

“The rise in self-employment requires a smart response from government...”

GOING IT ALONE

Duncan O’Leary

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As ever, all mistakes and omissions remain my own.

Duncan O'Leary

September 2014

Foreword

The way we work has changed for good. There are now 4.58 million self-employed people working in the UK, with this figure expected to outnumber public sector employees by 2020.

Self-employment has outstripped growth in permanent employment by 3 to 1 in the last decade, but government policy has yet to fully catch up with this structural shift.

IPSE (formerly the Professional Contractors Group, PCG), which represents nearly 22,000 members from across the self-employed community, has worked with government to make significant progress in creating a better environment for independent professionals and the self-employed to operate in. We sat on the Office for Tax Simplification's forum to address small business taxation, while we also work closely with the Cabinet Office, having helped establish the Security Clearance Forum, which works to ensure government departments are fair in their recruitment process for contractors. We also supply the Bank of England with economic data on independent professionals, to enable it to take this vital part of the labour market into account when considering monetary policy.

If the full potential of the self-employed is to be realised, though, it is clear that bolder and joined-up thinking is needed on infrastructure, regulation and tax. This report from Demos is therefore a welcome and timely intervention in the debate. The comprehensive analysis of the sector and particularly the 18 key policy recommendations that are highlighted certainly provide plenty of food for thought.

I look forward to the debate this report will spark as we seek to build a new innovation economy, with independent professionals and the self-employed at its heart.

Chris Bryce,
Chief Executive, IPSE

Executive summary

There are now 4.6 million people in the UK who are self-employed – around 1 in 7 of the UK workforce.¹ The proportion of the UK workforce who are self-employed is now at its highest ever and has been growing steadily for more than a decade.² On current trends, this growing group is set to outnumber the public sector workforce by 2020.³ After some debate, a consensus is slowly beginning to emerge. The economic downturn is likely to have accentuated the rise in self-employment, with employers reluctant to take on more staff in uncertain economic conditions. But the recession alone does not explain the change. The rise in self-employment predates the downturn and is expected to continue independently of the economic cycle.⁴

The evidence suggests that this shift is largely being driven by conscious choices. The freelancing model helps firms access expertise in a flexible way, manage peaks and troughs in demand for their services, test out new ideas without large fixed costs, and grow cautiously without over-extending themselves. Individuals, meanwhile, enjoy the freedom and flexibility that self-employment can bring. Surveys show that around three-quarters of those who are self-employed report that this is their preferred way of working;⁵ they cite having control over the content and hours of work as one reason for this.⁶

The aim of this report is to get beyond a discussion about the nature of the shift towards higher levels of self-employment, to consider the policy implications of it. The best way to understand those policy challenges is through the lens of power. Freelancers need the power to stand up for their own interests against government and against large companies.

Government can provide a supportive environment for freelancing, through investing in the kind of infrastructure that

enables flexible working. But it can also create obstacles to freelancing, through unnecessary rules and complex regulation.

Freelancers also face the challenge of asserting themselves with larger companies and public sector clients. Without large legal teams, or cash reserves, they can find themselves on the back foot when trying to resolve disputes with larger companies or address issues such as late payments. The public sector, meanwhile, can itself be a difficult customer, especially when procurement rules inadvertently favour large companies over small.

Public policy must therefore strike the right balance between heavy-handed interventions on the one hand, which can damage the flexibility that many of the self-employed value, and a laissez-faire approach on the other, which ignores power imbalances in the marketplace. In the long run, government can also add value by helping the self-employed protect themselves from risk, such as loss of earnings, and through providing the infrastructure that enables flexible working, whether freelancers are at home or on the move.

The report makes the following recommendations:

- *Recommendation 1:* to reduce red tape for firms and the self-employed, the Conduct Regulations and the Agency Worker Regulations should be merged.
- *Recommendation 2:* to reduce red tape for firms and the self-employed, an individual should have a single employment status for a given contract, which applies for all employment and tax law.
- *Recommendation 3:* to provide greater certainty over employment status, the Government should review and overhaul the current tests on which it is established, settling on no more than five simple criteria. This should involve eliminating a number of the current tests, which are either irrelevant or too open to interpretation.

- *Recommendation 4:* to address unnecessary complexity and to encourage entrepreneurial behaviour among the self-employed, the current disincentive for freelancers to invest in new skills should be removed. Training for the self-employed should be treated by the tax system in the same way as training for employees is.
- *Recommendation 5:* to help the self-employed protect themselves against loss of earnings, civil society organisations should work with the insurance industry to help freelancers access group protection policies. The Government should help convene the key players to explore this idea.
- *Recommendation 6:* to help the self-employed protect themselves against loss of earnings, the Treasury should model the costs of a new opt-in 'maternity/paternity extra' for the self-employed. To access the scheme, the self-employed would need to have chosen to make contributions above an agreed threshold for a defined period. Contributions to such a scheme could be tax deductible.
- *Recommendation 7:* to encourage saving for later life, the Government should work with the National Employment Savings Trust (NEST) to create a tailored pension scheme for the self-employed. This would allow individuals to withdraw a proportion of their pension contributions from the last two years at any time.
- *Recommendation 8:* to encourage saving for later life, the Government should engage the self-employed in dialogue about the kinds of behavioural prompts that most would find useful and acceptable in encouraging more regular pension contributions.
- *Recommendation 9:* to address the problem of late payment, the Prompt Payment Code should be strengthened. The code should specify that payment terms must not exceed 30 days and signatories should be expected to commit to paying interest automatically on any payments that are late.

- *Recommendation 10:* To help resolve disputes between big and small businesses cheaply and equitably, local enterprise partnerships (LEPs) should be given new powers to mediate in such disputes, building on the success of the Small Business Commissioner Model in Australia.
- *Recommendation 11:* to further open up government procurement to small businesses and freelancers, the Government should publish tender documents in an editable format. This would allow small and medium sized enterprises (SMEs) and others to suggest revisions that would make the bidding process less onerous.
- *Recommendation 12:* to further open up government procurement, tier 1 contractors should be expected to demonstrate how they will open up opportunities for subcontracting to the widest possible group of organisations and individuals. These organisations should also be expected to publish details of who they contract with, to promote accountability.
- *Recommendation 13:* to encourage the development of work hubs, the Government should examine whether and how they could be eligible for small business rate relief.
- *Recommendation 14:* to encourage the development of work hubs, local government should compile and publish interactive maps of derelict and disused buildings in their areas.
- *Recommendation 15:* to reduce barriers to the development of work hubs, the Government should evaluate the impact of recent changes to ‘permitted development rights’, with a view to extending them to larger buildings.
- *Recommendation 16:* to support flexible working in rural areas, the Government should commit to target not just a minimum speed, but also a maximum ratio between the fastest and slowest broadband speeds in the country.

- *Recommendation 17*: to support flexible working in rural areas, Ofcom should learn from experiments in crowd-sourcing information about mobile ‘not-spots’, in order to identify problem areas beyond one-off studies and coverage data provided by industry.
- *Recommendation 18*: to enable freelancers and others to work more efficiently on the move, the Government should ensure that all future contracts to deliver public transport build in the requirement to provide wi-fi for customers.

Introduction

In 1937 the economist Ronald Coase wrote his now-famous essay on the nature of the firm. Why, Coase asked, do firms exist at all? Standard economic theory, he argued, had no explanation for this. If economies are coordinated by the price system, rather than by central direction and control, why should businesses not be the same? Why bother with permanent employment contracts, managers and hierarchies? Why not simply buy in the skills you need, as and when you need them? As he put it:

Why are there these ‘islands of conscious power’? Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these markets transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur co-ordinator, who directs production.⁷

Coase’s answer was that indefinite contracts and permanent hierarchies bring benefits as well as costs. Most fundamentally, they can reduce ‘transaction costs’. When something needs doing within a firm, managers can simply direct their staff to do it, rather than worry about whether they need to find a new worker, or renegotiate an existing contract. Coase’s essay has become a set text for economists, providing a ‘theory of the firm’ – the economic unit economists had, until then, taken for granted.

Today, economists are busy asking themselves the opposite question. What accounts for the dramatic rise in self-employment? Why are more and more people working through one-off contracts, with a smaller proportion of the workforce hired as employees? There are now 4.5 million people in the UK who are self-employed – around 1 in 7 of the UK workforce.⁸ The proportion of the UK workforce who are self-employed is now at

its highest ever and has been growing steadily for more than a decade.⁹ On current trends, this growing group is set to outnumber the public sector workforce by 2020.¹⁰

After some debate, a consensus is slowly beginning to emerge. The economic downturn is likely to have accentuated the rise in self-employment, with employers reluctant to take on more staff in uncertain economic conditions. But the recession alone does not explain the change. The rise in self-employment predates the downturn and is expected to continue independently of the economic cycle.¹¹ There has been no dramatic change in the characteristics of those who are self-employed before and after the recession. And around three-quarters of those who are self-employed report that this is their preferred way of working.¹² The evidence points to a structural change in the UK labour market.

