

**A CBI SURVEY:
THE IMPACT ON
SMALL AND MEDIUM SIZED ENTERPRISES OF
THE CREDIT CRUNCH AND PROPOSED
CHANGES TO CAPITAL GAINS TAX**



**CONDUCTED BY GfK NOP
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INTRODUCTION

The findings within this report have emerged from a CBI study of the current impact of, and views held on, the recent 'Credit Crunch' and changes in the Capital Gains Tax (CGT) regime.

The survey results are based on a total of 500 telephone interviews completed by owners or senior financial decision makers within small and medium sized (SME) UK enterprises (5-250 employees). 44% were members of the CBI, the other 56% a sample of the general UK SME population.

The fieldwork was conducted by GfK NOP between 6th and 14th November 2007. A marked-up questionnaire containing the full survey results is appended.



SAMPLE PROFILE

Please note that some of the figures below add up to 99% rather than 100% - this is due to rounding of the data.

No. of Employees:

| | |
|-------------|----------|
| Less than 5 | Excluded |
| 5-10 | 10% |
| 11-50 | 42% |
| 51-100 | 26% |
| 101-250 | 21% |
| 251+ | Excluded |

Respondents; all senior financial decision makers:

| | |
|--------------|-----|
| MD/CEO/Owner | 44% |
| Director | 46% |
| Other | 10% |

Equity owners within their business:

| | |
|-----|--|
| Yes | 61% (Owners/majority shareholders more prevalent in smaller companies) |
| No | 38% |

Length of investment (for those with equity):

| | |
|---------|-----|
| <5yrs | 29% |
| 6-10yrs | 17% |
| >10yrs | 53% |

Industry Sector:

| | |
|----------------------------------|-----|
| Manufacturing | 22% |
| Construction/Engineering | 13% |
| Financial Services | 5% |
| Hospitality/Travel/Leisure | 9% |
| Professional/Business Services | 25% |
| Retail | 9% |
| Technology/Media | 4% |
| Transport/Distribution/Utilities | 8% |
| Other | 5% |



SUMMARY OF MAIN FINDINGS

CREDIT CRUNCH

- There is clear evidence that credit conditions have tightened for SMEs since the summer. Overall, 35% of the sample reported either recent or anticipated deterioration in the availability of capital to their business. Those with equity in the firm were most concerned.
- At this stage, the effect looks to be relatively modest, with only a small number of companies seriously affected. The data indicates, however, that SME's expect a greater deterioration in the availability of capital in the future. 12% report some deterioration at this time, whereas 22% are expecting it in the next 3 months, and 31% next 6-12 months. Those companies currently affected believe that this is likely to continue.
- Though they have been the least affected so far, firms with 5-10 employees are more likely to believe a deterioration will occur in the future than their larger counterparts.
- Companies in the Financial Services sector have the highest expectation of a future deterioration in capital, most likely because of the effect that the credit crunch has already had on these organisations.
- For those reporting either actual or expected deterioration in the availability of capital, this has primarily been in the form of more stringent conditions being imposed by lenders (85%, or 30% of the total sample), and increased cost of finance (79%, or 28% of the total sample). This is true for both existing and new or renewed finance.
- Of those reporting or expecting deterioration, fewer report that either existing lines will be reduced or withdrawn (33% for existing finance/36% for new/renewed finance) or that less new finance will be available (60%). The survey suggests that the issue of the reduction or withdrawal of credit would be a more serious concern to companies than the cost of credit being increased or more stringent conditions being imposed by the lender.
- The smaller firms are more likely to have had existing lines of credit reduced or withdrawn. Of those reporting or expecting deterioration, 41% of companies with 5-50 employees reported that this had occurred, compared to 22% for those with 51-250 employees.

