

The economics of small business

Published: January 13, 2026, 7:16 am

Small businesses do not work as microeconomic theory suggests. They don't maximise profit. Most, at best, provide their owners with a fair wage. That's why if you hit them hard – as Rachel Reeves has done – the economic impacts can be really serious.

<https://www.youtube.com/watch?v=s9ta9bXB5lg?si=qIn9wueAczXejCQy>

This is the audio version:

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This is the transcript:

We need to talk about the economics of small business.

What's very clear is that lots of people do not understand how small business really works. That's become apparent because of the budget. People are saying, how can it be that small businesses are so marginal that an increase in the cost of employers' national insurance might threaten their very existence? And my answer is, quite easily, actually.

What is obviously not understood is that small business does not make a profit. Now that's a very big thing to say because microeconomic theory, which is the theory that is

used and taught at universities and applied by people like the UK Treasury, says that every business exists to make a profit.

And the truth is, that is not the case in the vast majority of small businesses. Small businesses exist for a whole range of reasons, but making profit is rarely one of them.

Now I'm not disputing that business owners do of course want to make a return on their effort, but the return that they make is very rarely better than a wage.

It's really important to understand the distinction between that wage and profit and I can use myself as an example here because it will be entirely appropriate to do so.

For many years, I ran a firm of chartered accountants. I was its senior partner. I had two women as partners. We employed quite a lot of people. We serviced hundreds - nearly a thousand - clients at one point, but in all the time that I ran that firm, I probably made no more money than I would have done if I had, for example, been employed by one of the large firms of chartered accountants in the UK.

It was a comfortable living. I'm not pretending otherwise. I'm not complaining. I chose to do it. But I did not make what in economic terms would be a profit. In other words, a profit - a sum that was in excess of what I would have earned in exchange for my labour. My labour was remunerated with a wage. A good wage, but nonetheless one that was not excessive to the point that it was obviously above the sum that I could have earned elsewhere.

And this is true of the vast majority of small businesses. In fact, it's so true that many people make less money by being self-employed than they would do, in alternative employment. And that takes some explanation as well.

Why do people work for themselves when they make less than they would if they took a job? Well, there are a number of very good reasons.

The first is, they don't want the jobs that are on offer. And why not reject those jobs when so many of them are dull, boring, repetitive, literally in environments where people do not appreciate those who are doing the work, and where the person is very often oppressed by the work that they do? They choose to work for themselves to simply have a better work experience.

The second reason why people work for themselves is they quite simply don't fit into the model of employment that most employers impose. The assumption is that people are neurotypical. I have mentioned this issue before in this video series, and I will no doubt mention it again.

Neurotypical is somebody who can fit into the mould of expectation that HR departments by and large create for their employees. But the fact is that there are a lot of people who are not neurotypical. Sometimes we apply labels to them which are quite

inappropriate. Autistic is sometimes used, ADHD is also sometimes used, and these might be helpful in some circumstances, but they very rarely are in the workplace. Quite simply, people who are not neurotypical think in different ways from that which is normal.

There are large numbers of these people. They tend to make associations between ideas that are not created by neurotypical people. Those are exploited by the person who wants to work for themselves to create job opportunities that do not exist in the mainstream environment. They can, therefore, actually use their skills to best effect in self-employment, and that's exactly why they are self-employed.

It's not because they actually have chosen to be self-employed for that reason. It's because the mainstream employment environment provides them with no opportunity to use their skills in the way that they would wish, and so they become self-employed instead. And they are quite willing to accept a reasonable rate of wage in self-employment for the opportunity to do what they wish.

And then let's look at the other reason why many people are self-employed. It's quite simply because there isn't a job available to them. There are no jobs that suit their skill set, or are nearby, or provide the hours of work that they require to work around children, or other commitments of caring, or whatever it might be. And so, they need the flexibility that self-employment provides. Again, they'll accept a wage, in self-employment, but they will not be looking for a profit - in other words, a return over and above a wage to incentivise them to do the job.

