Institute for
Family Business

The UK Family Business Sector

An Institute for Family Business report by Capital Economics

February 2008

Institute for
Family Business

Foreword

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Our aim in commissioning this report is to highlight the size, scope and breadth of the UK family business sector.

This report, which was produced by Capital Economics, will encourage debate on a part of the UK economy that is not always well understood. The report aims to spotlight issues that family firms face, as well as strategies that policy makers should consider in order to underpin the ongoing development and growth of the sector. The UK economy draws strength from the breadth and diversity of entrepreneurial activity nationally; as the report confirms, family firms are a key component of the private sector, helping drive the creation of wealth and deliver benefits for society through employment and the support that family firms provide to our local communities.

The content of the report draws on the body of research on family firms that the IFB has identified from both private and government sources. We trust that the report will provide policy makers and other stakeholders with valuable insights into the sector.

Grant Gordon

Director General

About IFB
The Institute for Family Business was established in 2001 as an independent, not-for-profit organisation supporting a dynamic family-owned business sector in the UK through advocacy, education and research. IFB Advocacy promotes greater awareness of the sector and highlights policy areas that are of special importance in underpinning the growth and entrepreneurial development of family firms. IFB Education, which includes our national conference, seminars and educational events, offers programmes that seek to increase understanding with respect to the unique challenges and opportunities that family firms face. The association is the UK chapter of FBN International.
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The UK Family Business Sector

Contents

Executive Summary 2

1. What is a family business? 3

2. Characteristics of the family business sector 4
   - 2.1 Ownership typology 4
   - 2.2 Sectoral concentration 4
   - 2.3 Generational transfer 5

3. The size of the family business sector 5
   - 3.1 The number of family firms 5
   - 3.2 The turnover, employment & contribution to GDP of family firms 7
   - 3.3 Family firms by legal status 9
   - 3.4 Change in the size of the sector 11
   - 3.5 International comparisons 12

4. The wider contribution of the family business sector to the economy 13
   - 4.1 A breeding ground for start-ups 13
   - 4.2 Contribution to tax revenues 14
   - 4.3 The relative performance of family firms 16

5. The business & tax environment for family business 19

6. Conclusion 22

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Executive Summary

- We estimate that family firms account for 65% or 3 million of the total 4.6 million private sector enterprises in the UK economy.
- The vast majority of family enterprises are small and medium enterprises (SMEs). 56% are sole traders with no employees.
- But we also estimate there to be over 1,000 family firms with more than 250 employees. These alone account for 20% of the turnover of the overall family business sector.
- Because family enterprises are more likely to be small firms, they account for a lower share of turnover, employment and GDP than of the total number of firms in the economy – but the share is still substantial. Family enterprises produce around 38% of turnover in the private sector and are twice as important for the economy as private equity-backed firms. We estimate that they also account for around 38% of GDP in the private sector and 31% of GDP in the overall economy.
- Their share of employment is slightly higher, given that small firms tend to employ more people per unit of output than large firms. We estimate that family businesses account for around 42% of private sector employment, providing employment to 9.5 million people.
- The contribution of the family business sector to the economy extends beyond its direct contribution to output; it also acts as a crucial breeding ground for entrepreneurial talent and start-ups.
- Furthermore, we estimate that family businesses pay around £47bn per annum in taxes to the Exchequer, equivalent to almost 10% of the Government's total tax receipts. If we include taxes paid by employees of family firms, this raises the contribution to tax revenues to £73bn or 15% of the total.
- Meanwhile, there are good reasons for family firms to be more profitable and stable than other firms. Perhaps their biggest advantage lies in aligning the interests of managers and owners. Family firms also tend to have a longer time-horizon than other firms.
- The business and tax environment has generally been supportive of family business. However, further progress could be made in the development of a more favourable tax regime through extending the scope of business property relief and the protection of business asset holdover relief. Measures to improve the succession rate of family firms when it comes to passing the firm on from the current generation are also needed.

The UK Family Business Sector

1. What is a family business?

Talking about family business may conjure up thoughts of small father and son firms. But family enterprises form a backbone running right through the economy. They are particularly prevalent in the micro business sector (firms with fewer than ten employees). But they are also common in the rest of the small and medium enterprise (SME) sector.[1] And some of the very largest private and quoted UK companies are family firms, with well-known examples including JC Bamford (commonly known as JCB), Clarks Shoes and Associated British Foods.

Not only do family firms vary significantly in size, but they also differ in the degree of family involvement in the business. Some families will take a role in the day-to-day running of the business, whilst others will take a more hands-off approach with the involvement of professional non-family managers. Family firms also range in terms of longevity from early-stage to long-standing multi-generational firms.

Precise definitions of a family business vary, but the firms should have to meet some criteria about their ownership or management. A commonly accepted definition, as worded by "The Family Entrepreneurship Working Group" set up by the Finnish Ministry of Trade and Industry in 2004[2], is that:

- The majority of votes are held by the person who established or acquired the firm or their spouses, parents, child or child's direct heirs.
- At least one representative of the family is involved in the management or administration of the firm.
- In the case of a listed company, the person who established or acquired the firm or their families possess 25% of the right to vote through their share capital and there is at least one family member on the board of the company.

In addition, and particularly for smaller firms, subjective criteria need to be employed in order to distinguish family firms from entrepreneurs in owner-managed firms more generally. Most obviously, the firm itself can be asked whether it considers itself to be a family business.

[1] The Department of Trade and Industry definition of the SME sector is all firms with fewer than 250 employees. The micro business sector is considered a sub-set of the wider SME sector.

