level of per capita GDP and the rate of GDP growth.<sup>3</sup> This is consistent with the view that an enterprising small business sector contributes to economic performance; it may do so in a number of ways (see Chart 2.1).

**2.5** First, enterprise is a key driver of productivity growth in its own right. The creation and growth of new firms, and the implementation of novel ideas within existing businesses, contribute to a beneficial process of **productive ‘churn’**, by which market share is transferred through market forces from lower-productivity plants and firms to their more productive counterparts. This process raises productivity at an aggregate level.

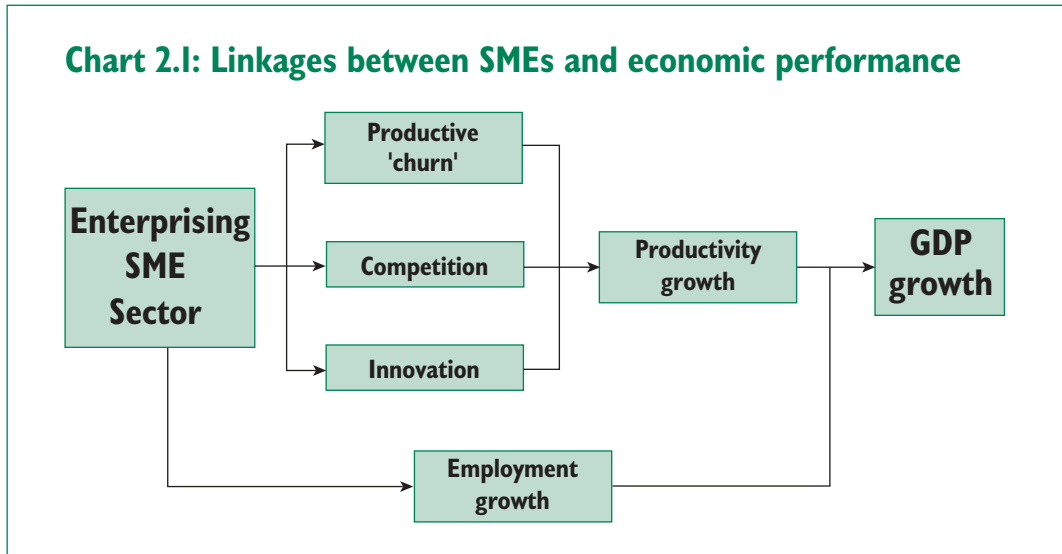
**2.6** Second, enterprising SMEs interact with other drivers of productivity growth. Enterprise is an important driver of **competition**: in attempting to raise their own market share, firms of all sizes provide a continual incentive for their competitors to invest, innovate and seek efficiency and quality improvements. Enterprising SMEs also play a key role in the process of **innovation**, experimenting with new ideas and putting them into practice. SMEs play an important role in ‘innovation networks’, for example by providing specialist equipment and services to boost the innovative potential of larger firms.

<sup>1</sup> HM Treasury: *Productivity in the UK: The Evidence and the Government’s Approach*, November 2000, [www.hm-treasury.gov.uk/mediastore/otherfiles/81.pdf](http://www.hm-treasury.gov.uk/mediastore/otherfiles/81.pdf).

<sup>2</sup> Office for National Statistics.

<sup>3</sup> OECD (2001), Audretsch and Thurik (2001).

**Chart 2.1: Linkages between SMEs and economic performance**



**Productive 'churn'** **2.7** The rate of productivity growth in an economy depends in large part upon the extent to which resources and market share are reallocated from inefficient to more efficient producers, a process referred to as productive 'churn'. This process includes the formation of new firms and the closure of their less productive rivals, collectively termed 'net entry', together with the transfer of resources between existing plants and firms. For the UK, these processes may together have accounted for around half of labour productivity growth, and as much as 90 per cent of total factor productivity growth, over a twelve-year period.<sup>4</sup>

**2.8** While these estimates include the reallocation of market share between existing plants and firms, many of which will be large businesses, SMEs account for a sizeable majority of net entry. International comparisons suggest that the UK has a relatively high churn rate,<sup>5</sup> and that higher rates of firm entry and exit are associated with stronger economic growth.<sup>6</sup>

**2.9** An investigation of productivity growth across a number of OECD economies<sup>7</sup> concluded that net entry at the firm level had a positive effect on labour productivity growth in nearly all of the countries surveyed. Differences in productivity between entering and exiting firms, many of which are SMEs, typically accounted for between 20 and 40 per cent of aggregate labour productivity growth over a five-year period. The study also found that new firms typically enter the market with a more efficient capital-labour mix than incumbents, and that entry is particularly beneficial for productivity in industries experiencing significant technological change.

**Enterprise and competition** **2.10** In addition to the contribution from productive churn, the competitive threat posed by new entrants and existing SMEs is also an important driver of productivity growth within larger firms.<sup>8</sup> Competition provides a clear incentive for all firms to innovate and to improve efficiency through internal restructuring. Since SMEs with significant growth ambitions present a strong competitive threat, they are particularly likely to provide a stimulus to productivity growth amongst rival firms.

<sup>4</sup> Disney *et al.* (2000).

<sup>5</sup> OECD (2001).

<sup>6</sup> Reynolds (1999).

<sup>7</sup> Scarpetta *et al.* (2002).

<sup>8</sup> Disney *et al.* (2000).

**2.11** Evidence supports the view that productivity suffers as a result of market power: firms operating in highly concentrated markets are characterised by lower *levels* of productivity, while greater product market competition is associated with more rapid productivity *growth*.<sup>9</sup> A recent OECD review concluded that “the link between product market competition and productivity is positive and robust”.<sup>10</sup> The level of market power in a given industry has been shown to be negatively related to the rate of innovation in that industry,<sup>11</sup> and to the level of technical efficiency within individual firms.<sup>12</sup>

### SMEs and innovation

**2.12** The SME sector plays an important role in its own right as a source of new product and process innovations. While many SMEs have only limited growth objectives, a minority of firms across the SME size spectrum are highly innovative, playing a vital role in generating and diffusing new ideas and technologies. Even amongst firms employing between 10 and 49 staff, nearly half are active innovators.<sup>13</sup>

**2.13** Larger firms have a clear advantage in their ability to finance and diversify research and development activities, to apply process innovations on a larger scale and to sell product innovations to a larger market. However, recent studies do not find that large firms are significantly more active in innovation than smaller firms.<sup>14</sup> Other features of smaller and younger firms may provide them with a relative advantage in generating and implementing novel ideas.<sup>15</sup>

**2.14** One dimension is the incentive that individuals face to invent or use their own ideas, as the allocation of property rights within large firms may not permit them to obtain the full economic value of their innovations. Moreover, where innovative working practices are identified, organisational structures in some larger businesses may be less conducive to rapid implementation. An alternative means of appropriating the benefits of innovation is by establishing a new firm; and lower resistance to change may allow easier implementation of new ideas in smaller and younger businesses.<sup>16</sup>

**2.15** Although innovations made by SMEs are, on average, of lower value in terms of their impact on the innovating firm’s own sales,<sup>17</sup> their wider economic benefits are greatly amplified when larger firms replicate or incorporate them into other processes, products and services.<sup>18</sup> SMEs also contribute to ‘innovation networks’, for example by providing specialised equipment and services, which in turn enhance the innovation performance of larger firms.<sup>19</sup> In this respect, small firms may be viewed as complementary to larger firms in the innovative process.

<sup>9</sup> Nickell *et al.* (1992), Nickell (1996), Nickell *et al.* (1997), Disney *et al.* (2000).

<sup>10</sup> OECD (2002).

<sup>11</sup> Geroski (1990), Blundell *et al.* (1995).

<sup>12</sup> Caves and Barton (1990), Green and Mayes (1991), Caves *et al.* (1992).

<sup>13</sup> Community Innovation Survey (2001). See, for example, Stockdale (2002).

<sup>14</sup> OECD (2002).

<sup>15</sup> Cosh *et al.* (1999).

<sup>16</sup> Acs *et al.* (1997).

<sup>17</sup> Tether and Storey (1998).

<sup>18</sup> Acs *et al.* (1999).

<sup>19</sup> Tether (1999).

## ENTERPRISE AND COMMUNITIES

**2.16** As well as being a key driver of productivity growth, successful enterprises form part of the bedrock of local communities, contributing to economic prosperity and social cohesion. They have a key role to play in delivering sustainable regeneration and higher living standards in the UK's disadvantaged communities.

**2.17** Past approaches to business-led regeneration have often emphasised the value of large-scale infrastructure projects and the benefits of encouraging large businesses to locate in less prosperous communities. These approaches tended to undervalue the advantages of actively engaging the local population in the process of community regeneration, and local communities have sometimes suffered as a result of over-dependence on a single industry or large firm that has few strong local ties.

### Enterprise and sustainable regeneration

**2.18** Opportunities to participate in enterprise, either by establishing a new business or by working in a locally-owned small firm, enable people to contribute to and share in economic development in their own communities. Participation in enterprise also allows people to gain transferable new skills and experience that will enhance their prospects for subsequent employment.<sup>20</sup>

**2.19** While businesses do not necessarily employ individuals from their immediate neighbourhood, indigenous small firms are more likely to do so than the plants or offices of larger corporations that are based outside the local area.<sup>21</sup> Smaller, locally-owned businesses are more likely to develop local connections and networks – for example, by demanding goods and services from neighbouring suppliers – and their profits are more likely to be retained or reinvested within the local community.