- The rise in the cost of borrowing on existing credit lines has been modest for most SME's. 78% of those affected (27% of the total sample) have seen their cost of borrowing rise by 0-50 basis points, and only 10% (3% of the total sample) by more than 50 basis points. A rise of more than 100 basis points was reported by 1% percent of respondents, in just four industry sectors: Financial Services, Hospitality/Travel/Leisure, Technology/Media, and Transport/Distribution/Utilities.
- The rise in the cost of borrowing has been slightly higher for new finance, with 65% of those reporting or expecting deterioration (23% of the total sample) having seen their cost of borrowing rise by 0-50 basis points, and 16% (5% of the total sample) by more than 50 basis points. A rise of over 100 basis points was reported by 2% of the sample, in 6 industry sectors – Manufacturing and Construction/Engineering in addition to those previously stated.
- All aspects of finance have seen changes to cost and availability; 58% of those who had experienced or were expecting a deterioration reported changes to cost and availability of working capital, 53% reported changes to finance for capital investment, 34% changes to finance for mergers/acquisitions (M&A). Whilst the proportion is lower for M&A as a smaller number of companies are involved at any one time, anecdotal evidence would suggest that the constraints on M&A finance are greater than elsewhere.
- Larger firms (101-250 employees) look to be the worst affected. Of those reporting or expecting deterioration, 69% had seen deterioration in working capital, 66% in finance for capital investment, and 34% in finance for acquisitions/mergers. Within the industry sectors it is Technology/Media firms who have reported the greatest changes, 83% had seen deterioration in working capital, 83% in finance for capital investment, and 50% in finance for acquisitions/mergers.
- 55% of affected respondents (19% of the total sample) say that changes in credit availability are affecting business decisions and plans. This is lowest for those companies in the 101-250 employee bracket (46%), and higher for those for whom the respondent has a significant equity stake in company (company owners 73%). For those reporting a significant deterioration in the availability of capital (up to 9% of the total sample), over 75% say this is altering business decisions and plans.
- Financial services companies are most likely to have had their operational or business plans change (71%), whereas the Technology/Media sector (33%), despite seeing the greatest changes to the cost and availability of finance, is least likely to expect to alter operational decisions or business plans.



- Where operational decisions or business plans have been changed, it is most likely to have been in finance for capital investment (60%).
- Of the 19% of the total sample saying operational decisions or business plans have been affected, effects are most felt in decisions on staff recruitment (a balance of -21% cutting back on hiring, and a further balance of 17% postponing), and output and inventory levels (a balance of -23% cutting output or stocks). Capital investment and mergers and acquisitions activity is currently more postponed than cut back.
- The larger SMEs (101-250 employees) are slightly more affected in terms of employment and output. Smaller firms are more likely to be postponing capital expenditure and mergers and acquisitions.
- Overall investment in training is least likely to have been decreased, perhaps indicating the realisation amongst SME's of the need to maximise available resources at this time.

CAPITAL GAINS TAX CHANGES

CGT questions were asked of all respondents, even though CGT personally affects only those with equity in their business. The aim was to pick up views of respondents on the CGT changes more broadly, though as might be expected, those more personally affected tended to be more negative about the impact of CGT on the SME sector than the sample as a whole.

- 61% of respondents owned equity within their business; of these owners and majority shareholders were more prevalent within the smaller businesses. For 53%, the majority of their funds had been invested for more than 10 years, 17% for 6-10 years, and 29% for 5 years or less.
- The impact of the Chancellor's Pre-Budget decision to change the CGT regime is predominantly seen as negative. Of the total sample population only 6% see a positive impact, 50% see no impact, and 40% see a negative impact.
- The impact is seen as significantly more negative by those who own equity in their business, 54% of these respondents seeing a negative impact, 34% seeing no impact, and 6% seeing a positive impact. 35% see a 'very negative' impact.
- There is a further increase in the percentage viewing these changes as negative amongst those who have owned equity within their business for more than 5 years. 62% of those respondents who have had the majority of their funds invested for 6-10 years, and 57% of those respondents who have been invested for over 10 years seeing a negative impact.
- 50% of respondents in the financial sector viewed the changes as negative, the highest percentage for any industry sector.
- 63% of respondents do not regard the CGT changes as a desirable simplification of the tax regime, with only 28% agreeing that they are. Again, respondents are least likely to see the benefits of the CGT changes if they have equity invested in their business, and even less so the longer this equity has been invested.
- Changes in all three key measures affecting business assets are seen as important. The abolition of taper relief is seen as important by 68% (for 41% it is 'highly important'), the change in marginal rate is also seen as important by 68% ('highly important' by 35%), and the abolition of indexation relief seen as important by 60% ('highly important' for 30%)