Firms

Ronald Coase's insights explain why permanent employment contracts may be beneficial to employers, but also, by implication, when they may not. Planning can work well in stable conditions with settled patterns of production, allowing staff to be integrated into an organisational culture and way of working. However, where the work that is required is less stable in nature or volume, these benefits can vanish. Professor Andre Burke of Cranfield Business School explains the value of contract workers¹³ to organisations.¹⁴ Burke identifies a number of key benefits:

- *Capability*: freelancers can provide access to a range of skills and expertise beyond those held by the permanent employees of a firm. This is especially the case for irregular, highly specialised tasks for which there would be no business case to either hire new staff, or invest in training existing employees. The self-employed model allows organisations to be nimble, drafting in experts for a particular project, without incurring large costs.
- *Productivity*: contractors can help firms deal with peaks and troughs in demand for their services. A firm might be reluctant

to miss out on new business but nervous about the risks of taking on permanent staff. The peak in work volumes might easily be followed by a trough and many firms cannot afford to have staff facing periods of downtime. Engaging contractors can help organisations resolve this dilemma, allowing them to take on new business without having to commit to increasing staffing levels.

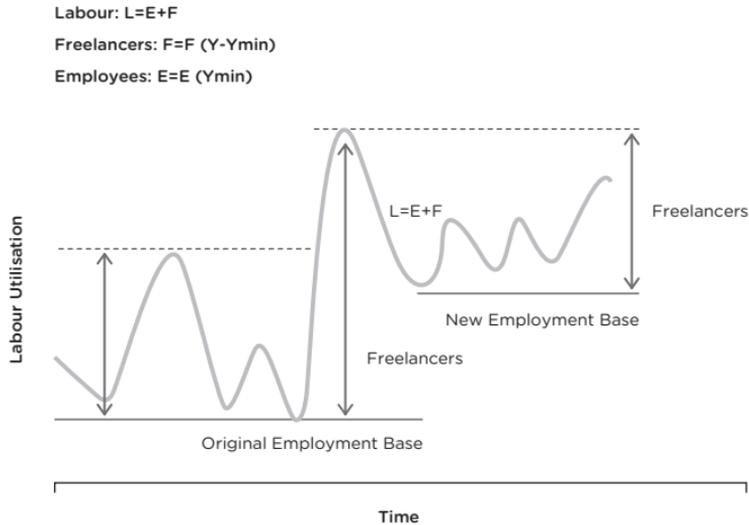
- *Innovation*: contractors can help ensure that growing a business, or trying out a new idea, is less risky than it might otherwise be. Often a business will want to trial a new product, service or way of working, but will not be able to guarantee the new venture is successful. By engaging contractors, companies can adopt a cautious approach, testing whether a new idea will work before taking on the fixed costs of permanent staff. This also allows firms to avoid taking existing staff away from the core functions of a business to implement new ideas. This approach can ultimately lead to permanent job creation. If the new idea works, or the business expands successfully, it can settle on a new equilibrium with higher numbers of permanent staff (figure 1).
- *Competitiveness*: contractors can reduce barriers to entry for new firms facing problems such as financial constraints. Especially in their early stages, poorly capitalised firms may not be able to afford to pay wages until they receive payment themselves for their products or services. By taking on contractors, firms can get round these cash flow problems, by paying their own contractors on a ‘pay as you earn’ basis, instead of the fixed cost of a monthly wage packet.

Professor Burke argues that these functions are becoming more and more important in an increasingly competitive economy. He suggests that the requirement for constant innovation and efficiency gains is encouraging employers to rethink how they access talent, reduce downtime among staff, try out new ideas, and overcome the challenges of early stage growth.

Individuals

Ronald Coase’s essay also provides a hint about why people might choose to work for themselves, rather than become the

Figure 1 Reducing the risk of revenue and employment growth



Source: Burke¹⁵

permanent employees of others. In his search for a definition of the firm, he characterises ‘the legal relationship normally called that of “master and servant” or “employer and employee”’.¹⁶ The essence of a manager–employee relationship – a permanent employment relationship – is the ability of the ‘master’ to control the way the ‘servant’ works. As Coase puts it:

It is this right of control or interference, of being entitled to tell the servant when to work (within the hours of service) and when not to work, and what work to do and how to do it (within the terms of such service) which is the dominant characteristic in this relation and marks off the servant from an independent contractor, or from one employed merely to give to his employer the fruits of his labour.¹⁷

Coase’s description of the ‘master–slave’ relationship may be some distance from the kind of workplaces we have, or ought to have, in modern Britain, but his essential point matters.

Survey evidence suggests that people's desire to take control over their own work, whether that concerns what they work on, when they work or how they go about their work is a key reason why many choose to go it alone.

The Royal Society of Arts (RSA) has found that though, on average, full-time self-employed people earn £74 a week less than their employed counterparts, they report a higher degree of satisfaction with their working arrangements than the average employee.¹⁸ When asked what they most valued about self-employment, 87 per cent said that it provides more freedom to do the things that they want and 82 per cent said that the work they do is more meaningful than that offered by a typical job.¹⁹ These findings are echoed in a recent survey commissioned by IPSE, in which the self-employed said that 'freedom to choose the work I want' (90 per cent) and 'flexibility of hours' (91 per cent) were either an 'important' or 'very important' advantage of their way of working.²⁰

The ability to choose when to work also appears important to people at different stages in their lives. Over a third of those surveyed by the RSA said that being self-employed enabled them to care for older relatives,²¹ while another poll of professional freelancers found mothers turning to self-employment as a means of balancing work and family commitments.²² This perhaps reflects the rapid growth in the number of self-employed women over the last decade and a half: 40 per cent more women have become self-employed in that period, almost twice the growth rate among men.²³

For many, self-employment can offer a degree of flexibility that permanent contracts of employment cannot. Such flexibility can also help people manage their health conditions – something that over half of all respondents to the RSA survey reported to be the case. This is likely to apply to many of those around retirement age, with the Bank of England suggesting that self-employment is increasingly becoming an alternative to retirement, allowing older workers to scale down their work rather than giving up entirely.²⁴

Public policy

Coase had one more insight that is pertinent to the debate over the growth of self-employment. He recognised in his essay that patterns of employment may be driven not just by economic considerations, but also by government policy: 'Exchange transactions on a market and the same transactions organised within a firm are often treated differently by Governments or other bodies with regulatory powers.'²⁵ Companies or individuals may therefore opt for a particular way of working as a response to taxes or regulations.

The fear that self-employment is being used as a means to avoid the legal obligations that come with contracts of employment has driven much of the debate in recent years. Trade unions and others have argued that workers are being denied employment rights by employers requiring them to register falsely as self-employed. Shadow ministers have described false self-employment as a 'scandal':

There are too many cases of employees being classed as self-employed when in practice they work for a single company, meaning they can be sacked without warning, do not receive holiday or sick pay, have reduced benefit entitlements and are also denied access to employment tribunals. Often desperately searching for employment, workers are made to... sign away their basic rights.²⁶

Meanwhile, there have also been fears that self-employment has been used as a means of tax avoidance, with both employers and individuals benefitting from the lower rates of National Insurance (NI) associated with contractors by comparison to employees. High profile cases, such as that of a BBC Director General, who was paid as a consultant despite working as an employee of the BBC, have propelled the issue into the media.²⁷

These issues matter and are addressed directly in the chapters that follow. However, it is essential that the policy debate is not limited to this, as has been the case too often in the past. More and more companies are engaging contractors for legitimate reasons; more and more people are choosing self-employment for legitimate reasons. This shift requires government to rethink policy across a range of areas, from

labour market regulation to skills and pension policy, infrastructure to government procurement.

This report argues that the best way to understand those policy challenges is through the lens of power. Freelancers need the power to stand up for their own interests, both against government and against large companies. Government can provide a supportive environment for freelancing, through investing in the kind of infrastructure that enables flexible working. But it can also create obstacles to freelancing, through unnecessary rules and complex regulation. This can impose costs and make it harder for individuals to choose the way of working that is right for them. Many freelancers are highly protective of the freedom and flexibility that contracting can provide them and their clients. Government must value this too as it explores new ways to help the self-employed invest in their future and protect themselves from risk.

Freelancers also face the challenge of asserting themselves with larger companies and public sector clients. Large organisations engage the self-employed because they value the expertise and flexibility that the model can bring. However, there is always the temptation for the large to bully the small. Not only can individuals be forced into accepting contracts that deny employment rights when they are due, but large companies can abuse imbalances of power even when dealing with experienced contractors. Without large legal teams, or cash reserves, freelancers can find themselves on the back foot when trying to resolve disputes with larger companies, or address issues such as late payments. The public sector, meanwhile, can itself be a difficult customer, especially when procurement rules inadvertently favour large companies over small.

Public policy must therefore strike the right balance between heavy-handed interventions on the one hand, which can damage the flexibility that many of the self-employed value, and a laissez-faire approach on the other, which ignores power imbalances in the market places. This report seeks to strike that balance through policy recommendations which simplify laws and rules rather than complicate them, place a premium on personal choice and discretion, and recognise the limits of what

can be specified by policy makers from Westminster.

The report draws on desk-based research and four roundtable seminars exploring the consequences of the rise of self-employment. These seminars have drawn in politicians, civil servants, academics, stakeholders and experts across a range of policy areas and, importantly, people who themselves are self-employed. The aim of the report is to get beyond a discussion about the nature of the shift towards higher levels of self-employment, to consider the policy implications of it. Throughout the report the terms ‘self-employed’, ‘freelancer’ and ‘contractor’ are used interchangeably – each term refers to the legal definition of self-employment.