**2.20** In turn, successful enterprises increase local purchasing power and create further business opportunities, inducing a 'virtuous circle' of increasing activity within the community. There are also supply-side advantages: as SME communities grow, they collectively benefit from shared labour pools and access to common services.

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<sup>20</sup> Bank of England (2000).

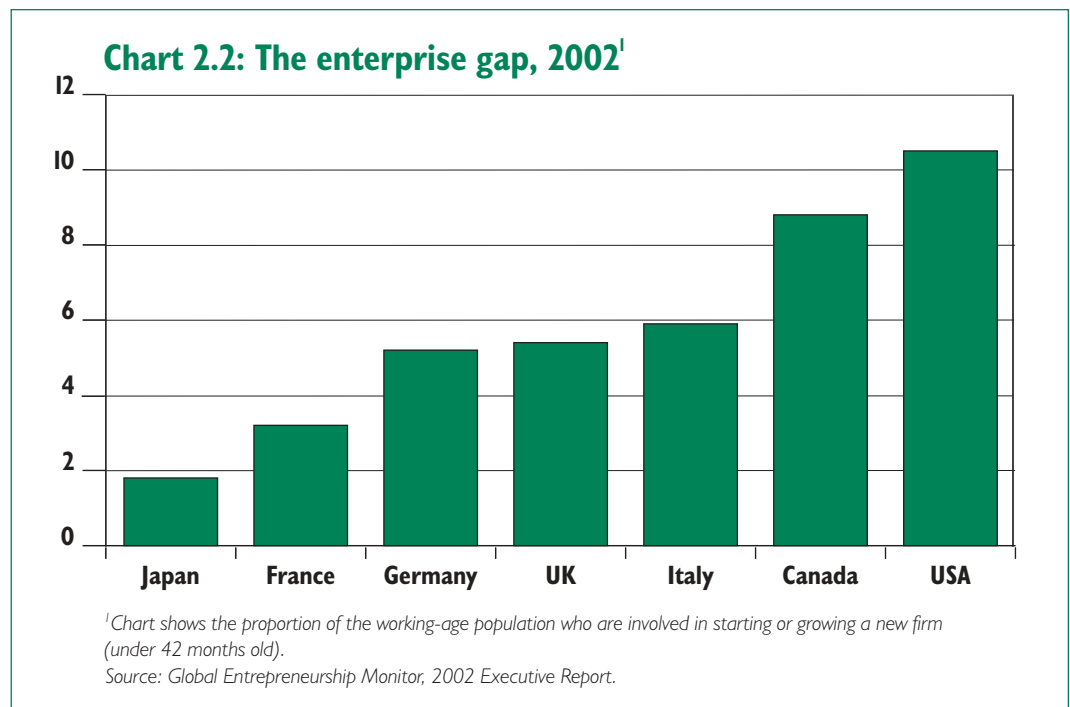
<sup>21</sup> Joseph (2000).

## Economic diversity

**2.21** A thriving small business sector provides the advantages of a more diverse economic base, leaving communities better placed to cope with the social and economic strains imposed by the decline of individual firms or industries. SMEs can also contribute to the local economy by broadening the available range of goods and services. This is particularly valuable in disadvantaged communities, where local provision of even the most basic goods and services can be very limited.

## THE ENTERPRISE CHALLENGE

**2.22** Despite the rapid growth of the SME sector since the 1970s, rates of entrepreneurial activity in the UK remain only moderate by international standards.<sup>22</sup> It is estimated that around 5½ per cent of working-age adults are engaged either in starting a new business or in running a young firm in the UK.<sup>23</sup> This figure is close to the European average, but is barely over half the US level. Moreover, the UK appears to lag the US in terms of high-growth start-ups: new firms in the US typically expand more rapidly than those in Europe.<sup>24</sup>



<sup>22</sup> DTI (2002a).

<sup>23</sup> Reynolds et al. (2002).

<sup>24</sup> Scarpetta et al. (2002).

## Enterprise in disadvantaged communities

**2.23** Entrepreneurial activity is particularly limited in the UK's least prosperous regions and communities. At a regional level, there is a wide variation in both business start-up rates and business density; in the North East, only 20 businesses per 10,000 residents registered for VAT last year, compared to a UK average of 37. Over time, differences in business creation rates contribute to a marked disparity in the total stock of businesses: for example, there are 203 VAT-registered businesses for every 10,000 residents in the North East, compared to a UK average of 352.<sup>25, 26</sup>

**Table 2.1: Start-up rates and business stock levels by region, 2001**

	Start-ups per 10,000 resident adults <sup>1</sup>	Start-ups as a proportion of total business stock <sup>2</sup> (per cent)	Total business stock per 10,000 resident adults <sup>3</sup>
United Kingdom	37	11	352
England	39	11	358
Wales	26	8	316
Scotland	28	10	290
Northern Ireland	28	7	427
North East	20	10	203
North West	32	11	298
Yorkshire and the Humber	29	10	289
East Midlands	34	10	333
West Midlands	33	10	326
East of England	40	11	379
London	59	13	476
South East	44	11	402
South West	36	10	374

<sup>1</sup> VAT registrations during 2001 per 10,000 resident adults at mid-2000.

<sup>2</sup> VAT registrations during 2001 as a proportion of the stock of VAT-registered businesses at the start of 2001.

<sup>3</sup> Stock of VAT-registered businesses at the start of 2002 per 10,000 resident adults at mid-2000.

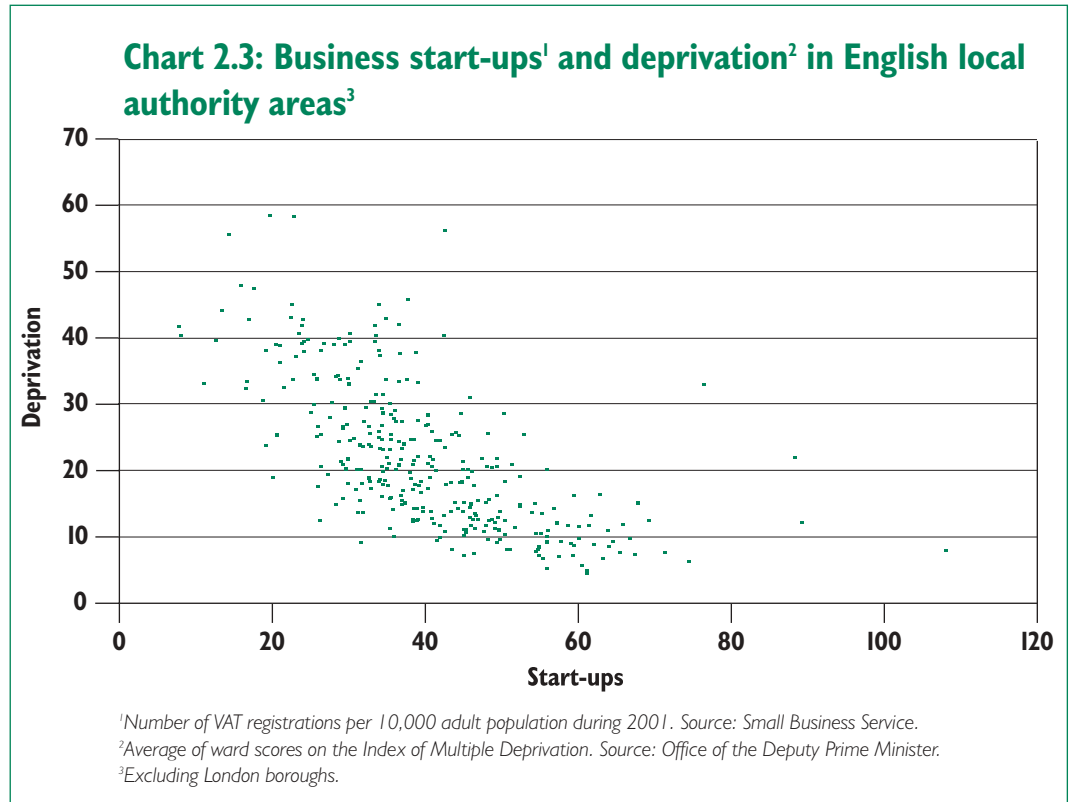
Source: Small Business Service.

**2.24** Substantial disparities also exist at a sub-regional level. Excluding London, the 20 most deprived local authority districts in England had 28 start-ups per 10,000 residents, compared to 55 in the 20 least deprived districts. A recent Bank of England study concluded that “the negative relationship between deprivation and entrepreneurial activity appears to be clear-cut in the case of the 50 most deprived local authorities”<sup>27</sup> and, more generally, high levels of local deprivation appear to be associated with low business formation rates.

<sup>25</sup> Differences in economic performance between UK regions are discussed in HM Treasury: Productivity in the UK: 3 – the regional dimension, November 2001, [www.hm-treasury.gov.uk/mediastore/otherfiles/REGIONAL\\_POLICY.pdf](http://www.hm-treasury.gov.uk/mediastore/otherfiles/REGIONAL_POLICY.pdf).