- A significant increase is seen in these figures when looking at those who own equity in their business. The abolition of taper relief is seen as important by 81% (for 56% 'highly important'), the change in marginal rate is also seen as important by 80% ('highly important' by 49%), and the abolition of indexation relief seen as important by 71% ('highly important' for 41%).
- Taper relief is seen as particularly important; of those saying CGT changes have been 'very negative' 85% cited taper relief as highly important.
- The changes to the CGT regime have had a significant impact on investment in business:
 - 43% of respondents indicated they would be altering investment in new business
 - 40% indicated that the changes would affect the divestment of their business
 - 36% were altering investment plans for their existing business
- Again, there has been significantly more impact for those with equity in their business:
 - 55% were altering investment in new business
 - 54% indicated that the changes would affect the divestment of their business
 - 47% were altering investment in their existing business
- Alteration in the levels of investment in existing and new businesses was most marked for the smallest and youngest businesses with the highest level of equity.
- Other areas that respondents raised as having been affected by the changes in CGT include a resulting lack of profits/returns when selling after years of investment. Other investments, such as property and saving, were also affected, as were retirement plans and pension funds.
- 30% of respondents believe they are likely to become less entrepreneurial as a result of the changes to CGT. This rises for those with equity (42%), affecting particularly those with investments of over 5 years (44%).
- There was a clear view of the government's policy on enterprise from respondents. 66% of respondents disagree that the government is fully committed to encouraging enterprise, 72% agree that the government's commitment to enterprise is in doubt, 70% that the changes to CGT have undermined the previous approach, and 93% that the government needs to do more to restore its commitment to an enterprise culture (only 6% of respondents disagreed with this statement while 61% strongly agreed).

CBI SME SURVEY NOVEMBER 2007 – MARKED UP QUESTIONNAIRE

- Final results based on a total of 500 telephone interviews completed by respondents, in the UK, who are owners or senior financial decision makers within small and medium size enterprises
- Fieldwork was conducted by GfK NOP between 6th-14th November 2007
- Unless otherwise stated, figures quoted are expressed in percentages based on the total number of responses (500).
- Please note that in some instances the figures presented may not add up to 100%. This is due to either the computer rounding of the figures or respondents being allowed to give multiple answers to a given question

INTRODUCTION/SCREENING SECTION:

QS1. What is your job title/function?

Base: All respondents (500)

| | % |
|------------------------|----|
| <i>Owner/Partner</i> | 11 |
| <i>MD/CEO/Chairman</i> | 33 |
| <i>Director/FD/CFO</i> | 46 |
| <i>Other (specify)</i> | 10 |

QS2. Currently, how many people do you employ?

Base: All respondents (500)

| | % |
|----------------|----|
| <i>5-10</i> | 10 |
| <i>11-50</i> | 42 |
| <i>51-100</i> | 26 |
| <i>101-250</i> | 21 |

SECTION ONE – ACCESS TO CAPITAL

Q1. Have you experienced any deterioration in the availability of capital for your business since the onset of the credit crunch?

IF YES: Has that been significant or modest?

Base: All respondents (500)

| | % |
|------------------------------------|----|
| <i>A significant deterioration</i> | 5 |
| <i>A modest deterioration</i> | 7 |
| <i>No change</i> | 88 |
| <i>Don't know</i> | 1 |

Q2. Do you expect to see any deterioration in the availability of capital to your business in the future?

Base: All respondents (500)

a) Over the next 3 months

| | % |
|------------------------------------|----|
| <i>A significant deterioration</i> | 7 |
| <i>A modest deterioration</i> | 15 |
| <i>No change</i> | 76 |
| <i>Don't know</i> | 2 |

b) Over the next 6-12 months

| | % |
|------------------------------------|----|
| <i>A significant deterioration</i> | 9 |
| <i>A modest deterioration</i> | 22 |
| <i>No change</i> | 64 |
| <i>Don't know</i> | 6 |

Q3. In which of the following ways is this deterioration in the availability of credit occurring, or do you expect it to occur for existing finance?

Base: All respondents indicating a deterioration in availability of capital (174)

a) For existing finance

| | % |
|--|----|
| <i>Increased cost of finance</i> | 76 |
| <i>More stringent conditions imposed by lender</i> | 82 |
| <i>Existing lines of credit reduced/withdrawn</i> | 33 |
| <i>Other</i> | 3 |
| <i>Don't know</i> | 5 |

b) For new or renewed finance

| | % |
|--|----|
| <i>Increased cost of finance</i> | 82 |
| <i>Lack of availability of finance</i> | 60 |
| <i>More stringent conditions imposed by lender</i> | 87 |
| <i>Previous lines of credit reduced/withdrawn</i> | 36 |
| <i>Other</i> | 1 |
| <i>Don't know</i> | 3 |

Q4. By how much has the cost of borrowing increased since the onset of the credit crunch?