The report is structured as follows:

- Chapter 1 examines tax and labour market regulation, exploring some of the definitional issues freelancers face. It argues that the current approach is unnecessarily complex and argues for a simpler approach, which gives more certainty about employment status to firms and the self-employed. Such a change would help clarify legal rights and obligations for employers and the self-employed. In doing so it would address key issues in tax and employment law.
- Chapter 2 examines how the self-employed can protect themselves from risk, in the absence of an employer providing benefits such as sick leave, maternity and paternity pay, and pension contributions. The chapter argues that the tax regime presents a barrier to the self-employed investing in skills for the future; it examines how the self-employed might be supported to protect their own income and how the pensions system could be reformed to support greater saving among freelancers.
- Chapter 3 addresses the relationship between the self-employed and larger businesses. It argues that policy needs to be mindful of larger firms squeezing out the smallest businesses in ways that are unfair and uncompetitive. It proposes a new approach to resolving disputes between large and small firms, tackling the problem of late payments and opening up government contracts to a wider range of bidders.

- Chapter 4 focuses on how government can provide a supportive environment for freelancing in the longer term. It argues that the self-employed rely heavily on digital infrastructure and examines progress in this area. The chapter also explores the rise of work hubs and the role of public policy in helping or hindering them.
- The report concludes that a structural shift in the way we work calls for a series of related shifts in government policy. It argues that each government department should be asked to consider the implications of the rise of self-employment as part of a wider debate about the changing way many of us work.

1 Labour market regulation

Successive governments in the UK have set themselves the goal of creating and maintaining a flexible labour market. In practice, this has tended to result in disincentives for employers to hire and fire staff being reduced. Such an approach has been regarded as conducive to job creation, enabling individual businesses, and the economy as a whole, to respond to changes in demand for products and services. As the Office for National Statistics (ONS) puts it, ‘Greater labour market flexibility helps an economy to respond to changes in demand and output by enabling wages and employment to adjust more easily.’²⁸

This desire for flexibility has largely been fulfilled. The World Economic Forum ranks the UK labour market as the fifth most efficient in the world, based on a measure that includes factors such as flexibility in wage determination, hiring and firing, and redundancy costs to employers.²⁹ However, despite these changes, policy makers have not entirely abandoned the idea that permanent contracts of employment come with statutory rights and responsibilities for employees and employers. For example, employers in the UK must provide paid annual leave, maternity and paternity leave and statutory redundancy pay, among other obligations. These employment rights are acquired by individuals as part of a reciprocal deal when they commit themselves to companies through employment contracts.

The relationship between an employee’s commitment to a firm and the rights owed in return is reflected in various aspects of employment law. Individuals acquire greater rights over unfair dismissal after two years’ service, for example. As their contribution to a company increases, so too do their statutory rights. Similarly, statutory redundancy pay rises with time served for a company. This logic continues in relation to the self-employed, who make only one-off commitments to companies

and are owed only very basic protections in return. Freelancing therefore represents the most flexible end of the UK's flexible labour market – allowing firms and individuals to work with one another without either making long-term commitments or taking on wider obligations.

In this context, definitions of employment matter. The law needs to ensure that employees committed to a company enjoy the rights they are owed in return, while preserving the flexibility offered by self-employment, which involves lesser commitments and far fewer corresponding rights. The UK operates with three broad categories of employment status – employee (including full time, part time and those on fixed term contracts), worker (including agency workers) and self-employed (including freelancers, consultants and contractors) (box 1).

Box 1 **Employment status: 'worker'**

The Government provides the following definition of 'worker':

A 'worker' generally means an individual who has a contract or other arrangement to do work or services personally for a reward. This category is often perceived as a hybrid of employee and self-employed status. 'Workers' have fewer protections than 'employees' in domestic employment law. All 'employees' are 'workers'. However not all 'workers' will be 'employees'.³⁰

Table 1 lists the ways in which employees are afforded more employment rights than workers, who in turn have more than the self-employed.

Employment status also has implications for tax and NI contributions for employers and individuals:

- *NI for individuals:* The self-employed must pay class 2 NI contributions, and class 4 contributions if profits are high enough. This is typically lower than the class 1 NI contributions made by employees.
- *NI for employers:* Employers must pay NI and make pensions contributions for their employees and workers. By contrast the

Table 1 The employment rights of employees, workers and the self-employed

Employment right	Employee	Worker	Self-employed
Minimum wage	●	●	-
Protection from unlawful deductions from wages	●	●	-
Paid annual leave	●	●	-
Maternity, paternity, adoption leave and pay	●	●	-
Right to request flexible working	●	-	-
Right to request time to train	●	-	-
Protection from discrimination	●	●	●
Minimum notice periods	●	-	-
Collective redundancy consultation	●	-	-
Statutory redundancy pay	●	-	-
Protection from unfair dismissal (after two years)	●	-	-
TUPE ³¹	●	-	-

self-employed are responsible for their own NI and pensions contributions.

- **Income tax:** Many self-employed people work through limited companies. In addition to providing legal protection for freelancers, this structure allows for income to be treated in a different way from the salaries of employees. For example, limited companies are able to retain profits for future investment in their business rather than pay income tax on them.

Getting it right

Given these differences, it is important to individuals, employers and society as a whole that employment relationships are categorised in the right way. Employment rights are important in providing protection for individuals who may lack bargaining power with employers. For example, they help ensure that the self-employed cannot be treated as employees in their daily work but denied the pension payments and sick pay that employees are entitled to.

However, for those individuals with more bargaining power, often at the higher end of the income scale, these rights can be experienced as burdens because professional freelancers recognise that their willingness to work flexibly is one of the key reasons companies wish to engage them. Contractors can be brought in for a one-off task, without the need for long-term contracts of employment, which may not be appropriate. The freelance bargain is to trade job security for greater flexibility, self-determination and, potentially, more pay when there is work available.

For employers, the ability to agree different kinds of employment relationships matters. Contracts of permanent employment provide employers with some advantages – for example, transaction costs are kept low when employers do not have to specify every output through a contract.³² However, engaging the self-employed for specific or time-limited tasks can be vital for employers seeking to cope with fluctuations in the volume of work, or to bring in specialist expertise without the extended commitments that employment contracts bring. Therefore, it is important that employers are confident about the nature of the working relationships they are entering into.

Wider society also has a stake in ensuring that employment relationships are categorised appropriately. Tax is one aspect of this. Other taxpayers lose out if companies and individuals pay the tax associated with self-employment when, in fact, the employment relationship is that of an employee. Wider society also has an interest in the generation of jobs, which is affected by the ability of employers and individuals to strike up employment relationships that are right for them. Oxford Economics has calculated the added value of freelancers in professional roles to be worth £21.3 billion³³ (this figure is the amount of GDP that would be lost should all professional freelancers have chosen to work as employees).

Uncertainty

It is often far from clear to either individuals or employers which category an employment relationship falls into, for three reasons:

- Employment status is highly contingent. Although people may consider themselves to be a ‘freelancer’ or contractor, the legal definition depends on the precise nature of each ‘employment relationship’. Legally, a ‘freelancer’ might be classified as self-employed during one contract but an employee during another.
- Contracts are not sovereign. The employment status of an individual rests not just on what has been agreed on paper, but also what happens in practice – the nature of the ‘employment relationship’. It is possible, therefore, to be described as ‘self-employed’ in a contract but not treated as one in law. This can happen either through an employment tribunal or through an investigation by HM Revenue & Customs (HMRC).
- There is no single test of an individual’s employment status – and the tests can be open to interpretation. For example, HMRC identifies factors such as whether an individual is ‘part and parcel’ of an organisation as one of the key factors in determining employment status (box 2). Open-ended criteria like this create uncertainty for firms and individuals, who are left guessing how they might be interpreted by the Government for a given contract.

Box 2 Employment status: key tests

HMRC lists the following factors as relevant to determining employment status:

- *personal service: whether the individual is required to perform services personally*
- *mutuality of obligation: the extent to which an employer is required to offer work and the extent to which an individual is expected to do it*
- *right of substitution: whether the individual can send a replacement or engage a helper*
- *provision of equipment: whether the individual provides whatever equipment is needed to do the job*
- *financial risk: whether the individual risks their own money, bearing overheads for the work*

- opportunity to profit: *whether the individual can earn a profit through working more efficiently*
- length of engagement: *whether the contract is for a fixed period*
- part and parcel of the organisation: *whether the individual is an integral part of their client's organisation*
- employee-type benefits: *whether the individual enjoys benefits such as paid leave*
- right to terminate contract: *whether the individual or client is required to give a notice period*
- personal factors: *whether the individual works for a number of clients and has a 'business-like' approach to gaining new contracts*
- mutual intention: *what both parties intend the employment relationship to be*³⁴

Some of the tests are obscure rather than intuitive. For example, HMRC counts whether or not individuals provide the main items of equipment to do their work as a key factor in determining employment status.³⁵ Yet whether or not an individual owns the computer they are working on, or the tools they are using, indicates very little about the nature of the relationship between an individual and a company. A contractor might be based in the office of a company, using that company's equipment, but working with complete autonomy while he or she does so.

There is inconsistency in legislation. For example, the Agency Workers Directive and the Conduct of Employment Agencies and Employment Businesses Regulations have different definitions of 'agency workers' (set out in box 3). It is also possible for the self-employed to opt out of the Conduct Regulations if they are registered as a limited company, but this is not the case for the Agency Workers Directive. Thus an individual can hold multiple statuses at the same time, being an employee of their own company, an 'agency worker' under the Conduct Regulations and self-employed under the Agency Workers Regulations.

Tax law and labour market regulation work in parallel. Separate systems of employment rights and tax law make it possible to be self-employed for tax purposes but for an employment tribunal to judge that someone is classified as an employee for the purposes of employment rights.