<sup>26</sup> To an extent, VAT registration data may exaggerate the difference in levels of economic activity, as they do not capture businesses that lie below the VAT turnover threshold. Such businesses may form a higher proportion of businesses in deprived areas. However, differences also show up in self-employment rates, which are substantially below the UK average in disadvantaged communities. See Kempson and Mackinnon (2002).

<sup>27</sup> Bank of England (2000).



## Enterprise and gender

**2.25** Countries exhibiting the highest rates of entrepreneurial activity are typically characterised by more widespread involvement of women in enterprise.<sup>28</sup> Despite recent growth in the UK, a man is more than twice as likely as a woman to be involved in business ownership,<sup>29</sup> and a recent study showed that the UK had the third-lowest rate of female entrepreneurship amongst a sample of 15 industrialised countries.<sup>30</sup> While women account for 45 per cent of total employment in the UK, only 26 per cent of the self-employed are female. Lower female self-employment rates may partly reflect the sectoral distribution of self-employment,<sup>31</sup> greater difficulties in raising finance<sup>32</sup> and the fact that women are more likely to have primary childcare or other domestic responsibilities.<sup>33</sup>

**2.26** Female-owned businesses also tend to be smaller than male-owned firms: a survey of 600 businesses found that only 29 per cent of female-owned businesses had more than five core employees, compared to 55 per cent for male-owned businesses.<sup>34</sup> This evidence, along with the low rates of female self-employment, suggests that women may face particular impediments to participating in the processes of business creation and growth.

<sup>28</sup> Reynolds *et al.* (2001).

<sup>29</sup> Small Business Service (2002a).

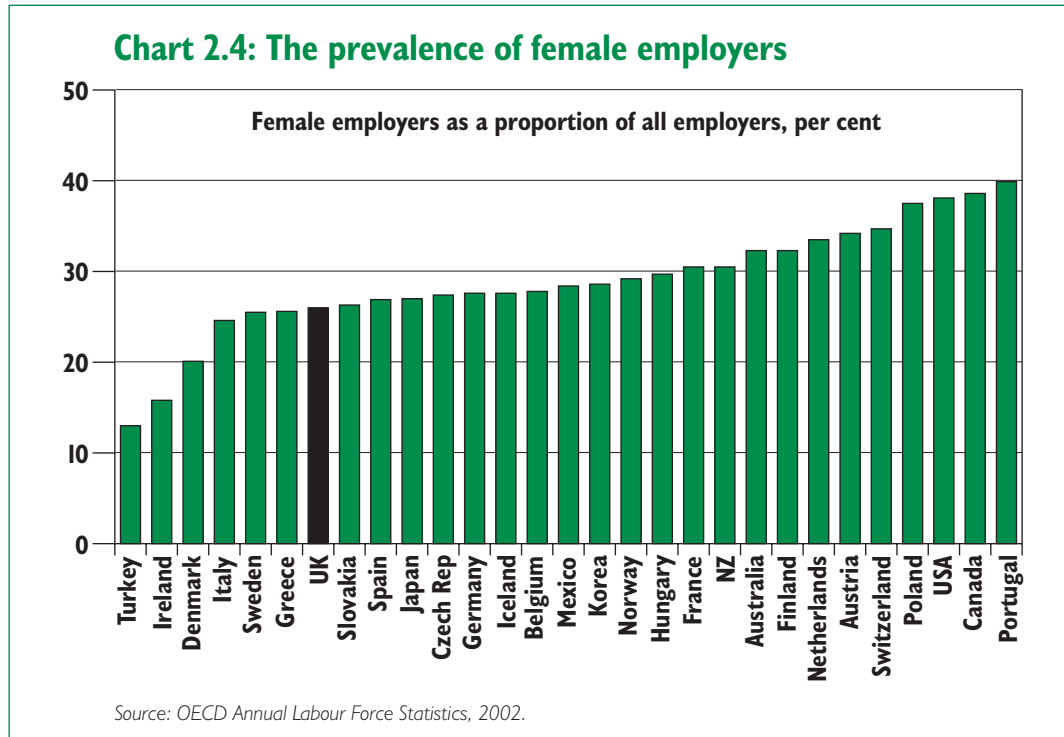
<sup>30</sup> OECD (2001).

<sup>31</sup> For example, self-employment is particularly common in the construction industry, which is dominated by male employment.

<sup>32</sup> Carter and Rosa (1998), Greene *et al.* (1999).

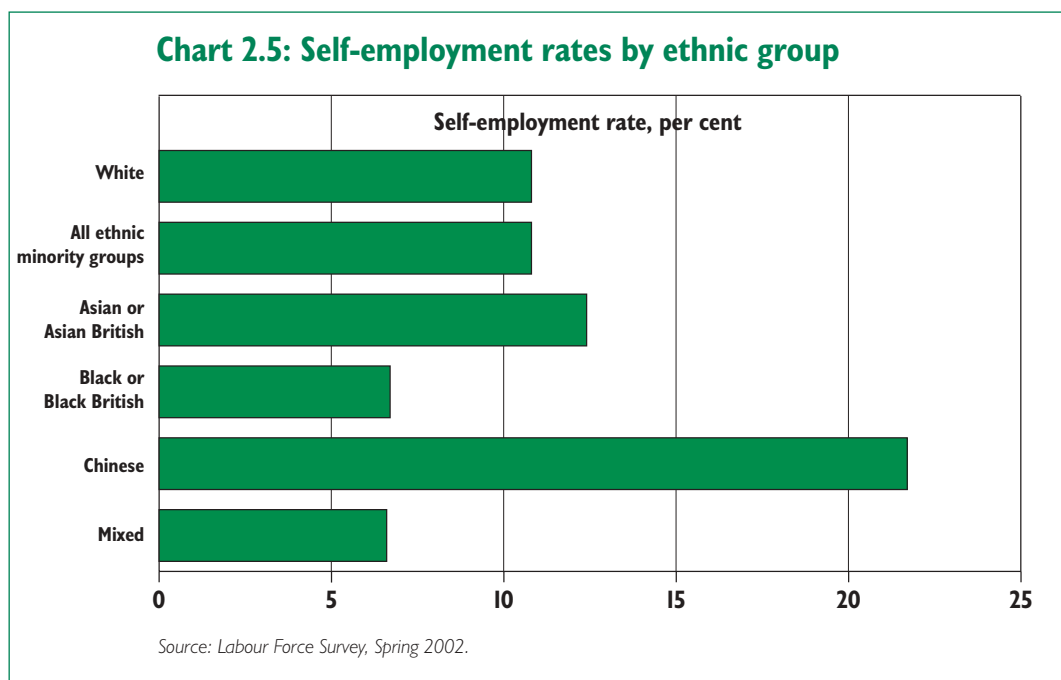
<sup>33</sup> Barclays (2000).

<sup>34</sup> Rosa *et al.* (1996). These results persisted even after controlling for business sector and age.



## Enterprise and ethnicity

**2.27** In aggregate, ethnic minorities exhibit a similar self-employment rate to the white population (Chart 2.5), but there is substantial variation in entrepreneurial activity between different minority groups.<sup>35</sup> In particular, while individuals of Afro-Caribbean origin are more likely than other ethnic groups to have considered starting a business or becoming self-employed, they are less likely to have realised these plans.<sup>36</sup>



<sup>35</sup> Small Business Service (2001a).

<sup>36</sup> Small Business Service (2002a).

**2.28** In addition, established ethnic minority businesses often seem to experience particular constraints to growth. They tend to be smaller than their white-owned counterparts, with more micro-businesses and very few medium-sized firms. This may partly reflect the sectoral composition of minority businesses: for example, a large number of South Asian businesses operate in sectors such as catering, clothing and food retailing, which may offer limited growth potential.<sup>37</sup> But this sectoral concentration also suggests that minority groups may face barriers to participating in enterprise in higher-growth sectors.

## THE GOVERNMENT'S APPROACH TO ENTERPRISE POLICY

**2.29** To ensure that the potential economic and social benefits of enterprise are exploited as fully as possible, it is vital that the opportunity to participate in enterprise should be open to anybody with the talent and potential to do so, and that the right conditions should be in place for individuals to start and grow a successful business.

**2.30** The Government's approach to meeting the enterprise challenge recognises the crucial role of market forces, for example in driving the productivity-enhancing process of business 'churn' and in generating the competitive forces that provide a link between enterprise and productivity growth.

**2.31** Accordingly, the Government's enterprise policy is motivated by the need to ensure that market forces are harnessed to best effect. It does not seek to favour SMEs over larger firms; rather, it aims to ensure that firms of all sizes can compete on a level playing field, and that enterprise can flourish through new firm creation and within existing businesses.

**2.32** However, the Government's policy also recognises the limitations of market-driven processes. Left to themselves, markets cannot always be relied upon to deliver outcomes that are optimal from a social perspective, and there is a role for governments to intervene where this is the case.

**2.33** Accordingly, two key objectives underlie the Government's approach to enterprise:

- to build an **enterprise-friendly environment**. It is vital that talented individuals should consider running their own business to be a valuable and rewarding career option, that the right conditions are in place for businesses to thrive and prosper, and that government regulations are fair and proportionate; and
- to correct for **specific market failures** that create obstacles to successful enterprise. Relative to larger firms, SMEs face particular barriers to accessing finance, lack awareness of the availability and potential advantages of external business advice, and face difficulties appropriating the full benefits of training and research and development (R&D).