[2] "Family entrepreneurship: family enterprises as the engines of continuity, renewal and growth-intensiveness," Family Entrepreneurship Working Group, 2005

2. Characteristics of the family business sector

2.1 Ownership typology

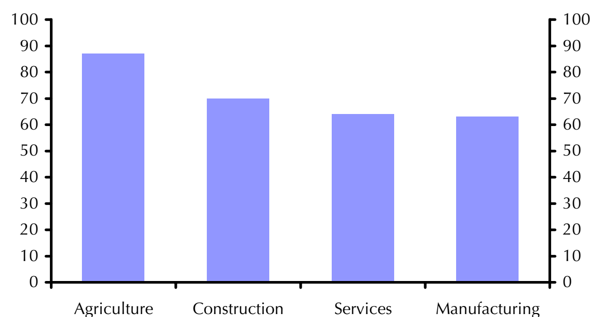
The tightest control is in owner-managed firms, which are owned by a single person who is also the only managing director. Sole-traders are therefore owner-managed. Bigger firms are more likely to be family-managed, where the ownership and management is in the hands of at least two family members. Lastly, in family-controlled firms, the family takes a more hands-off approach and the management and/or ownership is shared with non-family members. The family remains in full control of the company, however, by holding a significant proportion of the voting rights. The largest family firms will be family-controlled.

For small and medium-sized firms, the UK findings of an FBN International Monitor survey suggest that around 40% are owner-managed, 45% family-managed and 15% family-controlled.[3]

2.2 Sectoral concentration

Family firms are particularly prevalent in agriculture and construction. (See Chart 1.) Within the services sector, family firms are most likely to be found in distribution, hospitality, catering and tourism. They are under-represented in sectors such as banking, insurance and business services. This no doubt reflects the high start-up costs involved in these sectors; financial firms are under-represented in the SME sector as a whole.

Chart 1: Proportion of SMEs in each sector that are family firms, % excluding firms with no employees (DTI 2006 annual survey of small businesses)



With family firms more likely to be found in sectors other than business and financial services, it is no surprise that they have a low concentration in London, the financial heart of the UK. A Barclays survey of family firms found that they accounted for less than half of the business population in London, compared

[3] Pilot FBN International Monitor, Gallup Europe/Family Business Network, 2007

with three quarters in areas like the North West and East Anglia (the latter due to the agricultural connection).[4]

2.3 Generational transfer

The Department of Trade and Industry (or DTI, recently incorporated into the Department for Business, Enterprise and Regulatory Reform or BERR) publishes an annual survey of small firms. This found that 77% of family firms in the SME sector are controlled by the first generation, 10% by the second generation and 6% by the first and second generation. Only around a third of family firms tend to be passed onto the second generation and one tenth reach the third generation, the rest being either sold or closed down.

Surveys show that the bigger - and probably older - the firm, the more likely that it has already been passed onto future generations; family firms in the SME sector with at least 10 employees are twice as likely as those with fewer than 10 employees to be controlled by the second generation. The generation of ownership also varies by sector, with agricultural businesses most likely to be controlled by the second generation.

The Barclays survey of family firms suggested that most have no definitive plans about what to do with the firm in the future, with 61% of owners saying they had made no decision about what would happen when they stepped down from the helm. Of the remainder, 16% had already decided on a successor, 13% planned to sell the business, while 10% planned to close it down. Similarly, the FBN International Monitor showed that 19% of respondents intended to sell or transfer the business in the future.

3. The size of the family business sector

3.1 The number of family firms

Estimates from the DTI show that at the start of 2006, there were 4.47 million private sector business enterprises in the UK, including all unincorporated enterprises and companies. Column 3 in Table 1 breaks down this total according to the number of firms in each main size-band (by number of employees). Column 4 shows an estimate of the number of companies at the start of 2007 (4.60 million), based on the assumption that the number of firms in each size-band grew at the same rate in 2006 as in 2005.

Column 5 then shows what proportion of firms in each size-band might be family firms. The DTI annual survey of small businesses contains an estimate of the share of firms in the smaller employment bands which are family firms.[5] This shows that family businesses account for 65% of firms with no employees.

[4] "A Family Affair; Today's Family Businesses", Barclays, 2002
[5] Firms in the survey are asked:" Is your business a family-owned business?"

Table 1: Number of family businesses

1	2	3	4	5	6
Type of firm	**No. of employees**	**No. of all firms start-2006**	**No. of all firms start-2007**	**% of firms that are family-owned**	**No. of family firms start-2007**
Micro	0	3,262,715	3,365,999	65	2,187,900
	1-9	1,005,535	1,025,535	67	687,108
Other small	10-49	165,980	171,141	58	99,262
Medium	50-249	26,530	26,490	45	11,921
Large	250+	5,940	5,910	19	1,123
Total		**4,466,700**	**4,595,075**	**65**	**2,987,313**

Of course, businesses with no employees clearly do not qualify for the title of family firm by paying other family members to work for the company. Instead, some members of the family might work informally and on an unpaid basis for the business. Or the sole trader might intend to get other members of the family involved once the firm becomes large enough to do so. Alternatively, they might consider the firm to be a family business because they intend to pass the business onto a family member when they retire.