Base: All respondents indicating a deterioration in availability of capital (174)

a) For existing credit lines

| | % |
|--------------------------------------|----|
| <i>By 0-50 basis points</i> | 78 |
| <i>By 51-100 basis points</i> | 7 |
| <i>By more than 100 basis points</i> | 3 |
| <i>Don't know</i> | 12 |

b) For new/renewed credit lines

| | % |
|--------------------------------------|----|
| <i>By 0-50 basis points</i> | 65 |
| <i>By 51-100 basis points</i> | 10 |
| <i>By more than 100 basis points</i> | 6 |
| <i>Don't know</i> | 20 |

Q5. In which of the following areas have the changes to the cost and availability of finance occurred?

Base: All respondents indicating a deterioration in availability of capital (174)

| | % |
|---------------------------------------|----|
| <i>Working capital</i> | 58 |
| <i>Finance for capital investment</i> | 53 |
| <i>Finance for acquisition/merger</i> | 34 |
| <i>Don't know</i> | 19 |

Q6. Have these changes altered, or do you expect them to alter, your operational decisions or business plans?

Base: All respondents indicating a deterioration in availability of capital (174)

| | % |
|-------------------|----|
| <i>Yes</i> | 55 |
| <i>No</i> | 44 |
| <i>Don't know</i> | 1 |

Q7a. We'd like to know in which of the following areas of activity you are changing your operations or business plans? For each category, please indicate how the operations or plans are affected, if at all, relative to before the credit crunch.

Base: All respondents indicating an alteration to operational decisions or business plans (96)

a) Staff numbers/recruitment

| | % |
|-------------------------|----|
| <i>Increasing</i> | 5 |
| <i>Decreasing</i> | 26 |
| <i>Postponing</i> | 19 |
| <i>Bringing forward</i> | 2 |
| <i>No change</i> | 48 |

b) Output & stock levels

| | % |
|-------------------------|----|
| <i>Increasing</i> | 11 |
| <i>Decreasing</i> | 34 |
| <i>Postponing</i> | 2 |
| <i>Bringing forward</i> | 1 |
| <i>No change</i> | 49 |
| <i>Don't know</i> | 2 |

c) Capital investment

| | % |
|-------------------------|----|
| <i>Increasing</i> | 11 |
| <i>Decreasing</i> | 29 |
| <i>Postponing</i> | 25 |
| <i>Bringing forward</i> | 1 |
| <i>No change</i> | 32 |
| <i>Don't know</i> | 1 |

d) Investment in training

| | % |
|-------------------------|----|
| <i>Increasing</i> | 13 |
| <i>Decreasing</i> | 19 |
| <i>Postponing</i> | 9 |
| <i>Bringing forward</i> | 0 |
| <i>No change</i> | 59 |

e) Mergers & acquisitions

| | % |
|-------------------------|----|
| <i>Increasing</i> | 5 |
| <i>Decreasing</i> | 9 |
| <i>Postponing</i> | 22 |
| <i>Bringing forward</i> | 2 |
| <i>No change</i> | 58 |
| <i>Don't know</i> | 4 |

SECTION 2 – PROPOSED CHANGES IN CAPITAL GAINS TAX

Q8. How much, if any, of the equity of your business do you own?

Base: All respondents (500)

| | % |
|---|----|
| <i>Owner of the business</i> | 17 |
| <i>Majority shareholder in the business</i> | 20 |
| <i>Significant minority shareholder (>20%)</i> | 11 |
| <i>Minority shareholder (<20%)</i> | 13 |
| <i>None</i> | 38 |
| <i>Refused</i> | 1 |

Q9. How long have the majority of your funds been invested?

Base: All respondents owning equity in their business (307)

| | % |
|---------------------------|----|
| <i>Less than 2 years</i> | 12 |
| <i>2-5 years</i> | 17 |
| <i>6-10 years</i> | 17 |
| <i>More than 10 years</i> | 53 |
| <i>DK</i> | 1 |

Q10. What has been the impact on you and your business of the Chancellor's Pre-Budget decision to change the Capital Gains Tax regime?

Base: All respondents (500)

| | % |
|--------------------------|----|
| <i>Very negative</i> | 24 |
| <i>Modestly negative</i> | 16 |
| <i>No impact</i> | 50 |
| <i>Modestly positive</i> | 4 |
| <i>Very positive</i> | 2 |
| <i>Don't know</i> | 4 |

Q11. Do you regard these changes as a desirable simplification of the tax regime?

Base: All respondents (500)

| | % |
|-------------------|----|
| <i>Yes</i> | 28 |
| <i>No</i> | 63 |
| <i>Don't know</i> | 9 |

Q12. Please indicate the importance of each of the following to you and your business plans. For each one please tell me if it is not important, somewhat important, or highly important.