**Enterprise Areas** **2.34** A key element of the Government's enterprise policy is the recognition that social attitudes, the business environment and specific market failures can present significantly higher barriers to enterprise within the UK's disadvantaged communities. Moreover, it is in these communities that the benefits of enterprise will have the greatest social impact. The Government has responded with a series of measures concentrated on two thousand Enterprise Areas, the most deprived communities across the UK.

<sup>37</sup> Ram and Smallbone (1999), Smallbone *et al.* (2001).

**2.35** A number of measures already in place benefit firms located in the Enterprise Areas, including:

- an **exemption from stamp duty** for all property transactions up to £150,000 (see paragraph 3.20);
- a **Community Investment Tax Credit**, which will improve access to finance (see paragraph 4.15);
- the **Bridges Community Development Venture Fund**, which provides venture capital funding to firms that can demonstrate meaningful interaction with the local economy (see paragraph 4.27);
- measures to **regenerate high streets** and encourage the **cleaning up of contaminated land** (see paragraph 3.20);
- the **Phoenix Fund**, which supports independent organisations that deliver business support services and provide community development finance (see paragraphs 4.38 and 4.39); and
- support for the **Inner City 100** awards, which raise awareness of successful enterprise in less prosperous communities (see Box 3.2).

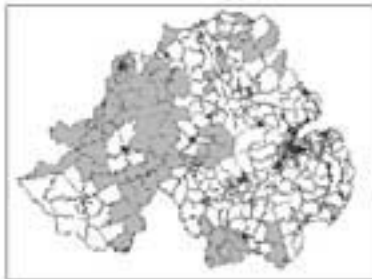
**2.36** These measures form part of the Government's broader strategy for neighbourhood renewal, coordinated by Local Strategic Partnerships at the local level and backed up by the Department of Trade and Industry's Public Service Agreement target for more enterprise in disadvantaged communities. The Government is now bringing forward the next stage of its strategy to boost enterprise in deprived areas. The new measures (announced in the Pre-Budget Report) include:

- a special package of support from the **Inland Revenue** and a commitment from **HM Customs and Excise** to examine with SBS and others how their support services for businesses, particularly with regard to VAT, can be enhanced and targeted more effectively in disadvantaged areas (see paragraph 3.42);
- new grants from the **Business Incubation Fund** to cover the costs of feasibility studies for incubators, with higher levels of funding in disadvantaged areas (see paragraphs 4.36 and 4.37);
- legislation for **Business Planning Zones** (BPZs), which will provide a more flexible planning regime for businesses in designated areas. BPZs will be particularly attractive to local authorities in the Enterprise Areas (see paragraph 3.40);
- a new tax incentive to encourage donations towards the running costs of **Urban Regeneration Companies** (see paragraph 2.51);
- an extension to the **Small Firms' Loan Guarantee Scheme**, widening eligibility to include firms in the retail and catering sectors, which are strongly represented in the Enterprise Areas (see paragraph 4.14);
- a series of **Enterprise Shows**, which will encourage potential and existing entrepreneurs and inform them of the services and support available locally (see paragraph 3.11); and
- a dedicated section in the forthcoming **Start-Up Guide for new businesses**, providing details of help available in the Enterprise Areas and how to access it (see paragraph 3.46).

## Chart 2.6: The Enterprise Areas



### Northern Ireland



Note: a postcode search for the two thousand Enterprise Areas can be found at [www.inlandrevenue.gov.uk/so/pcode\\_search.htm](http://www.inlandrevenue.gov.uk/so/pcode_search.htm).

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**Social enterprises** **2.37** Social enterprises, which are businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or community, have an important role to play in helping to deliver many of the Government's key policy objectives. The Government has therefore set out a programme illustrating how, working with other stakeholders, it will promote and sustain social enterprise activity.<sup>38</sup>

**Enhanced role of the Small Business Service** **2.38** Building a more enterprising economy depends upon cultural change: not just within society, but also within government itself. The *Cross-Cutting Review of Government Services for Small Business* estimated that, excluding agricultural support payments, public-sector expenditure on small business totals about £2.5 billion. The Review also highlighted the extensive range of government institutions that come into contact with, and provide services for, small businesses. These services provide a key part of the environment within which SMEs operate.

**2.39** In some cases, however, government service providers do not fully recognise the benefits and special needs of small business. The Review recommended that the Small Business Service (SBS), drawing upon its expertise on the SME sector, should work with service providers across government to raise standards (see Box 2.1). The SBS is also working closely with key advisory bodies and other relevant organisations, including the Small Business Council, the Small Business Investment Taskforce, the Ethnic Minority Business Forum and the Start-up Forum, which provide valuable advice and direction for policy and practice.

#### **Box 2.1: The Small Business Service**

**The Small Business Service (SBS) has an important role to play, both in improving the business environment and in addressing specific market failures. Through programmes such as the Phoenix Fund, it is also working to break down barriers to enterprise among under-represented groups.**

**The role of the SBS has been significantly enhanced following the inter-departmental *Cross-Cutting Review of Government Services for Small Business*. Its focus is:**

- to help all of government have the maximum impact on the economy by championing the needs of small business;
- to become a centre of expertise on small business issues;
- to use that knowledge to develop innovative new approaches across government to meet the needs of small business; and
- to become an engine for change, demonstrating what can be done, measuring progress against outcomes, and working with other regional and sub-regional partners to make use of shared knowledge, join up service delivery and avoid duplication.

**In fulfilling that new role, it is developing a framework for government policy towards small business based on the key drivers for economic growth, with the aim of driving forward the vision of making the UK the best place to start and grow a business by 2005. The framework is built around seven themes which will be built into seven national core strategies. The focus is on developing a culture where all those involved in supporting small businesses – across government and its key partners in the private and voluntary sectors – can make an effective contribution. To achieve that, there needs to be alignment in strategy and delivery at the local, regional and national levels, and all stakeholders need to learn from the experience of delivery how to develop better policy and regulation.**

<sup>38</sup> Department of Trade and Industry: Social enterprise: a strategy for success, July 2002, [www.dti.gov.uk/socialenterprise/pdfs/strategy.pdf](http://www.dti.gov.uk/socialenterprise/pdfs/strategy.pdf).

At the core of the new policy framework is the vision of an enterprise society where people with the initiative, skills and drive also have the opportunity to start and run a successful business; the environment within which small businesses operate is supportive and rewarding; and small businesses find it easy to respond to government and access its services.

To achieve this, all arms of government need to work closely together. There is a need for each Department and Agency dealing with or impacting on small business to identify its own contribution to the seven core strategies of:

- building an enterprise culture;
- encouraging a more dynamic start-up market;
- building the capability for small business growth;
- improving access to finance for small businesses;
- encouraging more enterprise in disadvantaged communities and under-represented groups;
- improving small businesses' experience of government services; and
- developing better regulation and policy.

These seven represent a strategic policy response to tackle barriers faced by people interested in starting a business, growth barriers for existing small businesses, and the particular challenges faced within disadvantaged communities and by under-represented groups. They will enable the Government to focus its efforts on producing real outcomes at the key phases of business development. Interventions at such points are likely to have the biggest impact on productivity. Achieving such timely interventions demands a determining shift in current delivery practices across government. The need is to:

- improve continuously the services delivered to small business customers;
- “think small first” in all it does;
- ensure equality of access for all small businesses; and
- make sure all its policy and delivery strategies to help small business are aligned at local, regional and national levels.

**2.40** All government providers, including the SBS through its development as a centre of expertise, will have an important role in ensuring that all government services meet the needs of small firms and deliver value for money. Robust monitoring and evaluation are essential across government, and the evidence collected should be used to inform the design and delivery of services for small businesses. Only through evidence-based policy-making can the Government ensure that its approximately £2.5 billion annual expenditure on services for small business has the greatest possible impact on small business performance.

#### Public procurement

**2.41** Government at all levels is a substantial purchaser of goods and services from business. The Office of Government Commerce (OGC) was established to ensure that the Government secures value for money in its procurement activities, not least by opening up opportunities for SMEs to compete for government contracts. OGC has worked together with the Small Business Service to provide advice to SMEs on tendering for government contracts and guidance to public procurers, highlighting the barriers SMEs may face. This will be supplemented by a web portal for SMEs.

**Role of local and regional institutions** **2.42** Building an enterprise economy will also depend upon ensuring the right balance between policies implemented on a national scale and those delivered at regional and local levels. The Government believes that regionally balanced growth, led by the regions themselves, is not only desirable in its own right but is also essential to raising productivity growth and to delivering rising economic prosperity and employment opportunity for all.

**2.43** Drawing upon research by the University of Cambridge and the *Cross-Cutting Review of Government Services for Small Business*, it is estimated that local government and regional institutions have responsibility for almost a third of annual public expenditure on services for small business, or approximately £750 million.<sup>39</sup> This figure takes account of the important role that local government and regional bodies play in marshalling European Structural Funds to promote regional development.

**2.44** The Government's new approach to regional economic policy is focused on realising the productive potential of all regions, including by raising enterprise awareness and opportunity. To meet this challenge, the Government is ensuring that every region has the resources and the institutions, within a national framework of accountability, to tackle specific regional and sub-regional issues and to deliver reforms.