Box 3 The Conduct Regulations and the Agency Worker Regulations

The Conduct Regulations were introduced in 2003. They were designed to protect workers from one-sided contracts, for example by prohibiting the use of ‘handcuff clauses’, used by agencies to prevent the self-employed from working directly with a client and ‘temp to perm fees’, where agencies charged the self-employed for becoming a permanent employee of the client at the end of a fixed term contract. They operate with the following definition:

‘Work-seeker’ means a person to whom an agency or employment business provides or holds itself out as being capable of providing work-finding services. Limited company contractors can choose to ‘opt out’, otherwise they are covered by the regulations.³⁶

The Agency Worker Regulations were introduced in 2010/11. Their purpose is to ensure that temporary workers supplied by an agency receive the same rights as regular employees after 12 weeks. They operate with the following definitions:

- (1) *In these Regulations ‘agency worker’ means an individual who:*
- ...
- (b) *has a contract with the temporary work agency which is (i) a contract of employment with the agency, or (ii) any other contract to perform work and services personally for the agency.*

- (2) *But an individual is not an agency worker if:*
- (a) *the contract the individual has with the temporary work agency has the effect that the status of the agency is that of a client or customer of a profession or business undertaking carried on by the individual; or*
 - (b) *there is a contract, by virtue of which the individual is available to work for the hirer, having the effect that the status of the hirer is that of a client or customer of a profession or business undertaking carried on by the individual.*

Limited company contractors will typically be excluded on the basis that they are genuinely self-employed and in business on their own account.³⁷

The uncertainty about a self-employed person's status can be damaging for both firms and individual workers. Firms may be reluctant to engage freelancers when they need them, through fear that they might later be recategorised as employees after an employment tribunal or HMRC investigation. A 2013 ComRes survey found that more than one in five SMEs identify the 'risk and uncertainty' surrounding the tax status of freelancers as a disadvantage of engaging them.³⁸

Lack of clarity can be a problem for individual workers, too. At the lower end of the income scale, the risk is that individuals will be denied the rights that they are entitled to. At the higher end of the income scale, professional freelancers risk losing business and facing higher business costs. A 2009 study estimated that contractors pay an average of £853 per year ensuring that they understand their tax status.³⁹

Solutions

The task is to find a simpler approach, which can provide more certainty for all involved. If this can be achieved it could reduce bureaucracy, help businesses take decisions with confidence, address exploitation and calm fears over tax avoidance.

The first step should be to simplify labour market regulation, so that different pieces of legislation work with the same definitions and procedures. Therefore the Conduct Regulations and the Agency Worker regulations should be merged so there is a single definition of a ‘worker’ rather than two different definitions. The opt out in the Conduct Regulations should be removed as part of the move to align the two pieces of legislation.

Recommendation 1: to reduce red tape for firms and the self-employed, the Conduct Regulations and the Agency Worker Regulations should be merged.

The simplification process should extend to aligning tax law and labour market regulation. It should not be possible to be self-employed for tax purposes but an employee when it comes to employment rights. This is unnecessarily confusing. It should be simple to establish the nature of an employment relationship and then impossible to be classed in more than one way by different branches of government. An individual should have a single employment status, which applies for all employment and tax law.

Recommendation 2: to reduce red tape for firms and the self-employed, an individual should have a single employment status for a given contract, which applies for all employment and tax law.

A fundamental question is how employment status is determined. A new approach is required which involves much less ambiguity about how and when decisions will be made. The task is to simplify the criteria to make the system far more predictable and accessible for all concerned. The current criteria used to determine an individual’s employment status have been built up through case law but can and should be rationalised and overhauled. Andrew Burke offers a definition of freelancing that could be used for this purpose. He argues that freelancers:

- supply services for a limited duration

- have remuneration that is output focused (implying they have control over *how* work is delivered)
- take on all or most of the cost and risk of their own labour downtime and below-expectation productivity within projects
- take on all the cost and risk of economic activity between projects⁴⁰

These four tests could be the foundation of a new approach –

perhaps with the addition of an explicit reference to freelancers enjoying control over how they deliver their work. If individuals are supplying services for a limited duration, have remuneration that is output focused, have control over how their work is delivered, and are taking on the costs and risks of their own productivity and activity between projects, then both employment tribunals and HMRC should be satisfied that they qualify as self-employed. This simplified approach would be far preferable to the long lists of indicators and tests currently provided by HMRC and other branches of government.

Recommendation 3: to provide greater certainty over employment status, the Government should review and overhaul the current tests on which it is established, settling on no more than five simple criteria. This should involve eliminating a number of the current tests, which are either irrelevant or too open to interpretation.

To address the second issue – of the *process* by which decisions are made – the challenge is also to provide a greater degree of certainty for all involved. This requires finding a middle ground between contracts, which do not always describe the reality of an employment relationship, and employment tribunals, which are rare, retrospective and involve high stakes.

Conclusion

The self-employed operate at the most flexible end of the UK's flexible labour market. Those who choose it trade the security of employee contracts for the greater flexibility, and sometimes

higher remuneration, afforded by the contracting model. In this context, establishing the employment rights and tax obligations of the self-employed is critical. However, the UK has an unnecessarily complex approach to classifying workers' employment status, which creates red tape and uncertainty for businesses and workers themselves. The Government should simplify this by aligning different pieces of legislation, applying the same approach across employment and tax law, and rationalising the key criteria used to make decisions about employment status.

2 Protection from risk

The decision to go self-employed involves a trade-off between freedom and security. Freelancers enjoy the freedom to choose who they work for and on what conditions, but also lack the security that comes with a permanent job. By contrast with employees, the self-employed enjoy neither predictable income patterns, nor the various employment protections that permanent staff do. This chapter examines the particular challenges faced by the self-employed in this area – and whether public policy might help mitigate, if not entirely remove, some of the risks that come with this way of working. The chapter addresses three issues in particular:

- investment in training and skills development
- protection against loss of earnings
- saving for later life

Skills

Specialist skills are one of the key reasons that companies engage the self-employed in work. Andrew Burke puts it, ‘Freelancers offer businesses the flexibility to draw on an immense range of skills and expertise which means that their capability is not limited to that of their employee base.’⁴¹

Ensuring that skills are updated throughout people’s careers is therefore a key way in which the self-employed can protect their future earnings.

Unlike employees who work full time for companies, however, the self-employed cannot rely on a human resources department to diagnose their skills needs, or make investments in training on their behalf. There is some evidence that the absence of such support systems may be affecting levels of investment in

training. One study of European self-employed professionals ('iPros') found:

*Slightly less than two thirds had undertaken no formal professional skills development in the last five years and a higher proportion had no training in business skills. Of those that had done training, most were from professions where it was compulsory. The implication is that where training is not required, iPros [self-employed professionals] are unlikely to voluntarily undertake it.*⁴²

Public policy influences the ability of the self-employed to invest in training. First, if freelancers decide to establish their own limited companies, this provides the opportunity to retain funds in the business for future investment, including training. Second, when businesses calculate their profits chargeable to tax, expenditure on some types of training can be deducted from this figure.

There is inconsistency in the way that employees and the self-employed are treated, however. Business expenditure on training for employees is tax deductible as long as it is relevant to the purposes of the organisation,⁴³ but the rules are different for the self-employed. Freelancers may only treat expenditure on training as tax deductible where it improves existing skill-sets. Training to develop new kinds of skills, by contrast, is considered as investment in an asset of enduring benefit to the business and is therefore not tax deductible.⁴⁴ The HMRC guidance to practitioners explains:

*You should [therefore] allow proprietors a deduction for expenditure that merely updates existing expertise or knowledge but disallow any expenditure that provides new expertise or knowledge (particularly where it brings into existence a recognised qualification like a Master of Business Administration).*⁴⁵

The logic behind this approach is that expenditure on training for employees is qualitatively different from expenditure focused on yourself. Whereas employees might move jobs, taking their newly acquired skill-set with them, the self-employed, by

definition, will benefit personally from the investments they make. However, this approach adds unnecessary complexity to the system and provides a clear disincentive for the self-employed to branch into new areas of work. This runs entirely contrary to the desire of policy makers to encourage entrepreneurial behaviour and support a flexible labour market. If the Government wants freelancers to thrive in a ‘global race’ then it should not discourage people from responding to new opportunities and investing in their future.

The Government should simplify the system by aligning the tax treatment of training for employees and the self-employed. As is currently the case for employees, all training relevant to the business activities of the self-employed should be allowable for tax. This would remove the disincentive currently in the system for the self-employed to invest in new skill-sets and branch into new areas of work. In doing so, the Government would help the self-employed become more resilient to changes in the job market – and more able to capitalise on new opportunities.

Recommendation 4: to address unnecessary complexity and to encourage entrepreneurial behaviour among the self-employed, the current disincentive for freelancers to invest in new skills should be removed. Training for the self-employed should be treated by the tax system in the same way as training for employees is.

Research into the training needs of the self-employed has also identified the value many place on more informal forms of training:

Many spoke of the need for less formal self-help groups where everyday problems could be discussed and advice provided. We heard that such facilities were offered by the co-working movement and by others who had set up small groups to share experiences.⁴⁶

Such peer-to-peer support is often generated through friendships and professional networks, but there may be a role for organisations beyond government, from work hubs to trade

unions and professional bodies, to adopt a more deliberate approach to helping people make these connections.

Loss of earnings

Investing in training is one way in which the self-employed can take steps to protect their future earnings, but self-employment comes with some inherent risks. The project-based nature of self-employment means that future income can be much harder to predict, making it harder for freelancers to manage their finances. Meanwhile, self-employed people who work for companies forgo a range of employment rights that are eligible to employees. For example, the self-employed have no employer to provide sick pay, nor will they receive the maternity, paternity or adoption pay that employees do.

