

1

The Economic Impact of Small Businesses

1.1 Small Business in Perspective

In round figures,¹ Ireland has a population of four million people; approximately two million are in the workforce, and of these, 350,000 work for Government departments, State agencies or other public sector bodies (including health and education), and 100,000 work in agriculture. The rest (almost one-and-a-half million people) work in the enterprise sector – manufacturing industry, services, construction, wholesale and retail, hotels and restaurants, transport, self-employed professionals, and so on.

Of this one-and-a-half million, more than half – 777,000 people – work in businesses that employ fewer than 50 people (Table 1.1).

Table 1.1: Number of Enterprises by Level of Employment 2005

Business size	50+ employees	20-49 employees	10-19 employees	2-9 employees	1 employee	Total
No. businesses	7,000	4,000	6,000	85,000	131,000	233,000
Per cent	3.0	1.7	2.6	36.5	56.2	100
No. of employees	675,000	138,000	111,000	397,000	131,000	1,452,000
Per cent	46.5	9.5	7.7	27.3	9.0	100

Source: CSO data. March–May 2005

These businesses that employ fewer than 50 people are the subject of this report – for our purposes, they are ‘small businesses’.² Some 18 per cent of these businesses are limited companies, 12 per cent are partnerships, and the remaining 70 per cent are sole traders.

1 The figures cited in this chapter are drawn from the DKM report commissioned by the Small Business Forum, The Economic Impact of Small Business in Ireland, www.smallbusinessforum.ie, January 2006. As the DKM report shows, there is some variation in the estimates of the number of small businesses. For the sake of comparability with employment data, Table 1.1 uses CSO data

2 The EU defines small businesses as enterprises employing fewer than 50 persons with annual turnover and/or annual balance sheet totals not exceed €10 million. Recommendation 2003/361/EC, http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_124/l_12420030520en00360041.pdf

1.2 Growth in Small Business Numbers

There are just under a quarter of a million small businesses in Ireland – a number that has grown by more than 50 per cent over the past ten years. Between 1995 and 2000 the number of small businesses grew by an average of 6.6 per cent a year, but in the years since then, growth has slowed to 2.6 per cent. Of all businesses operating in Ireland today, over 97 per cent fall into the ‘small business’ category.

In 2005, Ireland had the highest rate of new business start-ups in the European Union and ranked 5th in entrepreneurial activity across 25 OECD countries, behind New Zealand, the United States, Australia and Iceland.³

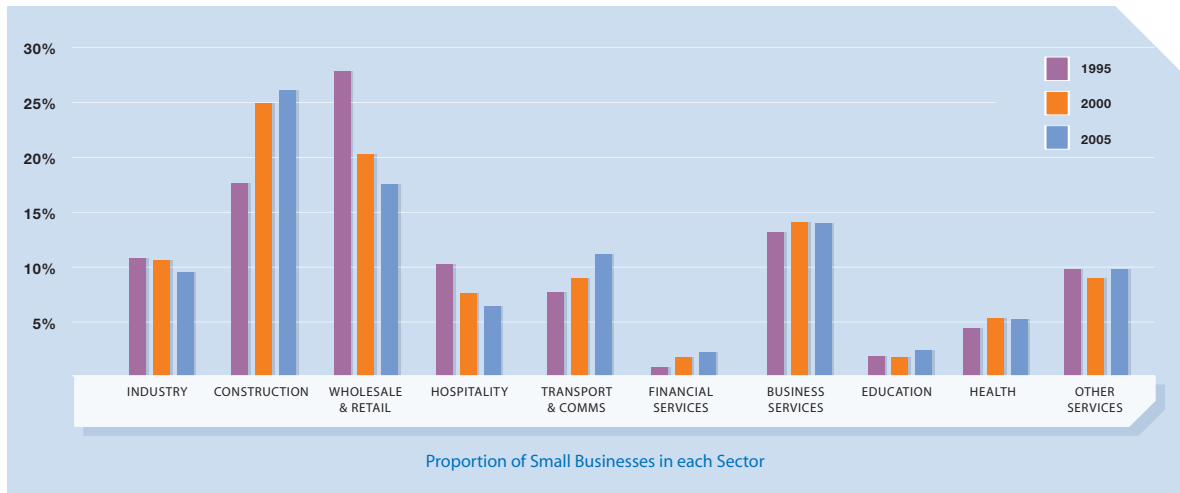
Employment in small businesses has grown by approximately 79 per cent over the ten-year period since 1995, and currently accounts for 54 per cent of private sector, non-agricultural employment.