**2.45** Institutional reforms include the introduction of Regional Development Agencies (RDAs) in England and, at a local level, the introduction of Local Strategic Partnerships. Similarly in Scotland, Wales and Northern Ireland the Devolved Administrations have set up, or in some cases further developed, their own regional and local economic bodies, whose responsibilities include the promotion of enterprise.

**2.46** RDAs are strategic drivers of economic development, regeneration and competitiveness in the English regions. To encourage and support enterprise, RDAs seek to align the regional provision of business support services with identified business needs. Increasingly, RDAs are working through sub-regional partnerships to coordinate the delivery of business support services at a more local level. These partnerships are made up of business support providers across the public, private and voluntary sectors. RDAs also work together with Local Strategic Partnerships (LSPs) to ensure that local neighbourhood renewal strategies are used to promote enterprise and support entrepreneurship. To strengthen their role, the 2002 Spending Review provided increased funding and flexibility to the RDAs, better equipping them to take forward their responsibilities, including their strategies for enterprise. Pilots of RDA-led management and coordination of Business Link operators are being developed in the North West, West Midlands and East Midlands.

**2.47** For the majority of small firms, the local level is where their experience of government is shaped. Many of the regulations that affect small businesses are enforced by local authorities, local tax offices and others. It is also the level at which specific business support services are coordinated and delivered by organisations including Business Link operators, local authorities, Learning and Skills Councils, Jobcentre Plus and Chambers of Commerce.

**2.48** The Government is committed to strengthening the role of local government in promoting economic development, working closely with RDAs and other stakeholders. For example, following the Comprehensive Performance Assessment, local government bodies that can demonstrate that they are delivering services effectively and efficiently will be given the freedoms and flexibilities that they need to play a full role in economic growth. At the same time, the Government is working to reduce ring-fenced grants and bureaucracy for all local government bodies to increase their flexibility to focus on their economic role.

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<sup>39</sup> Bennett (2002).

**Box 2.2: Examples of RDA-led initiatives to support enterprise**

**Incubation:** The South East England Development Agency aims to extend the region's network of Enterprise Hubs to 30 over the next five years. The hubs provide entrepreneurs with managed workspace and improved access to technology and innovation, finance and business support.

**Finance:** The South West Development Agency is seeking to ensure that businesses have access to a range of sources of finance to help them grow at each stage of their development. The Regional Venture Capital Fund will form the cornerstone of the 'Escalator of Finance'.

**Start-up strategy:** Yorkshire Forward is seeking to achieve higher business birth and survival rates through its birth-rate strategy: 'Can Do – Will Do'. The strategy takes a comprehensive approach, promoting cultural change within the region as well as specific support measures.

**Coordinating business support:** The North West Development Agency is working with the Small Business Service, Trade Partners UK, Learning and Skills Councils and other partners to develop a pilot of RDA-led management and coordination of Business Link services. This will improve services to small business by simplifying contracts, allowing more resources to be allocated to front-end delivery.

**Neighbourhood renewal** **2.49** Low levels of enterprise in disadvantaged communities are likely to reflect factors such as the physical environment, infrastructure, employment, crime, education and the provision of other services. The Government is committed to narrowing the gap in outcomes between less prosperous neighbourhoods and the rest of the country. All the main service Departments have Public Service Agreement floor targets which commit them to improving outcomes in disadvantaged areas, including on crime, education and employment, health and housing.

**2.50** Improvement in these areas will complement the Department of Trade and Industry's target to promote more enterprise in disadvantaged communities. At a local level, Local Strategic Partnerships are responsible for agreeing a strategy to improve outcomes in the poorest neighbourhoods, which will include planning for how enterprise will be increased in these areas. As well as funding through mainstream programmes, the Government is supporting this work by continuing the Neighbourhood Renewal Fund, established in the 2000 Spending Review, and increasing its funding to £525 million by 2005-06.

**Urban Regeneration Companies** **2.51** Urban Regeneration Companies (URCs) are independent companies that engage the private sector – alongside public sector partners such as local authorities, RDAs and English Partnerships – in order to develop and implement regeneration strategies in urban areas. The Government has consulted on the possibility of giving tax relief on companies' donations to URCs, and now intends to introduce a new tax incentive to encourage donations towards URCs' running costs. This will help to ensure that URCs can play an effective role in stimulating regeneration and enterprise in many of the UK's urban areas. Regeneration activity in the areas covered by URCs can also benefit from other tax incentives which the Government has put in place, including those targeted at the two thousand Enterprise Areas.



**3.1** The Government has a key role to play in ensuring that the right conditions are in place for enterprise to flourish across the economy. First and foremost, this depends upon building a more enterprising society, in which those with the initiative, skills and drive to start and run a successful business have sufficient confidence in their abilities and actively consider the prospect of starting a business. The Government also has an important role in ensuring that potential entrepreneurs have access to the information and support they need.

**3.2** The success of established businesses of all sizes will depend upon the features of the environment within which they operate; smaller firms may be particularly sensitive to changes in this environment. The uncertainty presented by an unstable macroeconomic climate presents a powerful deterrent to enterprising behaviour, and may be especially damaging to smaller firms. A strong competition regime is an important prerequisite for enterprise to flourish. Where government interacts with businesses, it should help and not hinder enterprising behaviour.

## BUILDING A MORE ENTERPRISING SOCIETY

### Social attitudes to enterprise

**3.3** In the past, social attitudes towards enterprise have presented a key constraint to business formation and growth in the UK. When a panel of experts was asked about the factors affecting levels of entrepreneurship in the UK, 30 per cent of comments related to cultural and social issues, almost double the average of 16 per cent in 19 other countries.<sup>1</sup>

**3.4** Indeed, less than half the population believe they have the knowledge, skills and experience required to start up a business<sup>2</sup> and, while their attitudes towards entrepreneurs are strongly positive, many young people are unsure of their own ability to meet the challenges of starting and running a business.<sup>3</sup> Participation in enterprise is also strongly related to an individual's level of educational attainment: research shows that those who have completed tertiary education are twice as likely to be setting up a business as those who have not.<sup>4</sup>

**3.5** Individuals in the UK are also less inclined towards self-employment than those in the US and Germany, and are less aware of the opportunities to start up in business.<sup>5</sup> The UK has an unimpressive record of converting entrepreneurial potential into action: survey evidence shows that, of those who were considering going into business in 2001, just 15 per cent had actually done so a year later. A further 53 per cent were still considering the possibility.<sup>6</sup>

**3.6** Studies show that individuals with little experience of enterprise tend to be more averse to it. For example, those who already know an entrepreneur are more likely to follow that route themselves.<sup>7</sup> Lack of entrepreneurial awareness is therefore likely to be a particular obstacle in less prosperous communities, where individuals typically have less exposure to successful enterprise.

### Enterprise in schools

**3.7** The Government shares the assessment of the Davies review of enterprise and the economy in education, which reported earlier this year,<sup>8</sup> that efforts to build a deeper and wider entrepreneurial culture must begin in schools. The review identified various ways to strengthen the links between the education system and business, as an important step in building a more enterprising society across the country.

<sup>1</sup> Reynolds et al. (2000).

<sup>2</sup> Reynolds et al. (2001).

<sup>3</sup> Davies (2002).

<sup>4</sup> Barclays (2002).

<sup>5</sup> Reynolds et al. (2001).

<sup>6</sup> Small Business Service (2002b).

<sup>7</sup> Reynolds et al. (2001).

<sup>8</sup> Davies (2002).

**3.8** The review found that schools already play a part in developing a more positive view towards careers in business amongst young people, though many lack the skills and confidence to turn positive attitudes into action during their future careers. Studies indicate that enterprise activities in schools can provide the means by which young people gain an awareness of the opportunities available to them in business, and develop skills and confidence that can help them to start up in business later in life.<sup>9</sup> Enterprise activities also strengthen the relevance and understanding of pupils' mainstream work in school.

**3.9** Yet while some schools have implemented imaginative programmes, such as mini-company schemes or enterprise projects, usually with business support, fewer than 30 per cent of young people gain enterprise experience at any point in their school careers. Moreover, few schoolchildren gain the necessary awareness of finance and economic issues, which are vital skills for any would-be entrepreneur.

**3.10** Recognising the important role of educating young people about enterprise, the Government has allocated additional resources to the Department for Education and Skills, to ensure that every child has some experience not just of work but also of business and enterprise before they leave school. This funding will rise to £60 million a year by 2005-06, in line with the recommendations of the Davies review. The Government will shortly publish its full response to the recommendations of the review.

### Encouraging enterprise

**3.11** The Small Business Service (SBS) has identified the need to build a more enterprising society as one of its seven core strategies. It will work with RDAs and private-sector providers to stage a series of Enterprise Shows, which will encourage potential and existing entrepreneurs and inform them of the services and support that are available locally. Personal Enterprise Shows in Scotland have already helped to encourage enterprise and to raise awareness of relevant issues (see Box 3.1).

**3.12** In addition to supporting specific programmes which aim to achieve this goal, the SBS will exploit its enhanced cross-government role to identify areas in government where action can be taken, not just to break down barriers to enterprise, but also to promote awareness of enterprise as a desirable and achievable career option.