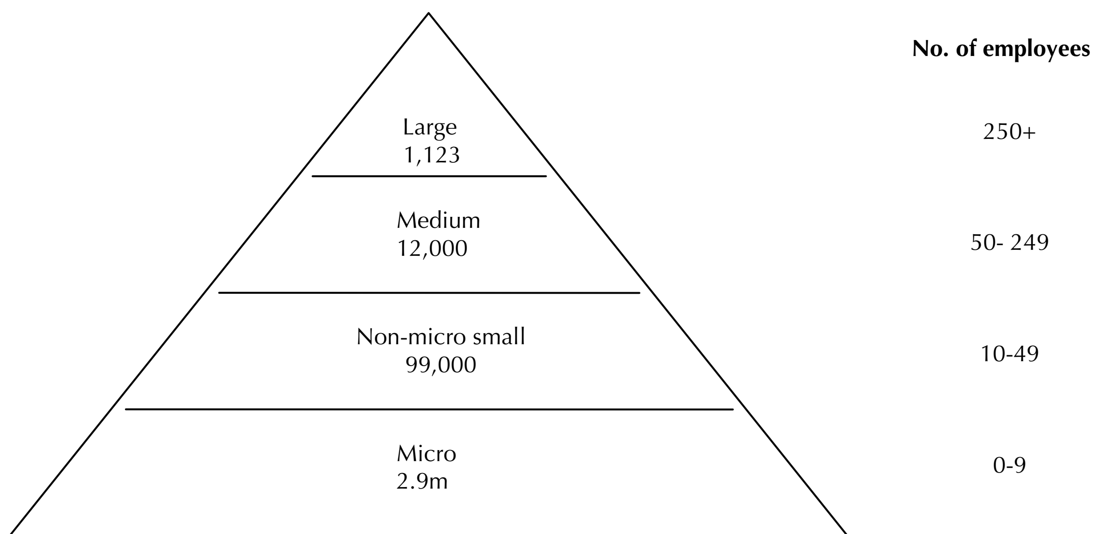
The survey also shows that family businesses account for 67% of firms with between 1 and 9 employees. This proportion falls to 58% of small firms with between 10 and 49 employees and to 45% for medium-sized companies (with 50 to 249 employees).

As for large firms (with over 250 employees), Julian Franks, Paulo Volpin and Hannes Wagner of London Business School have analysed the 700 or so biggest private and listed firms in the UK and found that 19% are family-owned.[6]

Column 6 then multiplies the proportion of firms which are family-owned/controlled by the number of businesses in each size-group, giving an estimate of the total number of family businesses at the start of 2007. We estimate there to be around 2.2m family businesses with no employees and around 0.7m with between 1 and 9 employees, making a total in the micro business sector of 2.9m. (See Diagram 1.) An additional 100,000 or so small firms with between 10 and 50 employees and 12,000 medium-sized firms take the total number of family firms in the SME sector to just below 3m. Including the 1,100 or so large family firms takes the total number of family businesses to 2,987,000.

[6] The 711 biggest companies were analysed (having excluded subsidiaries of companies appearing higher up the list). We cross-checked this estimate using Bureau van Dijk's FAME database, which allows all companies to be searched according to whether one named individual or family holds at least 50% of the company's shares. Around 14% of large firms with over 250 employees in the FAME database fulfilled this criterion, reassuringly close to the estimate of Franks et al.

Diagram 1: Number of family businesses by size of firm



3.2 The turnover, employment & contribution to GDP of family firms

We use a similar process to estimate the turnover and employment of family firms and find that while family businesses account for 65% of the total number of private sector enterprises, they account for a smaller – but still significant - 38.2% of turnover and 41.9% of employment in the private sector. (See Table 2.)

This reflects two factors. First, and most importantly, family ownership is less common among larger firms. Second, any given large firm is likely to have a slightly lower level of turnover and employment if it is in family hands than if it is non-family owned. While Franks et al. found that family firms accounted for 19% of the 711 biggest firms, family firms accounted for a slightly smaller 16% of the total turnover. This may be because growing a firm tends to be a bigger priority for non-family than family firms. (For SMEs, we assume that the average turnover of a family firm is the same as that of a non-family firm.)

Table 2: Turnover & employment of family firms

Type of firm	No. of employees	No. of family firms (mn)	Turnover of family firms[7] (£mn)	Employment of family firms (mn)
Micro	0	2.19	144,827	2.38
	1-9	0.69	281,414	2.52
Other small	10-49	0.10	241,850	1.94
Medium	50-249	0.01	186,915	1.18
Large	250+	>0.01	210,764	1.49
Total		**2.99**	**1,065,771**	**9.51**
As a % of all private sector		**65.0**	**38.2**	**41.9**

There is no breakdown, to our knowledge, of the contribution to gross domestic product (GDP) of different sized firms. However, figures from BERR and the ONS suggest that the contribution of the total SME sector to private sector turnover is a good guide to its share of private sector GDP. For example, figures for 2004, the latest available, indicate that SMEs accounted for 51.3% (or £1,231bn) of the total £2,400bn turnover in the private sector and an almost identical 51.1% (or £496bn) of the total £970bn private sector GDP in 2004.

We therefore assume that the contribution of family firms to private-sector turnover is also a good guide to its share of private sector GDP. Given our estimate in Table 2 that family firms account for around 38% of private sector turnover, this would mean that family firms accounted for about £407bn of the total £1,000bn private sector GDP in 2006 and are set to contribute £430bn in 2007.[8] It would also mean that they account for about 31% of the £1,300bn of GDP in the whole economy (i.e. in the public as well as private sector).

This makes the family business sector a more important contributor to economic activity than private equity-backed firms. The British Venture Capital Association has estimated that private equity-backed companies generate annual sales of around £425bn and account for 2.8mn employees – compared to the £1,065bn of turnover and 9.5mn employees of the family business sector. Meanwhile, the family business sector is broadly as important to the economy as the 700 biggest quoted companies (i.e. the FTSE All-Share). Analysis

[7] The DTI's figures on turnover in the private sector used to construct this table exclude the financial sector due to measurement difficulties. Accordingly, these figures do not include turnover of family firms in the financial sector. If family firms are less prevalent in the financial sector than in other sectors, this means that 38.2% is a slight overestimate of the proportion of private sector turnover accounted for by the family sector.