1.3 Business Activities in the Small Business Sector

Small businesses operate across the entire range of business sectors in Ireland. Construction is the single largest sector, accounting for a quarter of all small businesses. The number of small firms in Wholesale & Retail has declined marginally over the past ten years, reflecting some consolidation in this sector. The number of industrial firms grew strongly between 1995 and 2000, but has been static over the past five years.

Figure 1.1 shows the sectoral spread of small businesses and how it has changed over the past ten years. Construction shows the greatest increase in the number of businesses since 1995, while Financial Services shows the largest percentage increase – albeit from a much lower base.

Figure 1.1: Sectoral Distribution of Small Businesses, 1995, 2000 & 2005



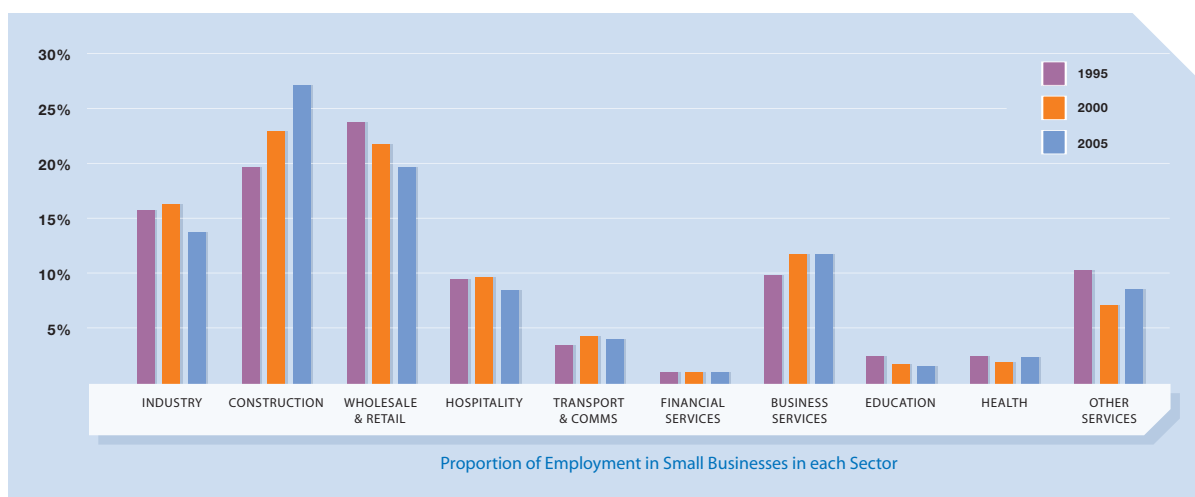
Source: CSO data. March–May 2005

1.4 Sectoral Distribution of Employment

Figure 1.2 below illustrates the sectoral distribution of employment among small firms from 1995 to 2005.

The construction sector currently accounts for slightly more than a quarter of all employment in small business. Furthermore, it is worth noting that employment in small industrial enterprises has been contracting since 2000.

Figure 1.2: Sectoral Distribution of Employment in Small Businesses by Sector, 1995, 2000 & 2005



Source: CSO, Financial Regulator, IDS MediaGroup, DKM estimates

1.5 Sales and Export Performance

The average turnover in small industrial firms in 2003 was €1.9 million, compared with €700,000 in small services firms and €300,000 in small construction firms.

In Industry, in Construction and in Services, the turnover of small businesses declined slightly as a percentage of total sectoral turnover between 2000 and 2005.

Reliable exports figures are available only for industrial firms: average direct exports per small industrial firm were €500,000 in 2003. Larger firms accounted for over 97 per cent of industrial exports. Larger firms also tend to export a much higher proportion of their output (80 per cent) compared to small firms (28 per cent). These figures, however, do not take into account the contribution small firms make to the supply chains of larger exporting companies.

1.6 Contribution to the Irish Economy and Society

Small businesses make substantial contributions to the total economy both in terms of contributions to the economic and social infrastructure and in terms of tax and other contributions to the Exchequer.

Contributions to Economic Output

Small businesses make a substantial contribution to gross value added (GVA) in the economy. GVA is defined as the value of output produced minus the cost of intermediate inputs. In the Construction sector, small businesses accounted for over 70 per cent of GVA in 2003 (around €7.2 billion), while in the Services sector (excluding financial services, for which figures are not available), the contribution was over 40 per cent (€15 billion). In indigenous Industry, small businesses contributed approximately one-third (€2.1 billion) of total GVA.