#### **Box 3.1: Personal Enterprise Shows in Scotland**

The Personal Enterprise Shows in Scotland are national exhibitions for potential entrepreneurs, providing information, advice and inspiration for people with an interest in starting their own businesses. Shows are organised into five key zones: **Becoming an Entrepreneur, Getting Started, Using Information, Managing the Business and Next Steps.** The show includes informative Factbooks on what is involved in becoming an entrepreneur, and seminars on **Motivation, Marketing and Money.**

The most recent show was held at the Scottish Exhibition and Conference Centre in Glasgow in March, attracting over 5,000 visitors. Feedback from visitors was exceedingly positive. The show operates as part of the Small Business Gateway, and this year's show was organised in conjunction with West Scotland Local Enterprise Companies (Ayrshire, Dunbartonshire, Glasgow, Lanarkshire, Renfrewshire). These companies led the campaign of follow-up events.

If the show repeats past rates of 'conversion' of visitors into business start-ups, the success of the Glasgow event should help to create over 1,000 new businesses over the coming 12-18 months.

<sup>9</sup> OFSTED (1998).

**3.13** The Government also recognises the important contribution of voluntary, community and other not-for-profit organisations in raising awareness of enterprise opportunities, and in providing support, encouragement and guidance to those starting out in business for the first time. Accordingly, it supports the work of a number of such organisations (see Box 3.2), many of which are particularly active in the two thousand Enterprise Areas.

**Box 3.2: Supporting voluntary, community and other not-for-profit initiatives to promote enterprise**

The Government supports a variety of initiatives, including:

- the **Inner City 100**, which publicises the 100 fastest-growing inner city businesses around the country. It aims to raise awareness of successful enterprise in disadvantaged communities, where fewer people start and grow businesses, and to demonstrate that enterprise can flourish there;
- **Young Enterprise**, which aims to inspire and equip young people to learn and succeed through enterprise. The programme includes a well-known mini-company scheme, in which students set up and run their own companies and make real profits and losses. Last year 42,000 students were involved in running companies through the Young Enterprise company scheme;
- the **Prince's Trust**, which works with 14 to 30 year olds who face disadvantage – offering them the support, encouragement and basic financial assistance they need to achieve their goals. The Business Start-up programme offers low-interest loans, grants, mentors and other support for young adults who want to start a business;
- **Enterprise Insight**, which aims to foster a spirit of enterprise within the UK. It works with partner organisations, including Young Enterprise and the Prince's Trust, to develop links between businesses and schools, to support and encourage young people who wish to become entrepreneurs, and to raise the profile of enterprise in society;
- the **Business Volunteer Mentors Association**, supported by the Phoenix Fund. Almost 1,000 volunteers from the business community provide mentoring support to assist the development of pre-start-up and newly-established businesses; and
- **Enterprising Solutions**, the national social enterprise award which celebrates success and innovation in the social enterprise sector.

## REWARDING SUCCESSFUL ENTERPRISE

**3.14** Entrepreneurs are motivated by a wide variety of factors, but the potential financial rewards are a principal attraction.<sup>10</sup> Those who invest in enterprise, for example through direct or indirect equity holdings, are also driven by financial motives.

**3.15** The tax system is an important mechanism by which governments can influence the financial rewards to those who engage or invest in enterprise, and therefore levels of enterprise in the economy. The primary aim of tax policy is to raise sufficient revenue for the Government to pay for the services which its policies require, and to service its debt. But how and what is taxed sends clear signals about the economic activities which governments believe should be encouraged and discouraged, and the values they wish to entrench in society.

<sup>10</sup> Small Business Service (2002a).

**Rewarding enterprise and investment** **3.16** In recent years, the Government has introduced significant reforms to modernise the business tax system in order to promote enterprise and productivity and to ensure that the UK provides an attractive environment for establishing and investing in business.

**3.17** So that success in enterprise is fairly rewarded, the Government has cut the main and small companies' rates of corporation tax from 33 per cent and 23 per cent to just 30 per cent and 19 per cent respectively – the lowest rates in the history of corporation tax. It has also introduced a starting rate of corporation tax, and reduced it from 10 per cent to zero in Budget 2002, so that 150,000 small companies no longer pay any corporation tax.

**3.18** To promote long-term investment in, and by, business, the Government has introduced a generous capital gains tax taper for businesses assets. From April 2002, the effective rate of tax for a higher rate taxpayer was reduced to just 10 per cent for business assets held for over two years, making the UK regime one of the most favourable in the world. The Government has also introduced permanent 40 per cent first-year capital allowances for small and medium-sized enterprises, bringing forward tax relief for investing firms and providing a cashflow boost to fund investment in plant and machinery.

**Business rates** **3.19** Recognising that business rates represent a higher proportion of turnover, overheads and profit in small businesses as compared to larger concerns, the Local Government Bill introduces a mandatory rate relief of up to 50 per cent for single-property small businesses in England with a rateable value below £3,000, tapering to zero at a rateable value of £8,000. The scheme is self-financing, and the costs will be met by a small supplement on all those businesses not in receipt of the relief.

**Fiscal incentives in disadvantaged areas** **3.20** In addition, the Government has introduced specific tax measures to facilitate access to suitable business premises and to enhance the environment in disadvantaged areas. It has already exempted from stamp duty all property transactions up to £150,000 in the two thousand Enterprise Areas and, subject to EU state aids approval, will abolish stamp duty altogether for all non-residential property transfers in these areas. It has also introduced a 150 per cent accelerated payable tax credit for owners and investors for the costs that they incur in clearing up contaminated sites.

**Moving from benefits to self-employment** **3.21** There are particular barriers to making the transition from benefits to self-employment. The structure of the benefits system affects this transition by determining the relative rewards of remaining on benefits and becoming self-employed. The New Deal self-employment option is designed to help with setting up and running a business; it ensures adequate rewards to self-employment by providing an allowance during a six-month 'test-trading' period that more than matches the level of benefits that would otherwise be available. This can allow the most vulnerable the opportunity to start their own business.

**3.22** In addition, people starting up in self-employment may face an initial period of low income as their business gets established. Existing tax credits provide financial support for self-employed people with children or a disability, as well as for those in low-income employment, rewarding work and addressing the problem of the unemployment trap. From April 2003, this assistance will continue as part of the new Working Tax Credit, which will also extend support through the tax credit system to both employees and self-employed people on low incomes aged 25 or over without children or a disability, provided they normally work at least 30 hours a week.

## THE MACROECONOMIC CLIMATE

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**3.23** The macroeconomic climate is clearly an important feature of the environment in which all businesses operate and, in the past, volatile growth of output and demand in the UK created uncertainty and discouraged enterprise within firms of all sizes. Research indicates that macroeconomic instability hinders the efficient allocation of investment.<sup>11</sup> But smaller businesses are often least well placed to cope with economic instability: they are less likely to have internal reserves upon which to draw in times of distress, and less diverse product or customer bases may leave some smaller firms particularly vulnerable to fluctuations in demand.

**3.24** To address the legacy of past instability, the Government moved quickly in 1997 to establish a new framework for macroeconomic policy, based around a new framework for monetary policy and two tough new fiscal rules.<sup>12</sup> This new framework has delivered a platform of economic stability, leaving the UK better placed to cope with turbulence in the world economy and creating the right conditions for businesses to invest, grow and prosper. Under the new framework, the UK has experienced:

- the **longest period of sustained low inflation** since the 1960s, and the lowest inflation in the European Union (EU);
- **interest rates** around their lowest levels since the 1960s, with long-term rates on a par with the major EU economies; and
- **real-terms business investment** averaging 13<sup>1</sup>/<sub>2</sub> per cent of GDP over the past five years, compared with barely over 11 per cent during the previous decade.

## PROMOTING COMPETITION

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**3.25** Vigorous competition is the lifeblood of strong and effective markets. It encourages all firms to innovate, invest and reduce slack, driving productivity gains and putting downward pressure on costs. A strong competition regime is essential to ensure that all businesses, including start-ups and SMEs with growth potential, can exert this competitive pressure to best effect.

**3.26** In the past, the UK's competition regime was widely accepted as being much weaker than those of other major economies. Anti-competitive behaviour stifled enterprise, preventing new businesses from entering the market and competing on an equal basis, yet the penalties for engaging in anti-competitive behaviour were weak. The competition authorities could not take effective enforcement action against firms, nor could third parties take action for the harm they suffered.

**3.27** Since 1997, the Government has taken a series of steps to build a world-class competition regime. The first pillar of reform was the Competition Act 1998, which prohibits anti-competitive agreements and abuses of dominant market position. These reforms have already started to take effect. The Global Competition Review<sup>13</sup> recently ranked the UK as equal second in the world league table, a rating bettered only by the US Department of Justice and Federal Trade Commission.

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<sup>11</sup> Beaudry *et al.* (2001).

<sup>12</sup> HM Treasury: Reforming Britain's economic and financial policy: towards greater economic stability, *Palgrave*, 2001.

<sup>13</sup> Global Competition Review (2002).

**3.28** The Enterprise Act builds on this foundation. It greatly increases the competition focus of the UK regime so that firms of all sizes can compete on a fair basis, including by:

- giving full independence to the **UK competition authorities**, so that their decisions are free from political interference in the overwhelming majority of cases;
- giving the **Office of Fair Trading** a clear proactive role to keep markets under review, and enabling it to refer markets to the Competition Commission where they may not be working effectively. This includes powers to investigate the impact of existing and proposed regulation on competition;
- improving the **mergers and monopolies** regimes, giving greater certainty through clearer timetables and a more transparent decision-making process; and
- introducing new criminal penalties for individuals who engage in **cartels**, covering the most serious form of anti-competitive activity.