Base: All respondents (500)

a) Change in the marginal rate to 18%

| | % |
|---------------------------|----|
| <i>Highly important</i> | 35 |
| <i>Somewhat important</i> | 33 |
| <i>Not important</i> | 32 |

b) Abolition of taper relief

| | % |
|---------------------------|----|
| <i>Highly important</i> | 41 |
| <i>Somewhat important</i> | 27 |
| <i>Not important</i> | 32 |

c) Abolition of indexation relief

| | % |
|---------------------------|----|
| <i>Highly important</i> | 30 |
| <i>Somewhat important</i> | 30 |
| <i>Not important</i> | 40 |

d) Impact on staff share schemes

| | % |
|---------------------------|----|
| <i>Highly important</i> | 15 |
| <i>Somewhat important</i> | 13 |
| <i>Not important</i> | 71 |

Q13a. How, if at all, will your future business plans be altered by the changes in capital gains tax in each of the following areas? For each one please tell me if they will be altered significantly, modestly, or there will be no changes at all.

Base: All respondents (500)

a) Investment in your existing business(es)

| | % |
|---------------------------------------|----|
| <i>Altered significantly</i> | 14 |
| <i>Altered modestly</i> | 23 |
| <i>There will be no change at all</i> | 64 |

b) Investment in new business(es)

| | % |
|---------------------------------------|----|
| <i>Altered significantly</i> | 19 |
| <i>Altered modestly</i> | 25 |
| <i>There will be no change at all</i> | 57 |

c) Divestment of business(es)

| | % |
|---------------------------------------|----|
| <i>Altered significantly</i> | 21 |
| <i>Altered modestly</i> | 20 |
| <i>There will be no change at all</i> | 60 |

Q14. Are you likely to be more or less entrepreneurial as a result of the changes to CGT?

Base: All respondents (500)

| | % |
|------------------|----|
| <i>More</i> | 8 |
| <i>Less</i> | 30 |
| <i>No change</i> | 62 |

Q15. Finally, please tell me to what extent you agree or disagree with each of the following statements on the government's commitment to enterprise?

Base: All respondents (500)

a) The government is fully committed to encouraging enterprise

| | % |
|--------------------------|----|
| <i>Strongly agree</i> | 2 |
| <i>Agree</i> | 29 |
| <i>Disagree</i> | 35 |
| <i>Strongly disagree</i> | 31 |
| <i>No opinion</i> | 2 |

b) The government's commitment to enterprise is in doubt

| | % |
|--------------------------|----|
| <i>Strongly agree</i> | 37 |
| <i>Agree</i> | 35 |
| <i>Disagree</i> | 23 |
| <i>Strongly disagree</i> | 3 |
| <i>No opinion</i> | 2 |

c) The changes to CGT have undermined the previous approach

| | % |
|--------------------------|----|
| <i>Strongly agree</i> | 37 |
| <i>Agree</i> | 33 |
| <i>Disagree</i> | 19 |
| <i>Strongly disagree</i> | 2 |
| <i>No opinion</i> | 9 |

d) The government needs to do more to restore confidence in its commitment to an enterprise culture

| | % |
|--------------------------|----|
| <i>Strongly agree</i> | 61 |
| <i>Agree</i> | 32 |
| <i>Disagree</i> | 5 |
| <i>Strongly disagree</i> | 1 |
| <i>No opinion</i> | 1 |

CLASSIFICATION SECTION

Q16. What is your company's primary product or service line (>25% of sales)?

Base: All respondents (500)

| | % |
|--|----|
| <i>Chemicals</i> | 1 |
| <i>Construction</i> | 6 |
| <i>Engineering</i> | 7 |
| <i>Financial Services</i> | 5 |
| <i>Hospitality/Travel/Tourism</i> | 6 |
| <i>Leisure/Entertainment</i> | 3 |
| <i>Mining/Minerals/Natural resources</i> | 1 |
| <i>Manufacture of consumer goods</i> | 7 |
| <i>Manufacture of industrial goods</i> | 8 |
| <i>Other manufacturing</i> | 5 |
| <i>Professional/Business consultancy or services</i> | 25 |
| <i>Retail/Services</i> | 9 |
| <i>Technology/Media/Telecoms</i> | 4 |
| <i>Transportation/Distribution</i> | 7 |
| <i>Utilities</i> | 1 |
| <i>Healthcare</i> | 3 |
| <i>Education/Training services</i> | 1 |
| <i>Charity</i> | 1 |
| <i>Other (specify)</i> | 13 |