[8] Similarly, if family firms are less prevalent in the financial sector than elsewhere in the economy, 38.2% could be a slight overestimate of the proportion of private sector GDP accounted for by the family sector. Even if *none* of the financial sector was family-owned, however, family firms would still account for around 34.5% of private sector GDP.

of the FAME database suggests that the top 700 quoted companies have a turnover of around £1,200bn and employment of around 7.5mn. (See Table 3.)

Table 3: Turnover & employment of family firms compared to other sectors (Sources: BVCA & FAME database)

Type of firm	Turnover (£bn)	No. of employees (mn)
Family firms	1,065	9.5
Private-equity backed firms	425	2.8
Top 700 quoted companies (FTSE All-Share)	1,200	7.5

3.3 Family firms by legal status

Table 4 gives more information on the legal status of family firms. We have used DTI data showing the breakdown, by the number of employees and legal status, of the number of firms in the private sector as a whole. We have then applied these proportions to our estimates of the number and turnover of family businesses. The table shows both the number in millions and the percentage of family firms accounted for by sole traders, partnerships and companies. The majority - 56% of family firms - are sole traders with no employees.

Table 4: Number of family firms by size & legal status

Type of firm	No. of employees	Legal status						Total
		Sole Traders		Partnerships		Incorporated companies		
		mn	% of total	mn	% of total	mn	% of total	**mn**
Micro	0	1.67	56.0	0.21	7.1	0.30	10.1	**2.19**
	1-9	0.21	7.0	0.11	3.7	0.37	12.3	**0.69**
Other small	10-49	0.01	0.3	0.02	0.5	0.08	2.5	**0.10**
Medium	50-249	<0.01	<0.1	<0.01	<0.1	0.01	0.4	**0.01**
Large	250+	<0.01	<0.1	<0.01	<0.1	<0.01	<0.1	**<0.01**
Total		**1.89**	**63.3**	**0.34**	**11.3**	**0.76**	**25.4**	**2.99**

Lack of data means that we have to assume that a family firm with a given number of employees has the same likelihood of being a particular legal status as all firms in that size-group. But the penetration of family

firms across types of legal status might differ to other firms. So if family businesses are less likely than non-family businesses to incorporate, Table 4 will overestimate the share of family firms which are companies.

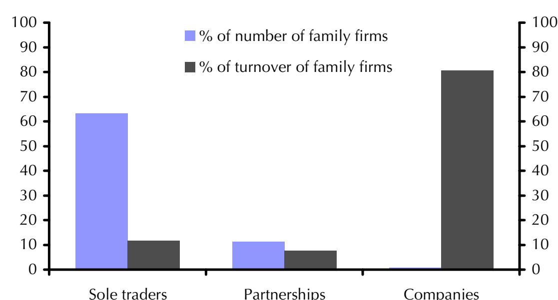
Table 5 uses a similar method to show what amount and proportion (the latter shown in bold) of turnover in the family business sector each type of business accounts for.

Table 5: Turnover of family firms by size & legal status

Type of firm	No. of employees	Legal status						Total
		Sole Traders		Partnerships		Incorporated companies		
		£mn	% of total	£mn	% of total	£mn	% of total	**£mn**
Micro	0	70,045	6.6	17,699	1.7	57,083	5.4	**144,827**
	1-9	46,778	4.4	37,903	3.6	196,734	18.5	**281,414**
Other small	10-49	7,596	0.7	19,583	1.8	214,671	20.1	**241,850**
Medium	50-249	680	0.1	4,470	0.4	181,765	17.1	**186,915**
Large	250+	128	<0.1	1,284	0.1	209,351	19.6	**210,764**
Total		**125,228**	**11.7**	**80,940**	**7.6**	**859,604**	**80.7**	**1,065,771**

Sole traders with no employees account for the majority of firms, but for only 7% of turnover. Incorporated companies are clearly the main contributor to activity in the family business sector, representing 81% of turnover. Chart 2 highlights the difference between the breakdown of the family business sector by legal status when looking at turnover as opposed to the number of firms.

Chart 2: Breakdown of family business by legal status



The 760,000 incorporated companies we estimate to be family-owned (shown in Table 5) include both private and publicly quoted companies. Indeed, a significant proportion of quoted companies are family-owned. A study by Manchester Business School, commissioned by the Institute for Family Business, found that 42 of the 673 FTSE All-share companies were family companies.[9] However, the study also found that family firms make up a smaller proportion of all quoted companies when it comes to market capitalisation. (See Table 6.) For example, while family firms accounted for 10% of the number of firms on the FTSE 100, they accounted for only 3.8% of market capitalisation. This supports the evidence discussed earlier that large family firms tend to have a lower level of turnover than large firms as a whole.

Table 6: Proportion of quoted companies that are family companies

Stockmarket	Family firms as a % of total number of firms	Family firms as a % of total capitalisation
FTSE 100	10.0	3.8
FTSE 250	5.2	3.7
FTSE Smallcap	5.9	6.1

3.4 Change in the size of the sector

There are good reasons why the degree of family control within a family business declines over time. First, as companies get bigger, family firms are more likely to tap into external funds, including public equity markets, in order to finance growth and acquisitions, thus diluting family control.

Second, family firms often run into problems when it comes to succession, namely the change of ownership of a firm because the owners wish to retire or exit the business. In section 2.3, we pointed out that only around a third of firms get passed onto the second generation.

Third, the tax regime could encourage families to sell their firm and unlock the funds. Capital gains tax taper relief (which is proposed to end in 2008) has reduced the effective rate of capital gains tax on investments held for at least two years from the headline rate of 40% to just 10%.

The relative size of the sector within the economy might be constrained if growing the firm is a lower priority for family firms than other firms. Surveys of family firms tend to show that the families are more focused on simply surviving than on growing the company. According to Barclays, six times more family businesses than non-family businesses are happy to continue running the business as it is at present.