### Competition in SME banking markets

**3.29** The Government is committed to fostering effective competition in all sectors, and the OFT is already taking action to promote competition in specific markets as part of its new proactive role. But ineffective competition in the SME banking market may present a particular constraint on enterprise within start-ups and established SMEs.

**3.30** A recent Competition Commission investigation<sup>14</sup> into this market identified a number of practices carried on by the major UK banks that operated against the public interest. The Commission recommended a package of remedies to improve competition and to address the problem of excess prices. These remedies included measures designed to ease switching of accounts between banks and to increase transparency of charging, which the eight largest UK banks have now accepted. But it will take time for these measures to have the desired effect on competition in the market so, as an interim measure, the Government has also secured the four largest banks' agreement to offer their SME customers in England and Wales either interest on their current accounts or an account free of money transmission charges from the start of 2003.

## ENSURING FAIR AND PROPORTIONATE REGULATION

**3.31** Effective and well-focused regulation is a necessity in a fair and civilised society, helping to correct market failures, promote fairness and ensure public safety. Fairly and proportionately enforced regulation also helps to ensure that honest and decent businesses – the vast majority – are not subject to unfair competition from the unscrupulous few. For example, the Government has provided a statutory right for small firms with 50 or fewer employees to claim interest for the late payment of commercial debts.

**3.32** However, unnecessary or poorly implemented regulation can stifle competition, innovation and enterprise, particularly within small firms. New firm formation rates are generally lower in countries with over-burdensome regulations and administrative obstacles, and this can reduce productivity in the wider economy.<sup>15</sup> Countries where there are high costs associated with starting a new business generally have lower employment rates,<sup>16</sup> and strict product market regulations are also likely to be detrimental to productivity performance.<sup>17</sup>

<sup>14</sup> Competition Commission (2002).

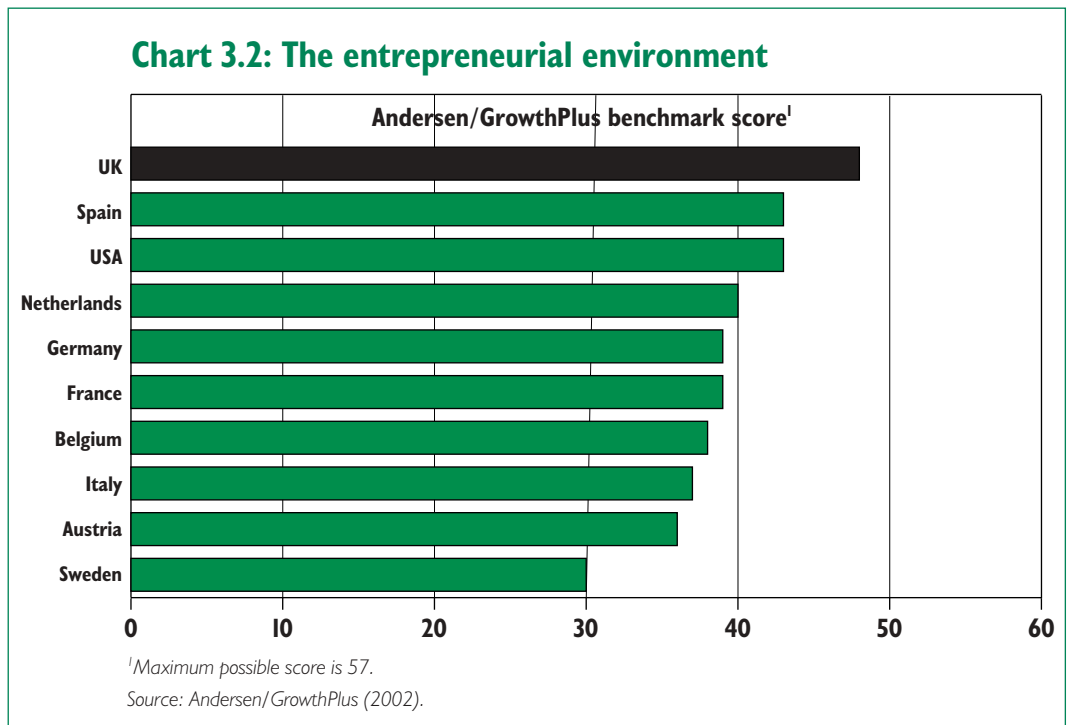
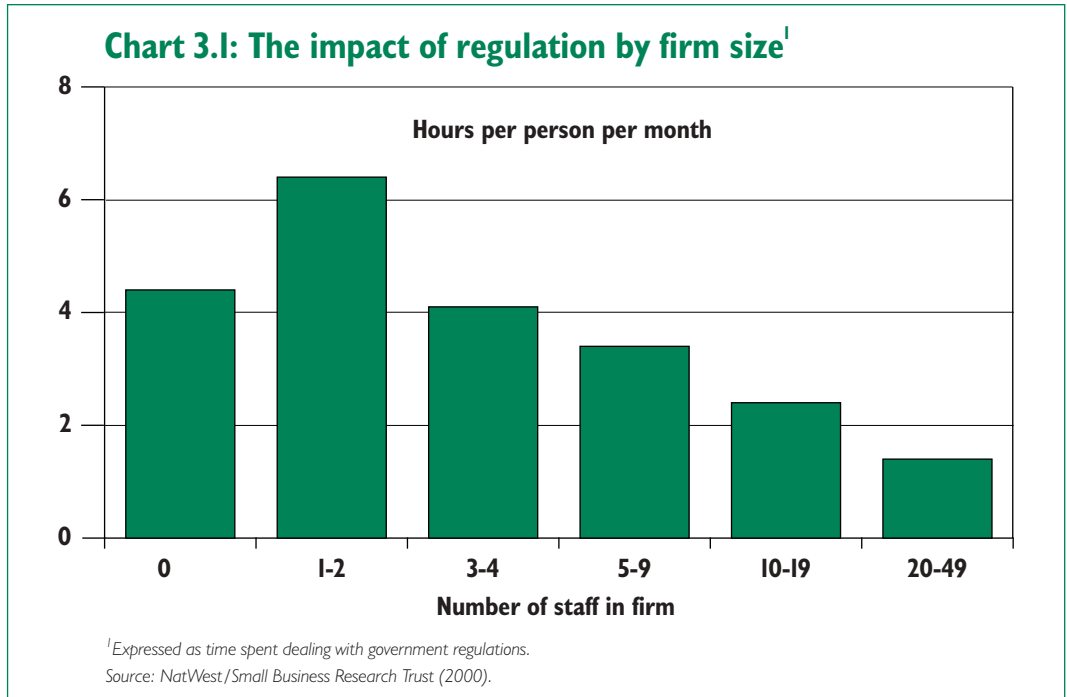
<sup>15</sup> Audretsch and Thurik (1997), Djankov *et al.* (2001).

<sup>16</sup> Fonseca *et al.* (2001).

<sup>17</sup> Scarpetta *et al.* (2002).

**The impact of regulation on small firms**

**3.33** Survey evidence indicates that the primary impact on small business is the administration time needed to comply with regulation,<sup>18</sup> particularly for the smallest firms (see Chart 3.1), where management time is an especially scarce resource. The Government recognises that some of the costs involved in complying with regulation, such as the time needed to learn about what is required, are fixed regardless of firm size.



<sup>18</sup> Small Business Service (2001b).

### International comparisons

**3.34** International comparisons show that the UK is a relatively lightly regulated economy. According to research based on the OECD International Regulation Database, the formalities and costs involved in establishing a new business in the UK are amongst the lowest in the industrialised world. In a sample of 17 countries, only Denmark and the US scored better.<sup>19</sup>

**3.35** A recent independent study of legislation, taxation and regulation affecting established firms in the USA and nine EU countries concluded, for the second consecutive year, that the UK provides the most entrepreneur-friendly environment (see Chart 3.2).<sup>20</sup>

### Delivering better regulation

**3.36** While the UK regulatory regime adopts a relatively light touch by international standards, the Government recognises the need to take further steps, especially for smaller firms. It has already reduced the costs for small businesses of complying with regulations, by:

- **putting systems in place**, such as Regulatory Impact Assessments and the Ministerial Panel of Regulatory Accountability, to hold Ministers to account for their regulatory performance and for the costs they impose on business;
- **reforming specific regulations**. For example, in February 2002, the Government announced a package of over 260 deregulatory measures, including simplifying fire safety regulation by moving from an inspection and certification regime to a risk-based approach.<sup>21</sup> The Government's proposals for reforming company law<sup>22</sup> emphasise the interests of smaller companies, and include a range of deregulatory measures to help these firms;
- **cutting the cost of VAT administration**. The UK has maintained the highest VAT registration threshold in the European Union, keeping the smallest firms out of the VAT system, and around 900,000 businesses can now opt to file their VAT returns annually instead of quarterly, improving cashflow and reducing compliance costs. More than 500,000 of these firms are also eligible to join an optional flat rate VAT scheme, which can reduce their compliance costs by up to £1,000 each year. From April 2003, eligibility for this scheme will be extended to all firms with turnovers up to £150,000; and
- **helping employers to deal with their payroll obligations** through better use of information technology, in line with the recommendations of the Carter Review of Payroll Services. From 2004-05, the Government will provide cash incentives for small employers to file their payroll returns to the Inland Revenue electronically.