The Government is seeking to do more for those who are unemployed but wish to work for themselves. For example, if the unemployed can demonstrate a credible business plan, it is now possible to claim an enterprise allowance. This scheme provides people with a mentor, to provide advice and support, alongside a weekly allowance (worth a total of £1,274 over 26 weeks) and a loan to help with start-up costs.⁴⁷

However, the state offers little protection against loss of earnings for those who are already self-employed.⁴⁸ In some areas, the self-employed are entitled to the same level of basic support provided to employees, such as the flat-rate Maternity Allowance, statutory sick pay (after six months off work) and income-based Jobseeker's Allowance. In some other cases, the self-employed have lower entitlements than their counterparts who work as employees. Contributory Jobseeker's Allowance, for example, is not open to the self-employed, because of the differences in NI contributions made by the self-employed and employees when they are in work.⁴⁹ In the absence of employer benefits and much state support, one option for the self-employed is to turn to income protection. Through this route, individuals are able to insure themselves against loss of income for anything from one year up to retirement age. Again, though, the self-employed face some disadvantages in this area. Where

employees can benefit from cheaper premiums through ‘group protection’ policies, purchased through employers buying in bulk, the self-employed are more likely to access policies as individuals in isolation (box 4).

Box 4

Group protection policies against loss of income

Insurance companies are able to offer group protection at a cheaper rate than individual policies because group policies allow people in similar circumstances to pool risk. For example, the employees of a particular workplace are all likely to face similar risks at work. Once the odds of an employee requiring time off work have been established, the law of averages makes it possible to spread risk across a group. Protecting ten individuals with a 1 in 10 risk of sickness or redundancy is less risky – and therefore cheaper – than protecting one individual. In the case of ten individuals, the fees the other nine people will balance out the costs of the one individual needing a payout. In the case of the one individual, there is not the cushion of other policy holders’ fees. The cost of insurance is therefore higher to make the deal worthwhile for the provider.

This raises the question of whether there are lessons to be learned from new consumer movements, such as switching or collective purchasing, which aim to bring together dispersed consumers to strike a better deal. For example, the Freelancers Union in the US (<https://www.freelancersunion.org/about/>) works to connect freelancers to group-rate benefits. It argues that ‘by coming together as an insurance pool, we’re also coming together as a powerful political constituency’.⁵⁰

This is an area ripe for innovation in the UK. If enough individuals in similar circumstances can be brought together there is the opportunity for ‘win–win’ deals, allowing insurers to offer group protection deals to the self-employed. The task is therefore one of brokerage and coordination, which civil society organisations, from trade bodies to professional groups, would

be well placed to perform. Their role would be to engage with the insurance industry to understand how such 'groups' could be put together to enable such deals to work. Having established the terms of deals for freelancers in these different groups, the job would then be to help make the self-employed aware of the opportunity to insure their income at a cheaper rate. The role of government should be to help kick-start the discussion by bringing together the key players to explore how such a scheme could be implemented.

Recommendation 5: to help the self-employed protect against loss of earnings, civil society organisations should work with the insurance industry to help freelancers access group protection policies. The Government should help convene the key players to explore this idea.

One area where insurance to cover loss of earnings is not an option is maternity and paternity pay. The news is not all bad for prospective mothers and fathers – the flexibility of self-employment may well allow parents more scope to combine work and family than many employees will enjoy in the longer run. However, the absence of anything except the statutory minimum maternity and paternity pay does present a challenge for self-employed parents finding themselves with new caring responsibilities but no way of covering their loss of earnings.

In the absence of a private market to address this problem, the Government should explore what role it could play in helping the self-employed pool risks and smooth income over time. One option would be to introduce a new opt-in maternity or paternity allowance for the self-employed based on the contributory principle. To gain access to this optional scheme, the self-employed would choose to make contributions above a certain threshold for a defined period – for example over two years. Self-employed parents who had paid into the system would then be eligible for 'maternity extra' or 'paternity extra' following the birth of their child.

The scheme would work through:

- *Personal choice*: individuals would choose whether or not to pay in.
- *Pooling of resources*: some would be paying in, while others were drawing out.
- *Pooling financial 'risk'*: some would pay into the system but never have children, creating surpluses to fund payments to other self-employed parents.
- *Avoiding 'free riding'*: only those having paid in would be eligible.
- *Smoothing income*: people would pay in before needing support and draw out when their children were born.

The Treasury would need to model the costs and cash flows of such a scheme – and consider whether government ought to pay into the scheme, to encourage participation and help provide a greater degree of financial protection. Contributions to such a scheme might also be treated as tax deductible, as is the case with income protection products in the private sector.

Recommendation 6: to help the self-employed protect themselves against loss of earnings, the Treasury should model the costs of a new opt-in 'maternity/paternity extra' for the self-employed. To access the scheme, the self-employed would need to have chosen to make contributions above an agreed threshold for a defined period. Contributions to such a scheme could be tax deductible.

Pensions

Forthcoming changes to the state pension are set to improve the position of the self-employed. Under the existing system both employees and the self-employed qualify for the basic state pension, but only employees earn rights to a second state pension through NI payments. The new, single tier, flat-rate system will change this, putting the entitlements of employees and the self-employed on an equal footing.

However, savings rates for the self-employed remain a concern for a number of reasons:

- The self-employed do not enjoy employer contributions as employees do. Research suggests that over the course of an average working life, employer contributions amount to more than £90,000.⁵¹
- Fluctuations in income present challenges for the self-employed to enter into a settled pattern of saving over long periods of time. Such fluctuations in income can also make pension contributions a risk: people worry about ‘locking up’ money they might need in the shorter term to help cover lean periods of income.
- There are behavioural barriers. For years pension policy has sought to find ways to tackle inertia – the gap between people’s intention to save and their actual savings rates. Now policy works with the grain of inertia, with auto-enrolment into occupational pension schemes, giving people the chance to opt out instead. The result is that the proportion of employees contributing to schemes has risen sharply, with more than nine in ten employees now enrolled.⁵² However, the self-employed are not affected by this shift in policy, raising the prospect that inertia will continue to drag down savings rates among the self-employed.

Research by the Resolution Foundation suggests that this combination of factors is having an effect. According to a recent study, only 30 per cent of self-employed people are contributing to a pension, compared with 51 per cent of employees.⁵³ The same study found that just 34 per cent of the self-employed have any kind of personal pension.⁵⁴ Such figures raise the question of how policy might encourage a culture of saving among those who work for themselves.

One way this problem should be addressed is through a pensions offer for the self-employed that has more flexibility than is currently on offer. This purpose of this additional flexibility would be to reduce the risks faced by the self-employed in ‘locking up’ money in a pension. Specifically, the Government should work with NEST to create a tailored pension scheme for the self-employed, which would allow individuals to withdraw a proportion of their pension contributions from the last two years at any time. This additional

flexibility would allow more self-employed people to put money aside with confidence, knowing that they would be able to access at least some of the money in the event of a cash flow shortage.

The economics of such a scheme would need to be carefully worked through – normally the additional flexibility for savers is balanced by there being less flexibility for those responsible for actually investing the funds in such a scheme. If money can be withdrawn at any time then certain forms of long-term saving are ruled out. This, in turn, could result in a lower rate of return for the scheme than is the case from traditional pension schemes. However, the model would still be likely to prove attractive to the self-employed and could become an important way of encouraging them to put money aside for retirement with confidence.

Recommendation 7: to encourage saving for later life, the Government should work with NEST to create a tailored pension scheme for the self-employed. This would allow individuals to withdraw a proportion of their pension contributions from the last two years at any time.

The Government should also engage the self-employed in dialogue about the kinds of ‘nudges’ or behavioural prompts that most would find useful and acceptable in encouraging more regular pension contributions, in the absence of auto-enrolment. One example of this might be including reminders to contribute to pension pots at the end of self-assessment tax forms, encouraging the self-employed to think about their long-term financial position when they complete the tax form, when they are likely to have the most clarity about their financial position.

Recommendation 8: to encourage saving for later life, the Government should engage the self-employed in dialogue about the kinds of behavioural prompts that most would find useful and acceptable in encouraging more regular pension contributions.

Conclusion

When people become self-employed they step into a less paternalistic world – without the support that organisations provide, often through human resources departments. The self-employed must consider their own training needs, find ways to protect themselves against loss of income without employee benefits, and take more responsibility for their own pensions. Most make this choice by trading greater flexibility for less security. However, there are ways that government and others can help mitigate these risks, which could improve the position of the self-employed. These include having a more supportive attitude – and tax system – towards investment in training, innovative approaches to helping the self-employed insure their income, and a more flexible pension system that reflects the unpredictability of income for the self-employed.

3 Big versus small

‘Small is beautiful’ wrote the economist EF Schumacher, coining a phrase that has become popular with businesspeople, politicians and thinkers impatient with the cumbersome nature of large bureaucracies. In an era in which there has been an explosion in the number of small and micro-businesses, it is tempting also to conclude that ‘small is powerful’⁵⁵ as more nimble, small organisations emerge to compete with corporate behemoths. For many small and micro-businesses, however, engagement with large businesses can be more frustrating and less straightforward than this story might suggest.

