

## **Small Business Owners' Perceptions and Experience of Regulation**

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### **ABSTRACT**

The view that excessive regulation constrains small business survival and growth has been a persistent theme within business and policy communities, despite the lack of a strong evidential base. Attention has focused on the disproportionate effect of legislation on small businesses, although recent studies have demonstrated that the actual effects of legislation are often relatively modest. This study extends previous work by contrasting small business owners' perceptions of the general regulatory regime with the actual effects of workplace regulation. Drawing from a large scale survey of small business owners in the UK, results demonstrate high levels of perceived dissatisfaction with the general regulatory regime. Dissatisfaction is not uniformly distributed across the small firms sector, but is mediated by sector, size and business age. Despite perceived dissatisfaction with the general regulatory regime, very few businesses report that they have been affected by recent employment legislation. Larger businesses were more likely than smaller businesses to report negative legislative effects. Moreover, regulatory demands appear to interact with competitive conditions, exacerbating their effect within intensely competitive sectors.

### **INTRODUCTION**

There have been long-standing and widespread concerns that regulation and 'red-tape' constitute excessive burdens on business (Sommers and Cole, 1985; Fairman and Yapp, 2005; van Stel and Stunnenberg, 2006). Early concerns about excessive regulation focused on the effect of red-tape in constraining small business growth. In the UK, three parliamentary White Papers published between 1985 and 1988 signaled the Conservative government's intention to reduce the administrative requirements of business in order to "release enterprise" (HMSO, 1985, 1986, 1988). The New Labour government, elected in 1997, has continued the commitment towards minimizing bureaucracy, establishing the Better Regulation Executive to reduce and remove regulation believed to constrain private enterprise. Despite these efforts, recent concerns have focused on the disproportionate costs to small firms in complying with regulatory and administrative demands (Bennett, 2006). Research suggests the existence of "severe diseconomies of scale" (Bennett, 2006) for small firms whose compliance costs are between two and ten times higher than large firms as costs per employee (Cressy, 2000; Poutziouris et al 2001, 2003).

The view that excessive regulation continues to stifle enterprise and constrain business growth is common across developed economies (OECD, 2001; Garibaldi et al, 2003; Massey, 2003). Chittenden et al's (2003) analysis of tax regulation in the US, UK, Australia and New Zealand argued that there was little evidence to suggest that long-standing government deregulation and simplification initiatives had reduced or even contained the burden of tax regulations facing small firms. An OECD survey of 8,000 businesses across eleven countries reported that red-tape accounted for 4% of annual company turnover, with small firms paying disproportionately higher compliance costs. Small businesses were found to be most critical of the general regulatory regime, in particular the consistency, flexibility, effectiveness, clarity and predictability of regulation (OECD, 2001).

Set against this broad context of concern regarding excessive regulation, has been an apparently conflicting policy development. Over the past twenty years, there has been a reorientation of labour market policy in developed economies away from passive, demand-oriented approaches in favour of an active supply-side approach (Mason et al, 2006). In the UK, this has been accompanied by a stream of employment law reform that has included the introduction of Working Time Regulations (1998), a National Minimum Wage (1999), Maternity and Parental Leave Regulations (1999) and the Part-Time Workers (prevention of less favourable treatment) Regulations (2000). Predictably, grave concerns were expressed by business lobby groups and employers organizations whose objections, underpinned by neo-liberal views of employment regulation, focused on 'perverse' inflexibilities, reductions in productivity and burdensome costs (Hurrell, 2005; Marlow, 2006).

The expectation that this stream of new employment legislation would place an additional regulatory burden and negatively affect small firms has been confounded by recent research. Studies of the impact of employment regulation in UK small firms have shown that the informal 'paternalistic' approach to employee relations is still largely intact (Atkinson and Curtis, 2004), that there is little principled opposition to extending employment rights (Harris, 2002) and that the actual effects "are quite rare" (Edward et al, 2004: 245). In a small-scale study of 18 case firms, Edwards et al (2004) identified four factors that explained why, given the prevailing concerns about excessive regulation, small businesses remained largely unaffected by employment legislation. Firstly, distinctions can be drawn between perceived potential effects and actual experience. Secondly, regulations are not uniformly perceived as being problematic, as some older laws (such as maternity leave) have become routinised. Thirdly, the effect of legislation is mediated by competitive conditions, which are more important influences on firm performance. Fourthly, as Vickers et al (2005) also suggested, a degree of informality tends to ease small firms' responses to regulation.

The study contributes to the debate regarding the effect of regulation on small business by exploring the perceptions and experiences of regulation among a large sample of small business owners in the UK. Particular attention was given to investigating whether the four factors identified by Edwards et al (2004) in their small-scale analysis of firms drawn from three industry sectors, could be found within a much larger sample of business owners operating in a variety of industry sectors.