Contributions to the Exchequer

In 2002, small businesses paid 11 per cent of corporation taxes (around €520 million), 37 per cent of income taxes (almost €4 billion), and 50 per cent of VAT in the services sector (over €4 billion)

Regional spread

Small businesses are spread throughout the country and are economically significant in every region, although the balance of large and small businesses varies from region to region.

- Small firms employ almost 70 per cent of those engaged in Services in the Border, Midland and Western (BMW) region, and just over 50 per cent in the Southern and Eastern (S&E) region;
- Industry is comparatively more important as a source of employment in the BMW region than in the S&E region.

The regional significance of small businesses from social, cultural and economic perspectives must be recognised. Goods and services produced and delivered locally are necessary for the creation and maintenance of vibrant communities.

Social and economic infrastructure

The small locally trading services sector forms an essential part of the infrastructure for social life throughout the country, and to a significant extent determines the cost base for both consumers and businesses. For this reason, the health of the sector must be maintained; open competitive markets, efficiencies, quality of product and service, innovation and productivity in the sector are important factors in overall quality of life and standard of living.

Supply chains

Small local suppliers are also an essential part of the supply chain for larger firms. The export figures for the country do not reflect the fact that many of the goods and services produced by small Irish companies are eventually exported, but indirectly, through their client multinational companies.

1.7 Trends

It was noted above that growth in the number of small businesses and in the numbers employed in such businesses has been strong over the past ten years. This overall growth, however, masks some trends, not all of which are positive:

- The growth in the numbers of small businesses has slowed appreciably since 2000, and the strongest growth has been in Construction.
- The number of small industrial enterprises has been static since 2000, and employment in them has declined.
- The number of small Wholesale & Retail businesses has declined, as has the number of small hospitality businesses (the latter particularly since 2000).
- GVA per worker in small industrial firms fell between 2000 and 2003, but rose considerably in Services and in Construction.
- Exports from small industrial firms accounted for only 2.6 per cent of total industrial exports in 2003.

1.8 International Productivity Comparisons

By looking at GVA per person employed, an overview can be obtained of the average contribution to the economy of each individual employed in each sector, and this can be compared with similar figures from other countries.

1.8.1 International comparisons: manufacturing⁴ (Table 1.2)

The data for GVA per person in the total manufacturing sector shows that Ireland in 2003 was by some distance the leader among the ten countries examined. This can be explained in part by the effects of large-scale foreign direct investment.

However, this overall positive performance masks the significant difference in productivity performance across different employment-size categories. This shows that out of ten countries, productivity in Irish manufacturing companies ranks:

- 5th in companies with between 1 and 9 employees;
- 8th in companies with between 10 and 19 employees; and
- 4th in companies with between 20 and 49 employees.

Table 1.2: Manufacturing per employment size classes
2003 Gross value added per person employed (apparent labour productivity)

Country	1-9 Employees GVA/€000	Rank	10 – 19 Employees GVA/€000	Rank	20-49 Employees GVA/€000	Rank	50 – 249 Employees GVA/€000	Rank
Bel	32.3	8	71	1	51.6	2	65	2
Den	51.7	1	46.1	3	50	3	54	6
Ger	27.8	9	32.6	10	42.7	8	50.4	9
Fra	35.6	6	39.1	7	41.8	9	45.3	10
Ire	36.6	5	36.7	8	48.8	4	89.7	1
Ita	24.2	10	33.7	9	41.6	10	51.3	7
Neth	33.3	7	51.8	2	53.3	1	63.7	3
Aus	37.1	4	41.7	6	46.4	6	57.7	4
Fin	46	3	45.4	4	46.3	7	55.5	5
UK	50.1	2	45.2	5	47.1	5	51.1	8

Source: Eurostat and UK Office of National Statistics

4 Statistical Classification of Economic Activities in the European Community (NACE), Classification D

Overall Manufacturing Performance

Manufacturing industry has a key role to play in the creation and expansion of added value in the Irish economy. While large companies have driven recent productivity gains in Ireland's manufacturing sector, there is considerable scope for productivity improvements in the small business manufacturing sector. Such improvements are of central importance to the indigenous economy.