This chapter addresses the power imbalances that freelancers, the smallest businesses, face when dealing with larger organisations in the public and private sector. It examines:

- the power imbalances between large and small organisations which contribute to problems such as late payments and a legalistic approach to dispute resolution
- the way in which onerous clauses and processes in public sector procurement contracts can tilt the playing field towards larger organisations, reduce competition, penalise small business and ultimately costs the taxpayer in the form of reduced efficiency

Business to business relationships

Though government can create barriers to business through regulation and red tape, the self-employed can face further barriers to business, created by larger companies. Perhaps the most high profile of these issues is late payment. The issue has been growing, with the overall level of late payment to SMEs almost doubling between 2008 and 2012.⁵⁶ Surveys find that

85 per cent of small businesses say they have experienced late payment in the last two years, with studies showing SMEs owed a total of over £30 billion in late payments.⁵⁷ When asked, almost a third of freelancers say it has a significant impact on their business.⁵⁸

These late payments can cause small and micro-businesses considerable problems: more than a third of companies say that they have sought external finance to cover gaps in cash flow caused by late payment,⁵⁹ and the Federation of Small Businesses calculates that this has led to £180 million in debt interest charges.⁶⁰ These problems can be magnified for the self-employed as the smallest businesses are less likely than larger organisations to have large enough cash reserves to absorb the cash flow problems that late payment can create.

Successive governments have sought to address the problem of late payments to small businesses. The Labour Government introduced a statutory right for businesses to claim interest on the late payment of commercial debts through the Late Payment of Commercial Debts (Interest) Act 1998.⁶¹ Ten years later, the Prompt Payment Code was established as a further, voluntary initiative to tackle the problem. With the support of the Government and several large businesses, the code was established by the Institute of Credit Management as a voluntary charter. Signatories committed to pay suppliers on time, provide clear guidance to suppliers, and encourage good practice in their supply chains.

The Coalition Government has also made addressing late payments a priority, with ministers leading the campaign to sign up more large businesses to the code. Around 1,500 organisations are now counted as signatories, including 70 FTSE 100 companies.⁶² Despite this progress on numbers, however, there are concerns about the capacity of the Prompt Payment Code to address the problem as it is currently constituted. These concerns are that the code:

- is not specific enough, stating only that firms should meet their payment terms, not that the terms themselves should be reasonable

- does not reach enough businesses and is unlikely to do so while it is voluntary
- lacks a means of redress when signatories do not live up to their promises

The 2014 Queen's Speech reflected some of these concerns: the Government promised to 'improve payment practices between small businesses and their customers'.⁶³

When seeking to legislate, the challenge successive governments have faced is that small businesses often prove reluctant to invoke legal powers. As the Business Secretary has acknowledged, 'Rights are very rarely exercised in practice because businesses are worried about jeopardising future commercial relationships.'⁶⁴ Any answer must therefore find a way of addressing the power imbalance between small and micro-businesses on the one hand and large organisations on the other.

In addition to this, legislation can produce its own unintended consequences. The risk of statutory rules, such as punishments for companies paying their suppliers late, is that large companies will simply extend their standard terms. Small firms might be more likely to be paid 'on time' – but with standard terms of a 60-day rather than 30-day wait. The problem of late payment might be solved, but at the cost of making cash flow even tighter for the small businesses that change was designed to help.

Further, it is not uncommon for large companies to find ways round the letter of the law, delaying payment by questioning expenses or quibbling over minor aspects of work, thus avoiding having to pay on time, and generating disputes. The law has not yet found a way to even the balance of power between small and large businesses.

Dispute resolution

To address this problem, the Government should seek to build on the work already carried out in this area. It should start by strengthening the Prompt Payment Code, which currently

contains no formal sanctions for non-compliance. To achieve this, organisations signing the code should be expected to share some of the risks of late payment. In practice, this would mean signatories to the code – from both the public and private sectors – committing to pay interest automatically on any payments that are late. This change would give the current approach extra teeth, allowing for ministers and others to continue to campaign for more large companies to sign up to the code.

Recommendation 9: To address the problem of late payment, the Prompt Payment Code should be strengthened. The code should specify that payment terms must not exceed 30 days and signatories should be expected to commit to paying interest automatically on any payments that are late.

There is a case for the Prompt Payment Code to be mandatory for all large businesses, something argued for by MPs from across parties in the seminars held to inform this report. Whatever the decision on this, the Government must also continue to search for creative solutions. There will always be ways in which large companies can comply with the letter of the law, but continue to exploit the power imbalance with small businesses and individual contractors. In particular, many know that where there are disputes over late payment or other contractual issues freelancers or SMEs have little appetite to address them through the courts. What is a relatively small legal fee for a large firm can be a large cost and an unjustifiable risk for a small firm without the same resources behind it.

The policy challenge is to find ways in which freelancer and larger businesses can be encouraged and supported to resolve disputes in a collaborative and constructive way wherever possible. One source of inspiration should be Victoria, Australia, where the post of Small Business Commissioner was created, following permissive national legislation in 2003. The legislation put the Office of the Victorian Small Business Commissioner (VSBC) on a statutory footing, providing it with the authority to perform the role. The aim of the VSBC is to resolve disputes

pragmatically and quickly. The responsibilities of the Commissioner include:

- to facilitate and encourage the fair treatment of small businesses in their commercial dealings with other businesses and with public entities
- to promote informed decision making by small businesses in order to minimise disputes with other businesses and public entities
- to receive and investigate complaints by small businesses regarding unfair market practices or commercial dealings
- to provide alternative dispute resolution to small businesses in disputes with other businesses and public entities

Any small or medium business operator requiring mediation on an issue of unfair market practice or commercial dealings can download an application form on the website of the VSBC. Both parties are then invited to a mediation session, dependent on their willingness to participate. By law there are some issues that must be referred to the VSBC; where this is not the case the VSBC publishes an annual report naming those businesses that do not cooperate with his office.

The office of the Victorian commissioner has been running for more than a decade, principally offering these mediation services at a cost of AU\$195 per party – significantly cheaper than addressing the issue through the courts. If a dispute does not require full mediation, other services such as information provision, advice and negotiation without mediation may also be offered to the parties involved. There is no cost for ‘preliminary assistance’, which does not progress onto the mediation stage.

This model – and fee structure – could be replicated in the UK, with little or no cost to the taxpayer, beyond some seed-funding to help put the organisational infrastructure in place. In Australia, business commissioners operate at a state rather than national level. In the UK, LEPs could perform the role, with their performance monitored and overseen by the Department for Business, Innovation & Skills (BIS). As business-facing organisations operating at a regional level, LEPs would be well

positioned to mediate between small and large enterprises. The Government should experiment with seed-funding of a small number of LEPs to undertake this role. The ability of the pilot areas to settle disputes to the satisfaction of all sides and their financial viability as self-funding organisations in the future should then be evaluated.

Recommendation 10: To help resolve disputes between big and small businesses cheaply and equitably, LEPs should be given new powers to mediate in such disputes, building on the success of the Small Business Commissioner model in Australia.

Government as a customer

The other key area where the smallest businesses can be squeezed out by larger organisations is public procurement. The public sector in the UK spends £230 billion each year on goods, services and works to deliver public services.⁶⁵ There are long-standing concerns about the proportion of contracted work that goes to large companies, driven by the fear that the public sector will miss out on the talent of those who work for themselves unless significant changes are made to procurement processes.

The Government has set itself a target of procuring 25 per cent of goods and services (by value) from SMEs by 2015. (This figure includes direct contracts with SMEs and those further along the supply chain.) Currently the Government spends just under 20 per cent of its goods and services like this,⁶⁶ with the best evidence available suggesting that this figure has been rising in recent years (see table 2).

The story behind this progress has been a concerted effort in government to open up government procurement processes, without compromising the fundamental principle of delivering value for money for the taxpayer.⁶⁷ Important steps taken by the Government include:

- breaking up large contracts into smaller lots
- simplifying bidding procedures

Table 2 **Proportion of central government procurement spend with SMEs, 2009/10–2012/13**

Year	Direct spend (%)	Indirect spend (%)	Total spend (%)
2009/10	6.5	–	6.5
2010/11	6.8	–	6.8
2011/12	10.1	–	10.1
2012/13	10.5	9.4	19.9

- introducing a mystery shopper service
- preventing departments from ruling out financially sound bidders because of low turnover
- addressing prompt payments of SMEs⁶⁸

The changes that have been made to date have tended to focus on removal of generic barriers to SMEs making successful bids. A complementary approach would be to generate greater dialogue with SMEs and others around specific contracts.

Often Whitehall culture can run counter to this, with organisations bidding for contracts deliberately kept at arm's length to ensure that the process itself is not prejudiced. The problem with this is that all the information about what makes each contract easier or harder to bid for remains locked in the minds of people and organisations outside government. SMEs know what puts them off, but government does not have a process for learning, contract by contract.

This could be changed by offering SMEs and others more opportunity for providing feedback about specific contracts, in an open and transparent way. For example, the Government should commit to publishing tender documents in an open source, editable format, allowing SMEs and others to suggest revisions, which would make the bidding process less onerous. This would enable organisations to point towards particular clauses in the contracts or aspects of the tender process that would make a bid or a contract harder for them to fulfil. Meanwhile, other individuals or organisations could suggest their own revisions, as well as having the opportunity to

comment on the revisions suggested by others – supportively or otherwise.

Recommendation 11: to further open up government procurement to small businesses and freelancers, the Government should publish tender documents in an editable format. This would allow SMEs and others to suggest revisions that would make the bidding process less onerous.

This open source approach could provide a simple feedback mechanism to inform how future tender documents were written. At the very least the civil service would have a steady stream of information about the clauses in contracts, or requirements in bidding processes, responsible for ruling out SMEs and individual contractors. More radically, government departments could build in time to revise individual contracts based on the feedback received. This opportunity to suggest revisions to contracts might take place during a short, defined period (of perhaps one or two weeks), before the Government would decide whether to make the suggested amendments to the final version.