## **METHODOLOGY**

Data for this study were drawn from a large-scale biennial survey of small business attitudes and opinions undertaken on behalf of the Federation of Small Businesses (FSB), a voluntary membership association of independent business owners in the UK. The sampling frame consisted of the FSB membership list. Questionnaires, designed by the research team, were distributed by the FSB mailing agency to 169,418 business owners in September 2005. In total, 18,939 usable responses were received by the November 2005 cut-off date, a response rate of 11.17%. Cost restrictions prevented follow-up mailings to boost response rates, and data protection restrictions on the mailing list prevented the research team from identifying and contacting non-respondents in order to investigate response bias. Without the option of conventional non-response bias tests, a comparison of early and late responses was used to test response bias. No significant differences between early and late responses were found across any of the variables typically used to describe the owners and the firms (age of owner, business entry mode, age of business, sales volume and VAT registration).

Perceptions of the general regulatory regime were measured using a Likert-type response scale for seven items: volume of legislation; complexity of legislation; rate of change; interpretation; inspection regime; enforcement regime; and compliance costs. The response scale measured responses from 'very satisfied' (1) to 'very dissatisfied' (5), was

supplemented by a 'not relevant' response category. The effect of specific legislation on the small business focused on six items of recent workplace legislation: the Disability Discrimination Act; Flexible Working legislation; Maternity Leave; Paternity Leave; Parental Leave; and Working Time regulations. Four self-reported measures were used: 'negatively affected' (1), 'not at all affected' (2), 'positively affected' (3), and 'not relevant' (4). See Carter et al (2006) for further details of the study's methodology and approach.

## RESULTS

### *1. Perceptions of the General Regulatory Regime*

As Table 1 shows, respondents reported high levels of perceived dissatisfaction with the general regulatory regime across all seven items. Over half of all business owners reported some level of dissatisfaction with the complexity of legislation (54%); the volume of legislation (53%); the rate of change (51%); and the cost of compliance (51%). Just under half of all business owners reported some level of dissatisfaction with interpreting legislation (48%), 31% were dissatisfied with the enforcement regime and 29% were dissatisfied with the inspection regime. These results can be contrasted with the very low levels of perceived satisfaction with the general regulatory regime (between 2% and 5% across the seven items) and substantial proportions of both neutral, 'not relevant' and non responses (between 43% and 68% across the seven items).

Two sectors, Financial Services and Hotels & Restaurants, registered particularly high levels of dissatisfaction with the general regulatory regime. These responses, particularly those from the Financial Services sector, were sufficiently distinctive to warrant further consideration. The Financial Services sector is subject to an atypically strict legislative regime centred on the Financial Services and Markets Act (2004), designed to protect investors. Similarly, the Hotels & Restaurants sector was subject to a new licensing regime that was being introduced around the time that the survey took place. With regard to the volume of legislation, 71% of Financial Services respondents reported dissatisfaction, compared with 52% across the total sample. Complexity and cost of compliance draw similarly high levels of dissatisfaction from Financial Services respondents (72% and 71% respectively, compared with 55% and 51% across the total sample). The rate of change (68%) and interpretation of legislation (65%) also drew significantly higher levels of dissatisfaction from the Financial Services sector than from across the total sample (51% and 49% respectively). Only two aspects of the general regulatory regime, inspection and enforcement, caused dissatisfaction among a minority of Financial Services respondents; however, even these attracted significantly higher levels of dissatisfaction among respondents within this sector, 44% and 47% respectively, compared with 29% and 31% across the total sample. The Hotels & Restaurants sector also registered higher than average levels of dissatisfaction with the general regulatory regime, particularly with regard to the volume, complexity, rate of change, interpretation and cost of compliance. Levels of dissatisfaction with the enforcement and inspection regime, although above average, were less marked within this sector.

A distinctive relationship emerged between levels of dissatisfaction with the general regulatory regime and business age. Small business owners become incrementally more dissatisfied with all of the elements of the general regulatory regime the longer they have been in business. As Table 2 shows, dissatisfaction with volume of legislation increased incrementally by years in business, from 32% of businesses less than one year old to 67% of businesses aged 30+ years. Similar incremental increases in levels of dissatisfaction were apparent within all of the other issues relating to legislation. Dissatisfaction with complexity of legislation increased incrementally from 38% among the youngest businesses to 68% among the oldest businesses; dissatisfaction with rate of legislative change increased from 33% to 63%; dissatisfaction with interpretation of legislation increased from 34% to 60%; and

dissatisfaction with cost of compliance increased from 36% to 65%. With regard to the inspection and enforcement regimes, dissatisfaction more than doubled between the youngest and oldest businesses, from 18% to 43% for the inspection regime and from 19% to 44% for the enforcement regime.