[9] "The UK Family Business PLC Economy," Dr. Panikkos Poutziouris, Manchester Business School, 2006

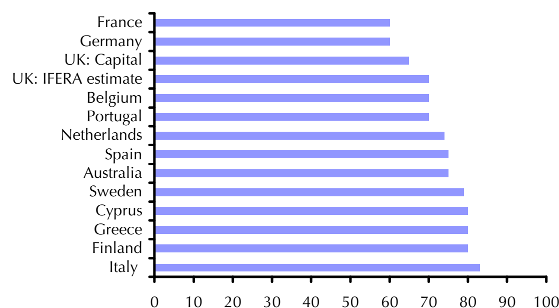
Of course, even if *existing* family businesses grow relatively slowly, this could be offset by the creation of *new* ones. That said, the long-term structural shift in the composition of the UK economy from agriculture and manufacturing to services, particularly business and financial services, is not particularly conducive to the creation of family businesses. As explained in section 2.2, family firms are under-represented in the financial sector.

Meanwhile, the recent health and stability of the economy could have reduced the incentive to create family firms. With unemployment close to historically low levels, the relative ease with which people can find employment elsewhere might have discouraged them from taking the risk of starting their own family business.

3.5 International comparisons

The UK has fairly low levels of family ownership compared with those abroad. The International Family Enterprise Research Academy (IFERA) published in 2003 an estimate of the share of family enterprises in all firms in various countries. As Chart 3 shows, the UK is towards the lower end of estimates. A similar pattern is seen in studies which have examined the quoted company sector on its own.

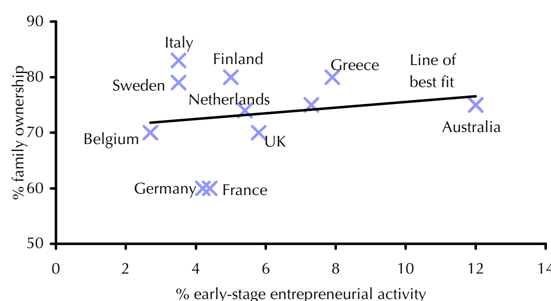
Chart 3: International comparison of family ownership (number of family firms as a % of total, IFERA data)



Family ownership is high in Scandinavian countries and notably low in France and Germany. According to the IFERA figures, 60% of firms in France and Germany are family-owned, compared to 70% in the UK.

Family ownership appears to be well correlated with the level of entrepreneurial activity. Chart 4 plots the degree of family ownership in different countries against the prevalence of early-stage entrepreneurial activity (as measured by the 2006 Global Entrepreneurship Monitor) and shows that there is a positive correlation between the two. The chart suggests that the relatively modest level of entrepreneurial activity in the UK has acted as somewhat of a constraint on the development of its family business sector.

Chart 4: International comparison of family ownership & entrepreneurial activity (IFERA & GEM)



The relatively low level of family ownership in the UK is still surprising, given that in many respects the UK has a more supportive tax system for family businesses (although the tax regimes in some other European countries have recently become more generous, with Sweden, for example, abolishing inheritance tax within the past few years). The UK's low family ownership might therefore instead be due to its more developed financial sector, with Franks et al. (2004) suggesting that it might reflect the UK corporate sector's greater ability to raise outside capital.[10] Alternatively, it might reflect the historical impact of the UK's previously punitive tax regime that included a high rate of inheritance tax.

4. The wider contribution of the family business sector to the economy

The influence of the family business sector on the economy extends beyond its contribution to output and employment. Family firms also provide a launch-pad for entrepreneurial start-ups, contribute to tax revenues and potentially boost both the performance and stability of the corporate sector.

4.1 A breeding ground for start-ups

A crucial way in which the family business sector helps the economy is via its role in supporting companies in their early stage of development. In particular, entrepreneurial start-ups usually begin their life as family businesses.[11] Barclays Brothers, owners of Littlewoods and the Daily Telegraph, began life as a sibling-owned partnership, with the second generation now involved in the business too.

Start-ups are crucial for the economy in a number of ways. First, they introduce new competition to the market, spurring other companies to improve efficiency and become more innovative. Start-ups also boost

[10] Franks, Mayer & Rossi, "Spending Less Time with the Family: the Decline of Family Ownership in the UK", London Business School, 2004

[11] Global Entrepreneurship Monitor, Family Business Specialist Summary, 2006

productivity growth directly through their introduction of new ideas, technologies and working practices. Of course, large firms innovate too. But the incentive to innovate may be greater for start-ups, where an individual probably gets a greater share of any returns from an invention or new idea than in a large firm.

Meanwhile, family firms are also an important source of spin-offs; a Global Entrepreneurship Monitor (GEM) on family business[12] found that 13% of family firms surveyed had developed out of existing family firms. This could be because it is easier to use finance from a family firm than generate external finance; GEM showed that family-based start-ups are better funded, using twice the amount of initial finance compared with non-family start-ups.

4.2. Contribution to tax revenues

A further way in which family firms contribute to the economy is via their tax payments. The type of tax contributed by family firms will clearly differ according to the category of firm. Family-owned sole-traders, for example, primarily pay income tax. Corporates, on the other hand, primarily pay corporation tax.

Looking first at the tax paid by SMEs, there will clearly be a very wide range in the tax paid by individual companies. Nonetheless, Manchester Business School has undertaken research to produce estimates of the average tax bill of a typical sole trader or partnership and of a typical small limited company.[13] Charts 5 and 6 show the breakdown of these average tax bills. Income and corporation tax are not the only tax payments family firms make; for example, they will also pay employers' national insurance contributions (NICs) and business rates.