Where contracts are so large that they will inevitably be awarded to large companies, the challenge for government is to ensure that there are fair opportunities for SMEs further down the supply chain. For example, one study found that the 50 largest suppliers to government were responsible for 35 per cent of government spending.⁶⁹ The procurement practices of these large ‘tier 1’ contractors therefore matters almost as much as that of government itself. As part of any bid for a government contract, tier 1 contractors should be expected to demonstrate how they will open up opportunities for subcontracting to the widest possible group of organisations and individuals. Tier 1 contractors should also be expected to publish details of who they contract with, to promote transparency and accountability in winning future contracts.

Recommendation 12: to further open up government procurement, tier 1 contractors should be expected to demonstrate how they will open up opportunities for subcontracting to the widest possible group of organisations and individuals. These organisations should also be expected to publish details of who they contract with, to promote accountability.

Conclusion

Small and micro-businesses enjoy many competitive advantages over large organisations, including the ability to be nimble and responsive to new opportunities. However, small businesses can also suffer from business practices which are unfair and damage competition. Large organisations tend to have greater resources, creating a power imbalance with freelancers when resolving disputes. Government can play a useful role in addressing this through creating new fora where small and large organisations can enter into dialogue and resolve disputes in an affordable and constructive way. The Government should learn from the success of small business commissioners at state level in Australia.

Government also needs to do more to create a level playing field between large and small businesses when putting its own contracts out to tender. Large businesses often have the ability to cope with onerous compliance requirements and convoluted contracts, where small organisations often cannot afford to commit the resources. The Government should build on the good progress it has made in this area by moving from generalised improvements in procedure to greater dialogue with SMEs and others about the structure of specific contracts.

4 Infrastructure

In the longer term, government plays an important role in creating the conditions for businesses of all sizes to prosper. This involves basic legal provisions that enable contracts to be struck and relied on, but it also applies to a country's infrastructure. As the Prime Minister has put it:

Infrastructure matters because it is the magic ingredient in so much of modern life... It affects the competitiveness of every business in the country; it is the invisible thread that ties our prosperity together.⁷⁰

For freelancers, this can be especially true. Unlike most employees, most freelancers often have no fixed workplace to commute to every day. Freelancers require their own micro-infrastructure – physical places to work which meet their business requirements – and depend heavily on macro-infrastructure, in the form of transport and digital infrastructure that help them connect and communicate with clients. This chapter examines the infrastructure needs of the self-employed, through both small-scale innovations, such as work and ‘enterprise hubs’, and large-scale investments in broadband and mobile connectivity.

Micro-infrastructure

Many freelancers have no single workplace to commute to each day; some simply work from home, but there are ‘push’ and ‘pull’ factors that make other options more attractive for others. ‘Push’ factors might include a lack of appropriate physical space at home, while ‘pull’ factors include proximity to clients and colleagues, the simple desire for human contact, and the

pragmatic recognition that meeting and mixing with others can help business prospects in the long run.

One of the ways this desire for appropriate micro-infrastructure is being met is through the burgeoning work hub movement. Work hubs offer ‘a flexible workspace offering an “office when needed” service for micro businesses and mobile workers’.⁷¹ The flexibility offered by this model can be important to freelancers in helping avoid the large fixed costs that come with renting office space, so that cash flow can be managed in between projects. Work hubs also offer flexibility around tenure that can reflect the length of particular contracts or projects.⁷²

Work hubs can provide physical infrastructure, but in doing so they can also give people the opportunity to mix with other like-minded professionals. There is a burgeoning literature on the advantages that can be gained from businesses ‘clustering’ around one another and sharing knowledge, ideas, contacts and inspiration as a result.⁷³ Economists describe this as a ‘spillover effect’, as clusters of businesses become more than the sum of their parts.

This helps explain why many freelancers choose to base themselves, at least part time, at work hubs within major cities, where these interactions with other freelancers and small business owners are multiplied. Policy makers are increasingly interested in extending these advantages to more people, by making more imaginative use of empty buildings in urban areas and developing shared working spaces for dispersed rural SMEs.

The Government has been the most proactive in its approach to rural areas, investing around £15 million in a new pilot programme of five rural growth networks.⁷⁴ A key plank of the policy is to address the lack of suitable premises for small businesses, through the creation of ‘rural enterprise hubs’. Enterprise hubs in the five pilot areas are based in underused business parks, brown-field sites or sites which already have outline planning permission for commercial or industrial development.⁷⁵ The pilots have been designed to run in partnership with local councils or LEPs, reflecting the need for councils to grant permission for premises to be renovated where

necessary and the wider economic remit of LEPs.⁷⁶ An example is described in box 5.

Box 5 Pilot rural growth network in Durham and Northumberland

The pilot programme in Durham and Northumberland is run in partnership with the North East LEP. It will deliver a programme of initiatives between 2012 and 2015 to support small business growth across rural communities in Durham, Gateshead and Northumberland. The specific objectives are to:

- *test new types of enterprise hubs in new locations*
- *develop government's understanding of the role played by enterprise hubs in stimulating and supporting rural enterprise*
- *build on and enhance existing hubs*
- *identify gaps in provision, new opportunities and potential to develop new networks⁷⁷*

Early evidence suggests that the ability to help replicate the clustering of businesses that occurs in cities may be one of the key areas in which the hubs can add value. A recent research report into home working noted: ‘The added value an enterprise hub can bring to the rural economy is in the way it can help the businesses operating from the hub to gain access to a variety of knowledge networks.’⁷⁸

But the policy question is how and whether government should play a role in supporting this way of working in the longer term. The risk is that government either subsidises hubs that would have existed anyway or throws money at developing premises where there is little demand. Either scenario would waste taxpayers’ money. Rather than fund work hubs directly, the Government should make it easier for entrepreneurs to start new ones where there is demand for them. One way of doing this would be to consider the taxation of work hubs, which house many small and micro-businesses but do not benefit from small business rates. This is because the occupants of work hubs are

not fixed in the same way as the tenants would be in most office space. As a result, space let out to small businesses for short-term use costs more than would be the case for a longer lease. The Government should examine the costs and benefits of addressing this anomaly.

Recommendation 13: to encourage the development of work hubs, the Government should examine whether they should be eligible for small business rate relief.

One simple contribution that local authorities could make would be to compile and publish interactive maps of disused buildings in their areas, showing their geographical location and information such as the dimensions of the property, its rateable value for business rates, its previous use and any other information pertinent to future planning permission. The general public could be invited to contribute information, helping identify derelict properties and helping reduce the costs of the exercise for each authority. Organisations such as the Local Government Association could play a coordinating role, helping authorities split the costs of the necessary software development between them. Such an initiative would provide a boost to entrepreneurs in urban and rural areas open to the idea of investing in work hubs in the future.

Recommendation 14: to encourage the development of work hubs, local government should compile and publish interactive maps of derelict and disused buildings in their areas.

Planning permission is another important consideration, as work hub providers find it slow and difficult to gain permission to convert rural buildings, in particular into workspaces. Progress has been made towards this in recent months; the Government announced that from March 2014 it would be possible to convert agricultural buildings to a range of other uses, including office space, without prior planning permission.⁷⁹ The Government has rightly adopted a cautious approach, with new rules applying only to small buildings (those of up to 450 square metres). However, caution and ambition can go together. The impact of

the changes should be closely monitored and evaluated, with a view to gradually extending these ‘permitted development’ rights to larger buildings.

Recommendation 15: to reduce barriers to the development of work hubs, the Government should evaluate the impact of recent changes to ‘permitted development rights’, with a view to extending them to larger buildings.

A further obstacle, particular to rural areas, relates to the broader macro-challenge of internet connectivity and good mobile reception. Research by the Rural Economy Unit at Newcastle University has found that even some of the government-backed enterprise hubs have been running with internet connection speeds of less than the 2mbs, which is often used to define ‘broadband’.⁸⁰ The Government’s own research has shown that rural enterprise initiatives have found it difficult to attract small business customers without access to broadband.⁸¹ In the short term, one way to address this would be to prioritise shared workspaces in the roll-out of broadband into rural areas. However, such an approach does not resolve the fundamental problem that, for many freelancers, Britain’s digital infrastructure does not yet adequately support a flexible way of working.

Research for the Federation of Small Businesses has found a quarter of SMEs dissatisfied with their internet provision. Speed of connection is the biggest concern, followed by reliability of connection. Value for money is placed third, though 43 per cent say they would be willing to pay more for a faster connection.⁸² Just over half, 57 per cent, of small business often experience no or poor mobile signals.⁸³ Good connectivity is especially important for small businesses in rural areas. According to analysis by the ONS:

Self-employment and working from home (or being based at home) are both more common in rural areas of England than in urban areas. They are more common still in sparse areas, where people are twice as likely to be home-based or self-employed, as those in less sparse areas (one in four in sparse areas compared with roughly one in eight in less sparse areas).⁸⁴

Despite the high proportion of people working from home, rural areas face the biggest challenges with connectivity. In surveys, 63 per cent of rural SMEs say they are dissatisfied with the speed of their broadband connection, compared with 48 per cent of businesses in urban areas.⁸⁵ Meanwhile, more than half of rural businesses in general are suffering with the slow speed of their broadband and more than a third are dissatisfied with the reliability of their internet services.⁸⁶ Research published by the now-defunct Rural Communities Commission brought to life some of the tangible consequences of this, including small businesses having to host websites in rural areas, despite the owners living in rural areas, leaving them unable to update them in real time.