Dissatisfaction with the general regulatory regime and employment size is also mediated by business size. In essence, levels of dissatisfaction rise with employment size, measured by full-time equivalents (FTEs). Dissatisfaction with the volume of legislation, for example, was lowest among businesses with 0-1 FTE, 41% of whom reported dissatisfaction, rising incrementally by FTE size (2-4 FTEs 51% dissatisfied; 5-9 FTEs 64% dissatisfied; 10-49 FTEs 73% dissatisfied; 50-99 FTEs 80% dissatisfied; 100+ FTEs 87% dissatisfied). A trend of rising dissatisfaction by employment size was repeated across all seven aspects of the general regulatory regime.

## ***2. The Effect of Specific Legislation***

In contrast to the relatively high proportions of business owners reporting perceived dissatisfaction with the general regulatory regime, only a small minority have been affected by the recent swathe of workplace legislation. As Table 3 shows, only 9% of businesses reported that they had been negatively affected by Maternity Leave; 7% reported being negatively affected by the Disability Discrimination Act, Paternity Leave and the Working Time Regulations; and 5% reported being negatively affected by Flexible Working legislation and Parental Leave. In contrast, the vast majority of business owners reported either being unaffected by legislation, or that the legislation was not relevant or non-respondents, in proportions that varied from 89% for the Disability Discrimination Act to 94% for Parental Leave.

Interestingly, the impact of specific legislation is sometimes perceived as being positive rather than negative. The proportion of businesses that regarded employment legislation as having a positive effect ranged from 1% in the case of Parental Leave to 4% in the case of the Disability Discrimination Act (Table 3). It may be speculated that small business owners who adopt a positive reaction to legislation do so because it creates a 'level playing field', preventing unfair competition from businesses which cut costs by non-compliance.

Importantly, the effect of specific workplace legislation is mediated by size of business, measured by FTEs (Table 4). The majority of businesses are unaffected by employment legislation simply because they are very small and in many cases operate from home. But for a minority of larger businesses, particularly those with 10 or more employees, the effect of employment legislation is negative. For example, around 5% of businesses with 0-4 FTEs regard the Disability Discrimination Act as having had a negative effect on their business, but this proportion rises to 13% amongst businesses with 10-49 FTEs, 17% amongst businesses with 50-99 FTEs and 22% for businesses with 100 or more FTEs. In the case of Maternity Leave, Paternity Leave and the Working Time Regulation, more than one-third of businesses with over 50 employees report negative effects, compared with fewer than 5% of businesses with 0-4 FTEs (Table 4).

In terms of sector specific effects, the Financial Services sector contained the highest proportion of businesses reporting negative effects by almost all of the legislation listed in Table 3, followed by Business Services and Construction. Sectors with the smallest proportion of businesses negatively affected by employment legislation were Health and Social Work, Personal Services (both industries dominated by micro-sized and home-based businesses) and, perhaps surprisingly, Hotels and Restaurants. However, a considerable minority of businesses in the Hotels and Restaurants sector regarded employment legislation

as having a positive effect, in particular the Disability Discrimination Act, Paternity Leave and the Working Time Regulations.

## CONCLUSIONS

The results of this study demonstrate typically high levels of perceived dissatisfaction with the general regulatory regime. Interestingly, levels of dissatisfaction are not uniformly distributed across the small business sector, but are mediated by employment size, sector and business age. The incremental increase in dissatisfaction by business age suggests a growing intolerance of the general regulatory regime that may mask other business pressures including growing competitive intensity, liabilities of staleness and potential exit decisions. In contrast, very few businesses had actually experienced any effect following the introduction of a broad package of employment legislation.

These results appear to provide some empirical support for three of Edwards et al's (2004) four explanations as to why employment legislation does not damage small firms. Firstly, there is a clear difference between the perceived potential effects of the regulatory regime and the actual experience of workplace legislation. This upholds Edwards et al's (2004: 245) first explanation that perceptions of effects tend to be "broad and general, rather than reflections of concrete experience". Secondly, Edwards et al suggested that some legislation, such as Maternity Leave, had become routinized and its effects mitigated with age. However, the results of this study found no difference in the level of negative effects experienced by firms between older legislation (Maternity leave) and newer legislation such as Parental Leave or the Disability Discrimination Act. Indeed, the highest levels of negative effects were attributed to Maternity Leave, the oldest piece of legislation under scrutiny. Thirdly, Edwards et al argued that the effects of legislation depended upon the firm's competitive conditions. The results of this study showed marked sectoral differences, with Financial Services businesses in particular, reporting negative effects of legislation. Marked sectoral differences appear to uphold Edwards et al's (2004) view that regulations interact with sectoral conditions and may exacerbate competitive pressures. Finally, Edwards et al argued that informality eased responses within small firms. Contrary to the popular view that the smallest firms are the most negatively affected by regulation, the results of this study show that the negative effects of workplace legislation tend to increase with firm size. Smaller businesses tend to be the most informal and formality increases with business size. If business size can be used as a proxy for the degree of formality, then it can be argued that smaller businesses have a degree of informality that can ease their response to workplace legislation. In this regard, these results appear to uphold Edwards et al (2004) fourth explanation.