Charts 5 and 6 include the tax collected by the firm for the Chancellor from employees, namely employees' income tax deducted via pay as you earn and employees' NICs. Strictly speaking, these are taxes collected, rather than actually borne, by the company, in that they are not actually part of the company's costs. However, to the extent that the Government would not be receiving these tax revenues were it not for the family firm giving employment to these workers, employees' income tax and NICs are also tax revenues attributable to the existence of the family firm sector.

[12] Ibid.

[13] "The Chancellor's Last Budget Statement: Politics or Economics? An evaluation of the likely impact on SMEs of Budget 2007," F. Chittenden and B. Sloan, May 2007, available at http://www.mbs.ac.uk/research/documents/MBSPostBudgetReportMay2007.pdf. The main sources of data used by the report are the FAME database for incorporated firms and the Family Resources Survey and anonymous business bank account data from Barclays Bank for unincorporated firms.

Chart 5: Average tax paid by a sole trader/partnership (% of average £4,900 total)[14]

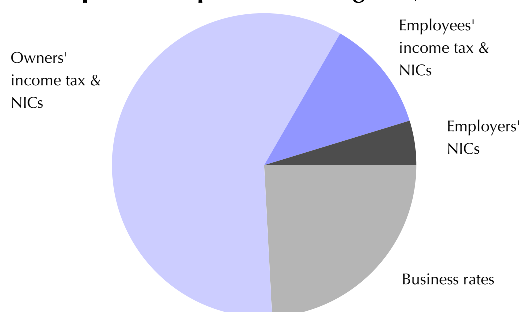
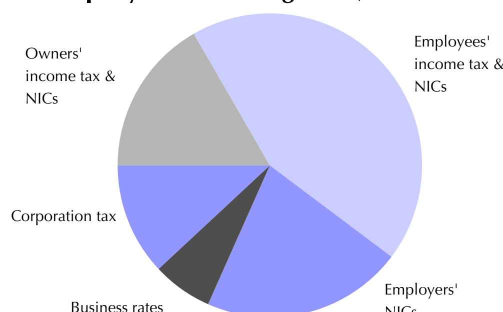


Chart 6: Average tax paid by a small limited company (% of average £57,000 total)[14]



Manchester Business School estimates that the taxes borne by sole traders and partnerships average £4,300 a year.[15] Including employees' income tax and NICs raises this to £4,900. Other small limited companies contribute on average £33,000, or £57,000 once employees' taxes are included.[16] In Table 4, we estimated that there are around 2.2 million family sole traders and partnerships and 760,000 small and medium-sized limited companies. Accordingly, we estimate that family SMEs provide the Chancellor with around £54.5bn of taxes per annum, £10.9bn from sole traders and partnerships and £43.2bn from small and medium-sized companies. (See Table 7.)

As for large companies, a survey commissioned from PricewaterhouseCoopers by The Hundred Group found that for every £1 of corporation tax paid by the largest 100 or so companies last year, a further £1 was spent on other business taxes, including business rates and employers' NICs.[17] Another £1 on top of that was collected by the firm in the form of employees' income tax and NICs. On average, total taxes borne for these largest companies amounted to 5.9% of a firms' turnover, or almost 9% once employees' taxes are included. Applying this proportion to our estimate of the turnover of large family incorporated companies suggests that large family companies provide the Chancellor with around £19bn in tax each year.[18]

[14] Adapted from Chittenden & Sloan.
[15] Chittenden & Sloan.
[16] Tax compliance costs sole traders/partnerships a further £600 and other small limited companies £1,900 on average.
[17] "Total Tax Contribution," PricewaterhouseCoopers LLP 2006 survey for the Hundred Group
[18] This does not include non-employment taxes collected by firms, such as value added tax or fuel and tobacco duties.

Table 7: Contribution to tax revenues from family firms

	Taxes borne by family firms (£bn)	Employees' taxes collected by family firms (£bn)	Total (£bn)
Sole traders & partnerships	9.6	1.3	10.9
Small & medium sized limited companies	24.7	18.5	43.2
Large incorporated companies	12.4	6.5	18.8
Total	**46.7**	**26.3**	**73.0**

Overall, we estimate the contribution of the family business sector to the Exchequer to be in the region of £73bn per annum, equivalent to 15% of the total £485bn tax received by the Chancellor from all sources in 2006/07.

4.3 The relative performance of family firms

Family businesses might also be a positive force when it comes to the performance of the corporate sector in terms of productivity and profitability. In theory, there are a number of reasons why family-owned businesses might perform better than non family-owned businesses:

- By aligning the interests of managers and owners, family firms incentivise managers to achieve the company's goals. This overcomes the principal-agent problem, whereby managers might pursue their own interests to the detriment of shareholders' interest.
- Family firms may enjoy greater loyalty from staff members, who are motivated to build up the reputation of the family brandname. Survey evidence suggests that a higher proportion of employees in family firms than in non-family firms feel loyal to their organisation.[19]
- Family firms are more likely to invest for the long-term and focus on long-run returns, rather than quarterly results. There is evidence that families tend to draw smaller salaries and dividends, allowing more profits to be re-invested back into the business.[20] Family firms may be willing to wait longer than most other investors for a return from capital invested – so-called "patient capital". It has also been argued that family businesses are more prepared than other firms to continue investing

[19] Results taken from the Workplace Employment Relations Survey and supplied by Professor Stanley Siebert of Birmingham University Business School. 74% of workers in family-owned firms who earned more than £285 per week strongly agreed with the statement "I feel loyal to my organisation" compared with 70% in non family-owned firms.
[20] Coutts 2005 Family Business Survey: Are family businesses better prepared than other businesses to compete in the future?"

during cyclical downturns, giving them an advantage over other quoted and private equity owned firms where investment tends to follow cashflow more closely.[21]