1.8.2 International comparisons: selected services

Eurostat data divides services into three main categories (Hotels and Restaurants; Transport, Storage and Communications; and Real Estate, Renting and Business Activities). The productivity performances of small businesses in each of these services sectors in Ireland and in eight other EU countries are examined below.⁵

Hotels and Restaurants⁶ (Table 1.3)

In terms of productivity, when compared with similar sized businesses in eight other countries, the Irish hotels and restaurants sector ranks:

- 5th for businesses with 1 employee;
- 6th for businesses with between 2 and 9 employees;
- 8th for businesses with between 10 and 19 employees; and
- 7th for businesses with between 20 and 49 employees.

Table 1.3: Services – Hotels and Restaurants per employment size classes
2003 Gross value added per person employed (apparent labour productivity)

Country	1 Employee		2 - 9 Employees		10 - 19 Employees		20 - 49 Employees		50 - 249 Employees	
	GVA/€000	Rank	GVA/€000	Rank	GVA/€000	Rank	GVA/€000	Rank	GVA/€000	Rank
Bel	15.7	7	18	7	17.7	7	22.7	5	43.4	1
Den	32.8	1	23.1	4	18.4	6	17.8	8	19.1	9
Ger	21.3	6	17.5	8	15.8	9	16	9	22.1	6
Fra	30.6	2	26.1	2	30.1	2	30.1	3	31.1	3
Ire	22.8	5	20.5	6	17.5	8	19.2	7	21.6	7
Ita	14.4	8	15.7	9	22.8	5	27.4	4	30.2	5
Neth	2.4	9	23.8	3	29.8	3	21.2	6	19.9	8
Aus	26.1	3	21.5	5	26.5	4	30.5	2	30.8	4
Fin	25.2	4	29.8	1	31.7	1	33.7	1	32.5	2

Source: Eurostat

Transport, Storage and Communications⁷ (Table 1.4)

In terms of productivity, when compared with similar sized businesses in eight other countries, the Irish transport, storage and communications sector ranks:

- 6th for businesses with 1 employee;
- 6th for businesses with between 2 and 9 employees;
- 2nd for businesses with between 10 and 19 employees; and
- 8th for businesses with between 20 and 49 employees.

⁵ UK figures for these services sectors in the same employment size classes were not available

⁶ Statistical Classification of Economic Activities in the European Community (NACE), Classification H

⁷ Statistical Classification of Economic Activities in the European Community (NACE), Classification I

Table 1.4: Services – Transport, storage and communication per employment size classes
2003 Gross value added per person employed (apparent labour productivity)

Country	1 Employee GVA/€000	Rank	2 - 9 Employees GVA/€000	Rank	10 - 19 Employees GVA/€000	Rank	20 - 49 Employees GVA/€000	Rank	50 - 249 Employees GVA/€000	Rank
Bel	57.9	3	48	3	61.1	3	56.1	2	57.1	4
Den	129.8	1	63.9	1	51	4	54.8	3	55	5
Ger	105.4	2	43.6	5	43.7	6	48.2	6	49.1	7
Fra	41.1	5	35.3	8	37.9	9	38.9	9	38.8	9
Ire	39.8	6	40.1	6	64.1	2	39.9	8	171.7	1
Ita	20.2	8	31.1	9	41.4	7	43.2	7	39.3	8
Neth	14.8	9	60.7	2	64.7	1	51.5	5	53.8	6
Aus	39	7	35.6	7	40.6	8	51.7	4	62.2	2
Fin	47.3	4	48	3	48.2	5	57.3	1	62.2	2

Source: Eurostat

Real Estate, Renting and Business Activities⁸ (Table 1.5)

In terms of productivity, when compared with similar sized businesses in eight other countries, the Irish real estate, renting and business activities sector ranks:

- 6th for businesses with 1 employee;
- 2nd for businesses with between 2 and 9 employees;
- 6th for businesses with between 10 and 19 employees; and
- 2nd for businesses with between 20 and 49 employees.