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**Table 1: Perceptions of Satisfaction with General Regulatory Regime**

	Not relevant %	Not ticked %	Very dissatisfied %	Dissatisfied %	Neutral %	Satisfied %	Very Satisfied %
Volume of legislation	10%	17%	30%	23%	18%	2%	1%
Complexity of legislation	9%	18%	32%	22%	16%	2%	1%
Rate of change of legislation	9%	19%	30%	21%	18%	1%	1%
Interpretation of legislation	9%	20%	27%	21%	19%	2%	1%
Inspection regime	12%	22%	15%	14%	34%	4%	1%
Enforcement regime	11%	22%	17%	14%	33%	3%	0%
Cost of compliance with legislation	10%	18%	31%	20%	18%	1%	1%

N = 18,939

**Table 2: Dissatisfaction with General Regulatory Regime by Years in Business**

	Volume of legislation %	Complexity of legislation %	Rate of change %	Interpretation %	Inspection regime %	Enforcement regime %	Cost of compliance %	None ticked %
<1 year	32	38	33	34	18	19	36	55
1-3 years	40	43	39	38	19	21	40	49
4-5 years	47	49	46	45	23	25	45	43
6-10 years	53	56	52	50	27	30	51	37
11-20 years	59	61	57	54	34	36	57	32
21-30 years	63	64	60	57	37	39	61	29
>30 years	67	68	63	60	43	44	65	26
Total	52	55	51	49	29	31	51	38

N = 18, 939



**Table 3: Effect of Specific Employment Legislation on Small Businesses**

	No Effect %	Negative Effect %	Positive Effect %	Not relevant %	Not ticked %
Disability Discrimination Act	66	7	4	11	12
Flexible Working	67	5	2	13	13
Maternity Leave	63	9	3	14	12
Paternity Leave	64	7	2	14	13
Parental Leave	65	5	1	14	14
Working Time	65	7	2	13	13

N = 18939

**Table 4: Effect of Specific Employment Legislation by Size of Firm (FTEs)**

	0 %	1 %	2-4 %	5-9 %	10-49 %	50-99 %	100+ %
<b>Disability Discrimination Act</b>							
Not at all/ No Response	89.9	90.4	89.9	85.8	80.5	72.5	69.9
Negative	5.6	4.7	5.8	9.1	12.7	16.9	22.2
Positive	4.5	4.9	4.2	5.1	6.8	10.7	7.9
<b>Flexible Working</b>							
Not at all/ No Response	95.5	97.1	96.1	90.4	80.6	71.6	60.0
Negative	2.4	1.6	2.3	6.7	14.0	21.1	40.0
Positive	2.0	1.4	1.6	2.9	5.4	7.3	0.0
<b>Maternity Leave</b>							
Not at all/ No Response	93.6	97.9	94.9	84.4	68.3	44.3	33.3
Negative	5.1	1.0	3.7	12.0	24.7	42.3	62.3
Positive	1.2	1.0	1.6	3.6	7.0	13.2	4.3
<b>Paternity Leave</b>							
Not at all/ No Response	96.0	98.2	96.9	89.9	72.1	52.5	46.9
Negative	3.1	0.9	2.2	8.0	22.6	37.8	48.4
Positive	0.9	0.9	1.0	2.5	5.3	9.5	4.7
<b>Parental Leave</b>							
Not at all/ No Response	96.5	98.2	96.9	91.6	81.0	65.9	49.2
Negative	2.8	0.9	2.0	6.7	15.7	29.3	47.6
Positive	0.7	0.9	0.7	1.7	3.3	4.8	3.2
<b>Working Time</b>							
Not at all/ No Response	93.6	95.9	95.3	88.1	75.1	53.3	42.2
Negative	4.5	2.8	3.6	9.2	20.8	38.7	50.7
Positive	1.8	1.3	1.1	2.8	4.1	8.0	7.0

N = 18,939