**3.37** The SBS has identified the importance of developing high-quality regulation as one of its seven core strategies, and will play an important role in raising understanding across government of the impact of regulation on small business.

<sup>19</sup> Baygan and Freudenberg (2000).

<sup>20</sup> Andersen/ GrowthPlus (2002).

<sup>21</sup> Cabinet Office: Regulatory reform – the Government's action plan, February 2002, [www.cabinet-office.gov.uk/regulation/actionplan/index.htm](http://www.cabinet-office.gov.uk/regulation/actionplan/index.htm).

<sup>22</sup> *Modernising Company Law*, Cm 5553, July 2002, HMSO.

### Better regulation on the ground

**3.38** The Enforcement Concordat<sup>23</sup> and the *Cross-Cutting Review of Government Services for Small Business*<sup>24</sup> set out the Government's commitment to improving the delivery of regulation on the ground. It will seek to meet this commitment by communicating regulatory requirements more effectively, by providing advice and support to help firms meet regulatory requirements, and by ensuring proportionate, risk-based enforcement.

**Communication 3.39** The *Cross-Cutting Review* found that many small businesses are insufficiently clear about what government asks of them, or how to meet those requirements. For example, smaller firms are typically less aware of the details of employment legislation, though the impact of these regulations may actually turn out to be less significant in practice than the business owner had previously expected.<sup>25</sup> This highlights the need for information to be effectively tailored to meet the needs of small firms, explaining clearly and concisely what they need to do to comply with regulations.

**3.40** The SBS is working closely with other departments and agencies to bring together in a simplified, accessible form information on government regulatory requirements and business support services. For new business start-ups, a guide to government requirements and sources of advice and support will be launched in hard copy in spring 2003, with an internet version following later in the year. This *Start-Up Guide* will also raise awareness of the types of additional support available to businesses in the two thousand Enterprise Areas.

**3.41** The SBS is closely involved in a cross-government project to develop new online and interactive services, providing practical and accessible help for businesses in dealing with government. These services will be available through a portal which will help business users to see at a glance what is relevant to them, to prioritise effectively and, where appropriate, to carry out related transactions. As an example of this approach, the Government has launched a package of information and advice on becoming self-employed, available through UK Online.<sup>26</sup> The user can also register for tax and VAT through a single transaction.

**Advice and support 3.42** The Inland Revenue and HM Customs and Excise are also taking steps to help new and established small businesses to meet their tax-related obligations (see Box 3.3). The Pre-Budget Report announces further help and support for employers in the two thousand Enterprise Areas. The Inland Revenue will work to deliver a more visible Business Support Team presence in these areas, along with targeted invitations to "EmployerTalk" events across the UK. HM Customs and Excise will be working with the SBS and others over the next few months to examine how their support services for businesses, particularly with regard to VAT, can be enhanced and targeted more effectively in disadvantaged areas.

**3.43** The Advisory, Conciliation and Arbitration Service (ACAS) is expanding and improving its services to assist and advise small businesses on employment matters. This is backed by an annual 4.7 per cent real terms increase in funding for the Department of Trade and Industry's employment relations agencies from 2002-03 to 2005-06. ACAS will expand the capacity of its telephone helpline by 33 per cent, from 750,000 to one million calls per year. Nearly two-thirds of callers are businesses with fewer than 50 employees. ACAS will also increase the volume of face-to-face advice given to small firms, with a doubling by 2006 in the number of training courses on the essentials of employing people. It is also developing high-quality online provision to improve access to training services.

<sup>23</sup> Cabinet Office (1998): Enforcement Concordat, [www.cabinet-office.gov.uk/regulation/PublicSector/enforcement/Enforcement.htm](http://www.cabinet-office.gov.uk/regulation/PublicSector/enforcement/Enforcement.htm).

<sup>24</sup> Small Business Service/HM Treasury (2002), [www.sbs.gov.uk/crosscutting](http://www.sbs.gov.uk/crosscutting).

<sup>25</sup> Blackburn and Hart (2001).

<sup>26</sup> [www.ukonline.gov.uk](http://www.ukonline.gov.uk).

**Box 3.3: Helping businesses meet their tax-related obligations**

To help businesses to understand the tax system, the Inland Revenue and HM Customs and Excise (HMCE) have established advice and support systems, with the needs of new and young businesses uppermost in mind. For those starting up a new business, the Inland Revenue and HMCE have jointly prepared specific information and guidance explaining how to register for tax, national insurance and VAT.<sup>1</sup>

**Inland Revenue's Business Support Teams**

In addition to an Employer's Helpline,<sup>2</sup> which deals with over a million telephone enquiries a year, the Inland Revenue's national network of Business Support Teams offers one-to-one visits to new and small businesses. The Teams can explain the firm's obligations in relation to payroll and other aspects of business tax and national insurance, and can provide advice on issues such as record keeping, allowances and self-assessment. The Teams can also check that payroll systems are processing information accurately and reliably. A variety of free workshops and other learning tools are available, tailored to the needs of new and small firms.

**HM Customs and Excise advice services**

HMCE provides a National Advice Service,<sup>3</sup> handling general enquiries on VAT, customs, excise duties and environmental taxes, and arranging appointments for businesses seeking face-to-face advice. The service handled two million calls in its first year. HMCE also ensures early contact with all new VAT-registered businesses, offering free seminars, one-to-one advice and trade sector leaflets. Two videos are available,<sup>4</sup> and HMCE runs a programme of fourteen Business Advice Open Days each year, providing quality advice to some 20,000 new or existing businesses.

<sup>1</sup> The *Starting up in business* guide is available from [www.inlandrevenue.gov.uk/startingup/pages.pdf](http://www.inlandrevenue.gov.uk/startingup/pages.pdf).

<sup>2</sup> 08457 143143.

<sup>3</sup> 0845 010 9000.

<sup>4</sup> *Customs matters: getting it right* and *Keeping records and accounts* are available through the National Advice Service.

**Proportionate and risk-based enforcement**

**3.44** The DTI and the SBS will provide guidance to help central and local government follow the priorities set out in the Enforcement Concordat, embodying the principle that prevention is preferable to prosecution. The SBS will also assess current compliance with the Concordat, and take action to ensure that businesses are aware of its principles.

**Regulations for planning**

**3.45** The availability of suitable premises is a concern for many companies.<sup>27</sup> The Government has therefore initiated wide-ranging reform of the planning system to increase its certainty, predictability, simplicity and speed. The Government is cutting red tape by abolishing county-level structure plans and introducing more responsive Local Development Frameworks to replace local development plans. It has also embarked on a wholesale review of national Planning Policy Guidance notes to ensure that they are up-to-date, clear and concise for local authorities and developers. In particular, guidance on retail, commercial and industrial development and small businesses is being revised as a priority. The 2002 Spending Review provided an extra £175 million for the planning system by 2005-06 to support these changes.

<sup>27</sup> Cosh and Hughes (2000).

**3.46** The Government also intends to proceed with the proposals for Business Planning Zones (BPZs), set out in the Planning Green Paper.<sup>28</sup> These will provide a more flexible planning regime for businesses, as no planning consent will be necessary in designated areas for development that is in accordance with tightly defined parameters. The Government will set these parameters to ensure that good quality environments are created and maintained. There will be scope for BPZs in areas with a high concentration of technology-based activity, where businesses start up frequently and have the potential to expand rapidly, and BPZs may also be attractive to local authorities as a means of stimulating economic activity in the two thousand Enterprise Areas.

## REDUCING THE COSTS OF HONEST BUSINESS FAILURE

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**3.47** Many potential entrepreneurs are dissuaded from starting new businesses by the perceived costs of failure. Survey evidence suggests that around half of all those not involved in entrepreneurial activities would need help to overcome their fear of business failure and its consequences.<sup>29</sup>

**3.48** Running a business is an inherently risky activity, to which not all individuals will necessarily be suited; it is neither the role of government to eliminate that risk, nor to push those who are unwilling or unable to bear that risk into enterprise. The ability to face and manage inherent business risk successfully is one of the defining features of the successful entrepreneur. However, governments can take steps to reduce the stigma attached to honest business failure, and to create effective incentives for the rescue of viable businesses.

**3.49** The Enterprise Act includes measures to achieve this. In particular:

- reforms to **personal bankruptcy law** will substantially reduce the cost and stigma of business failure in most cases, while providing stronger sanctions against the unscrupulous or dishonest; and
- **corporate insolvency** will be conducted in a way that recognises the interests of all creditors, and provides the greatest incentive for the rescue of businesses.

**3.50** Measures to tackle specific market failures that affect performance and inhibit growth, particularly within the SME sector, should also reduce the likelihood of failure for viable businesses. These measures are described in Chapter 4.

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<sup>28</sup> Department for Transport, Local Government and the Regions: Planning: delivering a fundamental change, December 2001, [www.planning.odpm.gov.uk/consult/greenpap/index.htm](http://www.planning.odpm.gov.uk/consult/greenpap/index.htm).

<sup>29</sup> Small Business Service (2002a).

