

The Evolving Environment for Small Business

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Twelve years ago, the Task Force on Small Business was set up to examine the needs of the small business sector and to make recommendations to ensure its survival and growth. The Task Force issued its report in March 1994.

At that time, the business environment was characterised by low disposable incomes, high taxation and high interest rates. In the intervening years, the business environment has been transformed. The economy is now vibrant and dynamic. It offers greater market opportunities for businesses, and provides one of the most strongly supportive cultural contexts for entrepreneurial activity in the world. The fact that the number of small businesses in Ireland has grown to almost a quarter of a million is ample evidence of this.

However, this economic transformation has brought with it new challenges and changes at both global and local levels that will have increasing influence on the development of Irish businesses in the years ahead.

2.1 Global Challenges

2.1.1 Global Competition

While globalisation and international market liberalisation have opened up many foreign markets to Irish business, they have also resulted in a greater international presence in the Irish locally traded market, where the great majority of Irish small businesses trade. Local businesses in Ireland now have to compete with some of the world's biggest international chains in every sector, from retail and entertainment, to tourism and the professions, attracted by the increased local demand from Ireland's growing population and wealth.

Those Irish businesses trading internationally are competing against companies that can produce products and deliver services at a much lower cost, have globally-focused business models and operate with economies of scale unavailable to smaller players. To compete in this global market, Irish businesses need to stay up to date across a range of developments and innovations – standards, regulations, management practices, technologies and markets. In addition, they need to offer superior levels of innovation, service and quality.

Competition in mass-market globally traded goods and services is especially strong from the newer member states of the European Union and from other rapidly developing countries, such as China and India, where wage rates and other costs are considerably lower.

2.1.2 The Growth of eBusiness

The Internet has changed business models and consumer behaviour in a variety of ways. Some of these changes work to the advantage of small businesses, that can use the technology to address much wider geographical markets for specialised products and services, and can source supplies from around the world. However, large companies with global distribution capabilities are increasingly using the technology to dominate world markets, to the detriment of those small businesses that traditionally depend on local custom.

Consumers are also using the Internet, not only for purchasing from suppliers around the world, but also for comparing prices and sharing information on product quality and back-up service. These better-informed consumers are less likely to buy from the local supplier, unless that supplier is competitive in all respects with the best in the world.

2.2 Local Factors

At local level, there have been enormous changes in the Irish business environment. The potential rewards for risk-taking have increased and policies and attitudes are generally pro-enterprise.

- The investment environment has been greatly improved due to high levels of asset appreciation and the halving of the capital gains tax rate, from 40 per cent to 20 per cent.
- The barriers to accessing funding for small business have lowered considerably as the investment environment has improved and short term interest rates have fallen.¹⁰
- For the vast majority of small companies, the corporation tax rate has decreased¹¹ and personal tax rates have been significantly reduced since 1994 – all companies now qualify for a 12.5 per cent rate of corporation tax on trading income, and the higher rate of personal income tax has dropped to 42 per cent.

Despite these positive developments, Ireland's competitiveness is now under threat from rising input costs and a tighter labour supply.

2.2.1 Input Costs

High inflation over the past few years has contributed to a sharp rise in business costs. For example:

- Electricity costs increased by 40 per cent between 2001 and 2004.¹² In September 2005, the Commission for Energy Regulation approved a further rise of 5.2 per cent on tariffs for SMEs during 2006.¹³
- Waste disposal costs have risen rapidly. Forfás research shows that in 1999, the average landfill gate fee was €30; by 2005, it had risen to €135. This is one of the highest costs in the EU; for example, average landfill gate fees in Denmark are €101 and in Scotland are €53.

10 As a member of the European Monetary Union, Ireland enjoys relatively low interest rates which (with small fluctuations) have been below 4% since 2002. This contrasts with the situation in the early to mid 1990s, when interest rates of 6–7% were common

11 The corporation tax rate for trading income in the broader services sector has been reduced. However for those small companies engaged in manufacturing or certain internationally traded services, the rate has increased from 10% to 12.5%. This has been accompanied by a number of measures to broaden the tax base

12 Statement on Prices and Costs, National Competitiveness Council, September 2004

13 www.cer.ie/CERDocs/press090905.pdf

2.2.2 Employment and Labour Supply

The success of the Irish economy over the past ten years has seen a considerable rise in levels of employment and opportunity. Levels of unemployment have fallen from over 12 per cent in 1995 to around 4.2 per cent in 2005 – one of the lowest in the EU.¹⁴ One of the consequences of this is that the labour market is now much tighter, and many businesses have difficulty finding and retaining suitable staff. As a result, wage rates in general are increasing and wage demands are further fuelled by rising consumer prices and in particular by the high cost of housing.

2.3 Challenges Facing Small Businesses in Ireland

In this changed business environment, the research carried out and submissions received by the Small Business Forum are in broad agreement on the challenges facing small businesses today. In summary, the main issues identified are:

- **Access to finance:** Small businesses continue to report difficulties in gaining access to appropriate levels of finance for start-up and growth. This difficulty appears to be more pronounced for businesses in the services sectors, with limited capital assets, and for businesses that are ineligible for support from the enterprise development agencies.
- **Regulatory burden:** Businesses are regulated by law in a variety of ways to ensure an orderly market that protects both themselves and other businesses, consumers and employees, and to ensure compliance with environmental, social and fiscal responsibilities. The cost of compliance, however, is significant, and is proportionately higher for small businesses than larger enterprises.
- **Infrastructure:** The growth of the economy over the past ten years has placed huge strains on the communications, energy, transport and social infrastructure, which have a negative impact on the performance and growth of businesses.
- **Management capability:** Entrepreneurs and small business owner/managers do not place enough emphasis on developing management capability – usually because of time or cost constraints, or because the available training programmes are not perceived to be relevant.
- **Innovation, both technological and non-technological:** Small businesses have particular difficulty in accessing, absorbing and exploiting new knowledge to create innovative products and services.
- **Entrepreneurship:** There is currently no coordinated national approach to encourage or support entrepreneurship, and there is no systematic programme of entrepreneurship education at primary, secondary and third-levels.
- **Local authority charges:** Local authority charges, and particularly development charges, can act as a disincentive to growth.
- **Access to information:** There is no single comprehensive information resource from which entrepreneurs and small business owner/managers can access information relating to starting up, developing and growing a business.

2.4 The Need for Action

As indigenous businesses will play an increasingly important role in ensuring Ireland's continuing prosperity in the years ahead, it is critical to create conditions now that will enable the small business sector to thrive and grow. Given the current strength of the economy following the past decade of growth, the Small Business Forum emphasises that it is now both opportune and appropriate to address the issues identified in this report, and respond to them promptly, comprehensively and convincingly.

The issues are dealt with in the next three chapters:

- Chapter 3 sets out the Forum's analysis and recommendations for improvements to the operating environment for all small businesses. It deals with the regulatory environment, local authority charges, access to information and advice, and infrastructure.
- Chapter 4 sets out the Forum's strategy for assisting those small businesses that are trying to grow. It deals with the key issues facing such businesses – finance, management capability, innovation, and the adoption of information and communications technology.
- Chapter 5 deals with the issue of entrepreneurship and business start-up.

The final chapter deals with the roles of the small business development agencies, and the implementation of the Forum's recommendations.