The Coalition Government has set itself a series of targets in upgrading the UK's digital infrastructure, including committing to universal access to broadband at a minimum of 2mbps for all by 2015.⁸⁷ Although this ambition is welcome, it raises the question of how the Government will continue to push itself and its partners beyond this target date. One answer to this would be to commit to target not just a minimum speed, but also a maximum ratio between the fastest and the slowest speeds in the country.⁸⁸ Such an approach would demonstrate its ambition for connectivity in rural areas.

Recommendation 16: to support flexible working in rural areas, the Government should commit to target not just a minimum speed, but also a maximum ratio between the fastest and the slowest broadband speeds in the country.

Tying this in with measures to improve mobile reception would help to ensure there is a fully comprehensive digital infrastructure in rural areas. To achieve this, the Government should seek to gain maximum leverage from future spectrum sales, drawing on lessons from the 4G spectrum sale, part of which included stretching coverage obligations.⁸⁹ In monitoring existing performance, Ofcom should learn from experiments to crowd-source information about mobile 'not-spots'⁹⁰ as a means to identify problem areas beyond one-off studies and coverage

data provided by industry. Ofcom should find low cost ways of drawing on – and making public – the information held by the public about where people can access proper coverage and where they cannot.

Recommendation 17: to support flexible working in rural areas, Ofcom should learn from experiments in crowd-sourcing information about mobile ‘not-spots’, in order to identify problem areas beyond one-off studies and coverage data provided by industry.

Improving connections to people’s homes will be important for freelancers, and the extent to which people are able to use their time productively on the move should also be addressed. This matters to companies of all sizes – the average worker spends nearly 200 hours a year commuting⁹¹ – and is vital for freelancers moving between projects and clients. There is considerable scope for improvement in this area. For example, less than half of London Underground stations have wi-fi access and there is no signal at all between stations. Only a minority of UK rail lines offer wi-fi, leaving passengers dependent on 3G networks for connectivity.⁹²

In Edinburgh, trams and buses are currently being fitted with free wi-fi services, at a cost to the Government of £2 million.⁹³ The Labour party has said that it would demand train operators include wi-fi as part of the service they offer to their passengers, and the Department for Transport has begun to include this requirement in contracts in a piecemeal way.⁹⁴ The Government should publish a target date by which time all public transport has a wi-fi connection available. Progress should be made towards this target by ensuring that all future contracts to deliver public transport build the requirement to provide wi-fi for customers.

Recommendation 18: to enable freelancers and others to work more efficiently on the move, the Government should ensure that all future contracts to deliver public transport build the requirement to provide wi-fi for customers.

Conclusion

All businesses depend on infrastructure as a platform for what they do. The infrastructure that enables flexible working is essential for the self-employed. Connectivity that allows people to work productively from home or on the move is vital for many freelancers. The Government has a big role to play in enabling this, through regulation and subsidy in the roll-out of broadband and through the specifications of contracts for companies providing public transport. In other ways, government can make a contribution to reducing barriers to the development of facilities such as work hubs, which growing numbers of freelancers are now making use of.

5 Conclusion

Since the 2008 financial crisis and subsequent downturn there has been a growing debate on the reasons for the rapid growth in the proportion of the workforce registered as self-employed. Some clarity is now beginning to emerge: most economists agree that there is a structural shift taking place in the labour market, alongside any shorter terms effects of a weak labour market. Survey evidence suggests that this structural shift is being driven predominantly by positive choices. Though a minority would prefer to work as employees, most of the self-employed say they favour this way of working.

The challenge now is to consider the policy implications of such a shift. If more people are choosing to be self-employed – and more companies are choosing to engage them – is government doing all it can to provide an environment in which the self-employed are able to thrive? Are government regulations as simple and streamlined as they could be? Is the law clear enough to provide certainty about the employment status of the self-employed, with all the implications that brings?

This report has argued that more can be done to address these issues, making the following recommendations:

- **Recommendation 1:** to reduce red tape for firms and the self-employed, the Conduct Regulations and the Agency Worker Regulations should be merged.
- **Recommendation 2:** to reduce red tape for firms and the self-employed, an individual should have a single employment status for a given contract, which applies for all employment and tax law.

Conclusion

- **Recommendation 3:** to provide greater certainty over employment status, the Government should review and overhaul the current tests on which it is established, settling on no more than five simple criteria. This should involve eliminating a number of the current tests, which are either irrelevant or too open to interpretation.

The decision to become self-employed involves making a trade-off between freedom and security. Individuals give up the predictable income patterns and employer benefits associated with being an employee in exchange for greater flexibility, self-determination and, sometimes, remuneration. To a degree this trade-off is unavoidable, but there are ways in which government can help the self-employed protect themselves against risk:

- **Recommendation 4:** to address unnecessary complexity and to encourage entrepreneurial behaviour among the self-employed, the current disincentive for freelancers to invest in new skills should be removed. Training for the self-employed should be treated by the tax system in the same way as training for employees is.
- **Recommendation 5:** to help the self-employed protect themselves against loss of earnings, civil society organisations should work with the insurance industry to help freelancers access group protection policies. The Government should help convene the key players to explore this idea.
- **Recommendation 6:** to help the self-employed protect themselves against loss of earnings, the Treasury should model the costs of a new opt-in 'maternity/paternity extra' for the self-employed. To access the scheme, the self-employed would need to have chosen to make contributions above an agreed threshold for a defined period. Contributions to such a scheme could be tax deductible.

- **Recommendation 7:** to encourage saving for later life, the Government should work with NEST to create a tailored pension scheme for the self-employed. This would allow individuals to withdraw a proportion of their pension contributions from the last two years at any time.
- **Recommendation 8:** to encourage saving for later life, the Government should engage the self-employed in dialogue about the kinds of behavioural prompts that most would find useful and acceptable in encouraging more regular pension contributions.

One of the risks that freelancers face as micro-businesses is that they will come off worst in disputes with larger organisations. Without large cash reserves, freelancers can suffer from late payments in ways that large companies will not, and are likely to ask lawyers to resolve disagreements because of the costs involved. There is also therefore an important role for government to play in helping address power imbalances between the smallest businesses and organisations that are much larger. In addition, government must be careful to ensure that its own procurement rules do not tilt the playing field away from small businesses, to the detriment of them and the taxpayer:

- **Recommendation 9:** to address the problem of late payment, the Prompt Payment Code should be strengthened. The code should specify that payment terms must not exceed 30 days and signatories should be expected to commit to paying interest automatically on any payments that are late.
- **Recommendation 10:** To help resolve disputes between big and small businesses cheaply and equitably, LEPs should be given new powers to mediate in such disputes, building on the success of the Small Business Commissioner Model in Australia.

Conclusion

- **Recommendation 11:** to further open up government procurement to small businesses and freelancers, the Government should publish tender documents in an editable format. This would allow SMEs and others to suggest revisions that would make the bidding process less onerous.
- **Recommendation 12:** to further open up government procurement, tier 1 contractors should be expected to demonstrate how they will open up opportunities for subcontracting to the widest possible group of organisations and individuals. These organisations should also be expected to publish details of who they contract with, to promote accountability.

Finally, government must do what it can to provide a supportive long-term environment for those who wish to work flexibly. Infrastructure is critical to this, including ‘micro-infrastructure’ like work hubs which are mostly provided by the private sector without government subsidy. Where possible government should seek to remove barriers to the emergence of these workspaces, rather than believe it knows where and when they are needed. More important still is the ‘macro-infrastructure’, which allows freelancers to work flexibly both at home and on the move. Here government has an important role in setting ambitions for the future and in using the leverage it has through public contracts to ensure that Britain keeps pace with the most advanced cities in the world:

- **Recommendation 13:** to encourage the development of work hubs, the Government should examine whether they should be eligible for small business rate relief.
- **Recommendation 14:** to encourage the development of work hubs, local government should compile and publish interactive maps of derelict and disused buildings in their areas.

- **Recommendation 15:** to reduce barriers to the development of work hubs, the Government should evaluate the impact of recent changes to 'permitted development rights', with a view to extending them to larger buildings.
- **Recommendation 16:** to support flexible working in rural areas, the Government should commit to target not just a minimum speed, but also a maximum ratio between fastest and the slowest broadband speeds in the country.
- **Recommendation 17:** to support flexible working in rural areas, Ofcom should learn from experiments in crowd-sourcing information about mobile 'not-spots', in order to identify problem areas beyond one-off studies and coverage data provided by industry.
- **Recommendation 18:** to enable freelancers and others to work more efficiently on the move, the Government should ensure that all future contracts to deliver public transport build the requirement to provide wi-fi for customers.

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It is no secret that the self-employed population of the UK has been growing steadily for more than a decade. There are now 4.6 million people in the UK who are self-employed – around 1 in 7 of the UK workforce – and on current trends, this growing group is set to outnumber the public sector workforce by 2020. What is driving this trend, and what it means, has been subject to a great deal of public debate. While it seems the economic downturn accentuated the rise in self-employment, the rise predates the downturn and is expected to continue into the recovery.

Going it Alone explores the policy implications of this shift. It argues that while many freelancers are attracted to the freedom and flexibility that self-employment can bring, individuals need the power to stand up for their own interests against government and against large companies. Public policy must therefore strike the right balance between heavy-handed interventions on the one hand, which can damage the flexibility that many of the self-employed value, and a laissez-faire approach on the other, which ignores power imbalances in the marketplace. With more people than ever going it alone, it is time to rethink policy on everything from tax and regulation, to skills, welfare and pension policy.

Duncan O’Leary is Research Director at Demos.

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