Now, there are five million or more small businesses in the UK. It might be larger than that. It's a little bit vague as to how many people who are self-employed are really running businesses that provide them with their main income or not. But whatever the true number is, this is a significant part of the UK workforce. If those people who run these businesses are considered in isolation, that's roughly one in six people working in the UK.

If we add in the people who work for them, and there are quite a lot - although probably 80 per cent of small businesses employ no one, bar the owner - if we add in the rest of the small businesses that do employ people, we find that nearly half of all employees in the UK work for smaller companies.

Now, some of those will be at the higher end of the small range, because the government defines small and medium businesses as entities with up to 250 employees, and I don't think they're small at all.

But if we look at the smaller ones, there are still a large number of people who work in these organisations. But even though people who have set up their own businesses begin to employ others, and I did, that doesn't necessarily mean they are doing so because they want to make a massive profit out of them.

As I've said, I made a decent wage out of what I did, but I never really made a profit. The people that I employed were doing jobs that were really valuable to support what I wanted to deliver to my clients for their benefit at a price that they could afford and I wasn't trying to exploit anyone, and the vast majority of small businesses work that way. They employ people to make it possible for the owner to do what they wish to do. That's it.

Now if you do something like Rachel Reeves has done now - not with regard to the minimum wage - I support what she's done on the minimum wage; let's be clear. I would like young people to have at least 10 an hour. It still doesn't seem very much. I would like the minimum wage to be at least £12.21 an hour. It's hardly enough to provide somebody with an opportunity for independent living. So I'm not complaining about the minimum wage increase - but if she believes that increasing employers' national insurance is going to help a person who is employing others in their business to diversify and to take people on to help them deliver to their clients, she's wrong.

Because once you get to the point where it becomes too costly, in terms of the reduction of the owner's wage, to supply that thing that the customer might want, which the business owner might want to supply, but which can only be delivered at cost to the business owner's wage, then, it's as simple and straightforward fact that the business owner does eventually reach a point where they make the tradeoff, saying, "I can't afford to do this anymore because however much I enjoy being in self-employment, because it suits my circumstances, I do eventually have other costs to meet and I will be forced either out of self-employment or back into employment." Or into nothing at all in some cases.

So, there's a limit to the extent to which additional costs can be imposed on smaller businesses and I do not think that Rachel Reeves has understood this.

It is claimed that her increase in the allowance for small businesses that don't have to pay employers national insurance of up to £10,000 a year should cover this circumstance. But, if you're in hospitality, if you're running a care service, if you're running a nursery, if you're running another of these deeply labour-intensive businesses, the likelihood is that you're going to have more than three or four employees on something like the minimum wage to deliver the service that you want to supply.

In that case, you can't get around this problem using that allowance. You've got a bill and you've got to pay it, and either the owner picks up the cost or the customer does because there is no choice if the business is going to survive.

Now I've heard lots of people say, well in that case these businesses aren't viable. They are within constraints, the constraint being that the owner needs to make a wage. You can force them out of business, you can say that the owner should put up with this, but they won't. And then society loses.

We don't seem to have people in our society, or people in our political parties, or people in the Treasury who really understand what small businesses do, how they work, how they think, how they reward their owners, and so on. They've bought hook, line, and sinker that you go into a business to maximize your profits. This is the biggest load of nonsense with regard to small business that has ever been written. That is simply not how it works for, I would suggest, well over 90 per cent of small business owners. They're there to make a wage, to do a job that they enjoy, for the benefit of society, because people want to buy something from them, but not because they're there to make a profit over and above the wage that they could make anywhere else.

Rachel Reeves didn't understand that. The cost for the small business community will be high, but it will also be passed on to many elsewhere in the economy. And that means this error on her part is going to have widespread implications. And that worries me because we need a vibrant small business sector if, as an economy as a whole, we are going to provide the employment, the growth and the prospects that the people of this country need.