Introduction

This paper will explain how the UK currently creates enterprises from legal units and how business profiling is used to determine enterprise structures for enterprise groups. The paper will then look at some of the issues that will arise as a result of the proposed change to the enterprise definition in the EU.

The paper will describe current legal unit supply to the business register and then explain the automatic processes in place to create an enterprise. The UK complies with the current EU regulation, by using combinations of legal units, if appropriate, when creating enterprises. For the more complicated businesses, profiling is used to determine the enterprise structure. The paper will examine how this methodology will need to change in order to comply with the proposed new definition of the enterprise. The main difference being that to qualify as an enterprise, it is necessary for a unit to have third party sales. This will mean that any unit with solely intra-group sales will not be considered to be an enterprise.

The impact of the proposed international profiling, based on a top down approach will also be considered. The top down approach based on IFRS global segments, can yield different organizational structures to a bottom up approach based on legal units. The UK currently profiles using a bottom up approach based on legal units. The paper will consider how these approaches lead to different enterprise structures.
Creating Enterprises

The UK business register is based on two primary administrative sources, Value added tax (VAT) and employment tax (PAYE). These are supplemented by Company registration data. Each of these three sources has a separate reference numbering system, so records have to be matched using a probabilistic matching tool.

A simplified version of the process is set out below:

- New VAT records are received each day. These are run through matching processes to see if they link to an existing legal unit. If they match the record will be linked to an existing enterprise.
- If the VAT record does not match to an exiting legal unit, a new enterprise is automatically created.
- PAYE records are received on a quarterly basis. These will be passed through matching routines to try to link them to an existing enterprise.
- Those that match to a company registration, but not to a VAT, will automatically lead to the creation of a new enterprise.
- Those that do not match to either company registration or VAT are currently held in a holding area for further treatment, to avoid the risk of duplication.

This process yields a set of simple enterprises, based on 1 VAT, 1 or more PAYE and 1 or more company.

The UK VAT system allows one member of an enterprise group to pay VAT on behalf of the whole group. The company paying the VAT is called a VAT representative, and the companies within the group not paying VAT are called non-representatives. This process enables ONS to build enterprise groups and also to create enterprises containing multi VAT and company registrations.
A rules based system joins records together to enable us to comply with the enterprise definition i.e. the smallest combination of legal units with autonomy.

So for example, for a small VAT group with a total employment of less than 20, all of the companies will be combined into one enterprise. This is deemed to be the smallest combination of legal units with autonomy.

For larger VAT groups, each VAT member would become an enterprise, and an enterprise group would be created on the register.

As well as the automatic processes, a number of clerical checks will be carried out when the matching process does not yield clear results.

**Business Profiling**

Profiling is defined as the practice of using company accounts, and meeting with company officials to build and define the structure of enterprises. The UK has run a profiling program for many years with the larger enterprise groups profiled on a rolling program and in reaction to business events.

The current UK approach is based on examining the individual companies and VAT records of the group. An array of checks for consistency and congruence are carried out as the first part of the process. Often the current group structures are considered sufficient following this exercise.

When this paper exercise identifies problems then the business is contacted. The business contacts used by individual survey domains are the first point of contact, but contacts higher up the group structure will be used as appropriate. Meetings will be held either with domain contacts or higher to agree a reporting structure. This can be described as a bottom up approach.

**How the proposed EU Enterprise definition could change the UK method.**

The following is an extract from the proposed new definition:
An **enterprise** is an organisational unit which has a sufficient degree of autonomy in decision-making and sells in its own will goods and services to a third party.

*Selling to a third party means: The exchanges are made with an independent buyer on the basis of commercial considerations*

*Selling goods and services in its own will to a third party is a necessary condition to identify the autonomous statistical unit enterprise.*

The key concern is the selling to a third party. The UK Business Register currently contains around 250,000 enterprises that are part of enterprise groups. The criteria of selling to a third party as a consideration in the delineation of an enterprise, is not part of existing UK processes. This is not an explicit requirement of the current definition.

To comply fully with this new definition we would need to ask each of the 250,000 enterprises where they sell there output. If the sales are intra-group sales, then this would invalidate the enterprise. We would then have to roll enterprises together until we get an entity that sells output to the external market. The only way to fully ensure that the autonomy question is answered is to profile. Since there are around 88,000 groups and we profile around 400 groups per year, this is not feasible.

The consequence of this change would be less granularity in survey results, and discontinuities in time series. We are not sure of the scale of this change yet, but work is being undertaken as part of an EU grant to assess the impact.

One good example is a large vertically integrated food business, that has agriculture, food processing and food retail (see below). We can assume that primary products, such as animal feed are sold within the group, so some form of consolidation will be required. The group has few enterprises but many KAU. The only way to assess the impact would be to re-profile using the new rules. This is obviously very time consuming and requires the goodwill of the business.
It is likely that all of the output of enterprise 1 is sold to enterprise 2. So under the new definition these would be consolidated into one enterprise and the classification of the consolidated enterprise will be based on the employment of the largest NACE code (based on top down methodology and using employment as a proxy for value added). So some industry granularity will be lost.

**Potential Impact: example of an integrated food manufacturer**

<table>
<thead>
<tr>
<th>Enterprise 1</th>
<th>NACE</th>
</tr>
</thead>
<tbody>
<tr>
<td>KAU Animal Feeds</td>
<td>1091</td>
</tr>
<tr>
<td>KAU Rearing</td>
<td>0147</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Enterprise 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>KAU Fresh Chicken</td>
</tr>
<tr>
<td>KAU Poultry</td>
</tr>
<tr>
<td>KAU Convenience Foods</td>
</tr>
</tbody>
</table>

**How international profiling could change the UK method**

The ESSnet on International Profiling has developed a methodology which is based on a top down approach using the IFRS accounting standard segments. The starting point is to assume each accounting segment could be a Global Enterprise (GE). The Member State where the Ultimate Controlling Institution resides would be responsible for profiling and delineating the GE. It will be vital to get cooperation from the top of the business for this to be successful.

The global enterprise is not explicitly defined by the new regulation, but one of the operational rules explains that the GE follows the same general rules around autonomy, but is a cross border entity.

This different emphasis from bottom up to top down will lead to different reporting structures and hence changes to survey outputs.
A key feature will be the role of other member states when the UCI is in another member state.

An example of the impact can be seen by the international profiling of a UK based oil company. The company accounts led to the identification of 3 operating segments, whereas the current structure on the UK register was based on 7 enterprises. Using the 3 segment structure would lead to the oil refining and chemical manufacturing, being joined together with retailing of petroleum products. This would be a major change for ONS surveys, and a reduction in industrial detail for users and policy makers.

A second example is an aerospace company. This business has five operating segments in the published accounts, but 10 operating streams. Here the company advised that the data we require could only be supplied by the 10 operating streams. So again using the accounting segments would lead to a loss of industrial detail, but on this occasion the company would not be able to report on the segmental basis.

The transition to the new method would have to be carefully managed. Since profiling is a labour intensive process, it would take several years to move all major groups to the new approach. This would leave a mixed approach during the transition period. This could easily result in a series of small changes being drip fed to surveys and hence to outputs, which is undesirable.

**Conclusions**

The new definition of the enterprise in conjunction with the proposed international profiling, if adopted, will lead to changes in UK business structures and consequently survey outputs.

A pragmatic rules based approach would need to be applied in order to make the change. It would not be practical to contact each of the current enterprises to establish third party sales. A larger profiling programme would be needed to agree the structure of the more complex enterprise groups.

Careful planning of the transition process will be required, to avoid a long period of uncertainty and drip fed changes to outputs.