- By offering more flexible working practices, family firms can recruit from a wider pool of labour than other firms. For example, family firms are more likely to have females on the board, particularly in the role of Chief Executive Officer.[22] This has the added bonus for the economy of boosting diversity in the workplace, as well as raising the proportion of the population in the workforce and increasing the economy's potential growth rate.
- Family members working for the business will probably stay for longer than staff in non-family firms and therefore gain more firm-specific expertise and lower the productivity losses of high rates of staff turnover. Family firms have a higher incentive to invest in staff training if they are more certain that the staff will stay long enough to make the investment worthwhile. One study of family firms found that the average length of service for the Chief Executive was 35 years.[23]
- Family firms take corporate social responsibility more seriously. This may partly reflect the fact that they tend to be small firms and therefore build up local relationships and goodwill with suppliers and customers.
- Family firms may have a more flexible approach to management and use a centralised decision process to enable quicker decision-making.

That is not to say that there are no disadvantages. Some of the criticisms levelled at the family business model, fairly or unfairly, include:

- If family firms recruit from family members only, the level of skill coming into the business can be sharply reduced. A nepotistic recruitment strategy can also discourage talented people who are not family members from seeking work at a family firm and adversely affect performance.[24] A recent PricewaterhouseCoopers survey of family businesses showed that only 22% have established criteria for choosing which family members can play an active role in the business.[25]

[21] "Trust as a competitive advantage: why family firms have an edge in the global marketplace," Baskin, 2001.
[22] Coutts 2005
[23] Herman Simon, "Hidden Champions," 2004
[24] "Measuring and Explaining Management Practices Across Firms and Countries," CEP Discussion Paper No. 716, Nick Bloom & John van Reenen, March 2006
[25] "Making a difference: The PricewaterhouseCoopers Family Business Survey 2007/08," November 2007.

- A reluctance to bring in outsiders, such as non-executive directors in larger firms, can hamper the use of external knowledge and lead to weakness in corporate governance.
- Family firms may lack professionalism and be reluctant to change and embrace new technology. They may cling to the management styles or strategies of previous generations and fail to adapt to new market challenges.
- Family conflicts, such as divorce and infighting, might disrupt the business.
- A reluctance to dilute control may hamper a family firm's growth.
- A family firm might suffer from a conflict between financial and non-financial (e.g. lifestyle-enhancing) objectives.

There is an ongoing debate as to whether these disadvantages outweigh the advantages or not, with the empirical evidence on the relative performance of family firms fairly mixed. At the very least, however, it seems to suggest that family businesses tend to do at least as well as non-family businesses.

There is also some evidence to suggest that family businesses tend to perform *better*. Perhaps most persuasive is research on the superior performance of the share prices of quoted family firms. This was first documented in the early 1990s by a Stoy Hayward study carried out by the London Business School, which showed that over a 20 year period, the group of family controlled public limited companies on the stock exchange outperformed the overall index by nearly 30%.[26] More recent research commissioned by Thomson Financial in 2005 showed that family firms outperformed across Europe[27]. Meanwhile, Manchester Business School created a Family Business Index of publicly quoted family firms, which outperformed the FTSE All-Share by 40% over 1995 to 2005.[28]

Admittedly, as discussed in section 3.4, family firms can be more conservative when it comes to growing their company beyond a certain size. However, the flipside to this arguably more risk-averse strategy is that family firms tend to survive for longer and therefore promote a more stable business sector and job security. Family businesses are likely to be older than non-family businesses. The DTI survey of SMEs, for example, showed that family firms are more likely than non-family firms to be at least ten years old. Meanwhile, age-analysis of the FTSE has shown that family companies tend to be older than their widely-owned FTSE peers.

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[26] "Managing the family business in the UK: Stoy Hayward Survey in conjunction with the London Business School," 1990
[27] Newsweek article "Best of the Best" published on 12th April 2005
[28] Ibid

5. The business & tax environment for family business

The policy environment has generally tended to be fairly supportive for family business. Indeed, a recent German study put the UK top out of 14 countries in a ranking of the location-specific conditions relevant for family businesses. The relative attractiveness of taxes, regulation, financing and labour costs was considered.[29]

Perhaps the most important policy development in recent years was the introduction of 50% business property relief (BPR) in 1987, increased to 100% in 1992, which exempted the transfer of most business properties from inheritance tax.

Since then, government legislation has been broadly supportive of the SME sector – where family firms are concentrated – as a whole. Table 8 shows some of the main measures which have been introduced in the last few years to help small and medium-sized firms. These include the introduction of capital allowances and a research and development (R&D) tax credit, as well as a reduction in the length of time business assets must be held before they are eligible for capital gains tax taper relief to just two years.

Table 8: Recent government measures to support SMEs

1997 onwards	Capital allowances introduced and subsequently made permanent which allow the cost of capital assets to be written off against taxable profits.
1998 onwards	Gradual reduction in the length of time business assets must be held for before they are eligible for capital gains tax taper relief.
2000	R&D tax credit introduced, which allows companies to deduct up to 150% of qualifying expenditure of R&D when calculating taxable profits.
2000	Enterprise Management Incentives Scheme, introducing tax-advantaged share options in order to help small firms recruit by offering tax free incentives to employees.

Some of the more negative measures include the rise in the corporate tax rate for small business from 18% to 21% in the 2007 Budget, although the headline rate for all other companies was cut from 30% to 28%. The 2007 Pre-Budget Report also contained some potentially damaging proposals. For a start, the Treasury plans to ban "income-shifting" whereby couples in family businesses split their income in a way that ensures that one of them pays a lower rate of tax on that income. This is expected to net the Treasury - and therefore cost family businesses - £475m in revenue between 2008 and 2011. Meanwhile, the Treasury plans to cut the

[29] Stiftung Familienunternehmen, "Competitiveness Report for Family Enterprises," 2007

headline rate of Capital Gains Tax in April from 40% to 18%. But it also plans to abolish the taper relief rate of 10% for investments held for more than two years, getting family business caught up in the crossfire as the Chancellor attempts to tackle criticism of low tax rates on private equity profits.