Table 1.5: Services – Real Estate, Renting and Business Activities per employment size classes
2003 Gross value added per person employed (apparent labour productivity)

Country	1 Employee GVA/€000	Rank	2 - 9 Employees GVA/€000	Rank	10 - 19 Employees GVA/€000	Rank	20 - 49 Employees GVA/€000	Rank	50 - 249 Employees GVA/€000	Rank
Bel	48.4	5	59.6	4	72.5	2	73	3	82.8	1
Den	101.7	3	84.4	1	77.2	1	77.5	1	82.4	2
Ger	148.7	1	50.4	8	57.6	4	57.7	7	49.3	8
Fra	132.2	2	50.6	7	52.5	7	54.8	8	55.6	7
Ire	46.4	6	70	2	55.3	6	76.4	2	65.7	4
Ita	29.5	8	33.6	9	39.3	9	40.5	9	41.8	9
Neth	25.4	9	51.7	6	57.3	5	59.3	6	59.6	6
Aus	45.6	7	67	3	59.5	3	65.2	4	72.5	3
Fin	64.4	4	55.3	5	51.2	8	62.5	5	61.8	5

Source: Eurostat

Overall Performance in the Services sector

Overall, the productivity of Irish firms with fewer than 50 employees in these three services sectors has generally been low compared with the other countries. Given the importance of the services sector to today's economy, the Small Business Forum is particularly concerned that the issue of productivity in services be addressed.

1.9 Levels of Entrepreneurial Activity

Ireland continues to perform well on international scales of entrepreneurial activity. The Global Entrepreneurship Monitor (GEM) Irish report 2005 estimates that one in ten of the adult population is either actively planning to set up a new business or has recently done so. This level of entrepreneurial activity ranks Ireland fifth of the twenty-five OECD countries that participated in the GEM project in 2005. These estimates, however, also show a relative decline in levels of entrepreneurial activity between 2001 and 2004.

GEM estimates that at present, one in every seven men and one in every 20 women in Ireland are actively planning or have recently established a new business venture.

1.10 Shortage of Comprehensive Data for Policy-making

In an attempt to arrive at a definitive statistical framework for its work it was necessary for the Small Business Forum to commission a profiling study of the economic impact of the small business sector in Ireland. The purpose of this work (undertaken by DKM Consultants) was to establish the size of the small business cohort, its sectoral and regional distribution, the levels of employment in it, its contribution to value added, and other related facts.

The statistical information relating to small businesses that is included in the DKM report is based on a range of sources, including the Central Statistics Office, the Revenue Commissioners, and DKM's own estimates. In some cases, the figures arrived at have been extrapolated from a number of sources, which are often inconsistent or incomplete. The simple truth, however, is that we don't know the exact figures in every case, and this is in itself an obstacle to the development of clear policies. We lack, for example, comprehensive data on family businesses and economic contribution by region.

The lack of comprehensive statistical information must now be addressed. The Central Statistics Office (CSO) is currently engaged in an extensive profiling survey as part of the process of resolving a number of data quality issues in relation to its business register. Once this process is complete, it is expected that a fully developed business register containing a range of information on enterprises across the majority of economic sectors will be in place. This information should be leveraged to assist policymakers and other interested parties in better understanding the role and evolution of the small business sector.

1.10.1 Recommendation: Improve data for policy-making for the small business sector

The Small Business Forum recommends:

Compile and publish an annual *Small Business Release* that presents up-to-date, robust data on a range of indicators relevant to the small business sector. The Release will enable emerging trends to be monitored and key business issues identified.

Responsibility: Central Statistics Office

Appendix D illustrates the type of information that such a release should include.

1.11 Increasing Importance of Indigenous Sector

It has been stressed elsewhere that indigenous industry will assume increasing importance in the Irish economy over the coming years, for a number of reasons:⁹

- To create new employment opportunities as low-value-added activities migrate to lower cost economies;
- To exploit the State's substantial investment in R&D and assert Ireland's position as a knowledge creator and innovator, and by doing so to add significant economic value; and
- To continue to facilitate the attraction of higher value-added inward investment.

In this light, we must recognise that one of the future economic engines of the country will be indigenous companies that have grown – and in some cases grown rapidly – to win market share. The small business sector is the incubating ground for these companies. Not all companies have the desire and the ability to grow into large companies – indeed the proportion of such companies is probably quite small – but they will form an important segment of the economy in the years ahead, and we should provide both the environment and the supportive interventions that will enable all businesses to reach their potential.

1.12 Conclusions

Small businesses form a very significant component of the Irish economy, in terms of employment, regional spread, contribution to the Exchequer, and the role they play in the social and enterprise infrastructure.

In the years ahead, as Ireland moves towards a knowledge-based economy, the importance of the small business sector will increase, and the vitality and dynamism of the sector must be supported, in order to ensure continued economic growth and high living standards throughout the country.