In terms of potential improvements to the business and tax regime for family firms, the following are common demands:

- Extend the scope of BPR, in particular to quoted companies. Shares in a quoted company qualify for 50% BPR, but only if more than 50% of the voting rights are held by the family or individual. Accordingly, there is potential for BPR to be extended in this area in order to help bigger firms to continue to grow under family ownership, as well as remove the disincentive for family firms to list their companies. Furthermore, the rules could be adapted to deal more fairly with joint venture interests.
- Preserve the tax status of business asset holdover relief. For capital gains purposes, BAHR is a postponement of an immediate charge to capital gains tax on the disposal of business assets by way of transfer of shares to the next generation. Ensuring that the availability of BAHR is not compromised by any changes to the CGT regime is crucial to ensuring that the intergenerational transfer of family business ownership can occur without impinging on the business' assets.
- Less red-tape. Family businesses are disproportionately concentrated in small firms, where the cost of tax compliance is relatively high. Manchester Business School has estimated that the overall tax bill of a sole trader or partnership is 10% of that of a small limited company, but that the tax compliance costs for a sole trader or partnership are around 36% of those of a small limited company. Furthermore, according to the PwC Family Business Survey, some 61% of family firms put government policy regulation and legislation as one of the top three challenges affecting their company over the next 12 months. Simplification of the tax system could help; a recent report by the Public Accounts Committee, for example proposed that start-ups should no longer be required to register separately for each different tax.[30] Other improvements could involve reducing the amount of new employment legislation, which can discourage family firms from taking on more staff, or increasing the exemptions for small firms from new legislation.
- Greater government support for ownership succession. The DTI has estimated that around 30% of UK small businesses are subject to age-related transfer failure and close down. Meanwhile, the PwC

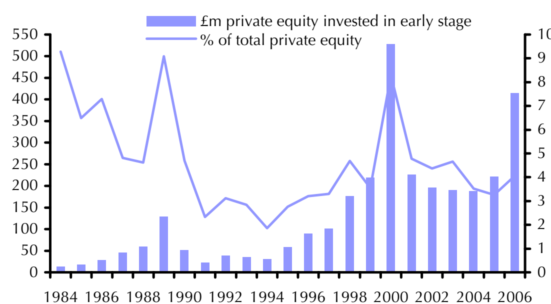
[30] House of Commons Committee of Public Accounts, "Helping newly registered businesses meet their tax obligations," July 2007.

Family Business Survey showed that of those family companies that anticipate a change of ownership within the next five years, only 47% have drafted succession plans. And succession will clearly become an even more important issue as the babyboom generation reaches retirement age over the next few years. We estimated the number of small family firms to be around 3 million. If we assume that a generation lasts for 30 years, this means that 100,000 small family firms leave a generation's control each year. Preventing the 30% or so of these that fail would boost the number of companies by 30,000 or 0.7% each year.

The simplest way in which the Government could improve succession rates would be to provide more information and raise awareness about the need for succession planning. It could also go one step further and provide actual assistance with business transfer planning or even help to match potential buyers and sellers.[31] Both France and Denmark, for example, have established internet-based market-places for buying and selling small and medium-sized enterprises.[32]

- Improve access to capital for growing firms. The absolute amount of private equity invested in early-stage firms in the SME sector has remained consistently low, as the sector has increasingly concentrated on larger later-stage deals. (See Chart 7.) This so-called "equity gap" might reflect the high fixed transaction costs associated with the provision of small amounts of capital or a shortage of potential exit options. The Government could therefore take steps to encourage greater private equity investment in family firms.

Chart 7: Private equity investment in early-stage companies (British Venture Capital Association)



[31] "Passing the baton – encouraging successful business transfers: Evidence and key stakeholder opinion," DTI Small Business Services, 2004

[32] "Entrepreneurship Action Plan," European Commission, 2006

Given that many family firms do not *want* to raise funds from institutional investors, an alternative policy would be to make it easier for them to raise "patient capital" from relatives. The Enterprise Investment Scheme was introduced to help smaller high-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchased new shares in the companies. However, relatives (other than siblings), including spouses, parents and children, are deemed "connected" to the company and are therefore not eligible for tax relief.

6. Conclusion

For those owning family firms, the attraction is clear. Greater staff loyalty, a more flexible lifestyle, a valuable heritage, a clearer incentive to see the business do well – the list of possible advantages are countless.

But the benefits extend far beyond the owners of family firms themselves. For a start, there are the jobs provided by family firms; around 9.5 million people are employed by family firms. And the greater willingness of family firms to invest for the long-run safeguards the future of these jobs – as well as bringing the promise of new ones. Meanwhile, a large part of the government's spending is financed by the £73 billion or so of tax revenues created by the family business sector.

It is not just individuals that benefit from the hive of activity in the family business sector. Non-family firms benefit from the innovation and new ideas, processes and technologies that family start-ups introduce to the corporate arena. In fact, given that most companies usually begin life as family firms, the UK owes the very existence of a robust corporate sector to the health of the family business sector.

With every two in three businesses owned or run by families, family firms are a linchpin of the UK economy. It is crucial to recognise the unique contribution of family firms to the long-term sustainable growth of the economy and therefore to ensure that the tax and policy regime remains supportive of the family business sector. Without it, the UK economy would be a poorer, slower growing and less entrepreneurial place.

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