Stimulate Growth

4

The Terms of Reference for the Small Business Forum placed considerable emphasis on achieving greater economic growth from the small business sector. Within the total cohort of small businesses, there is a significant subset that has both the capacity and the ambition to grow. Based on its examination of the factors that facilitate or constrain growth, the Forum identified four key areas that should be prioritised for attention to supplement the interventions already in place from the enterprise support agencies and the measures for the business environment recommended in Chapter 3. These are:

- Access to appropriate levels of finance;
- Management capability;
- Innovation, both technological and non-technological; and
- The exploitation of ICT.

It is critical that these issues are addressed in a comprehensive, co-ordinated and timely way, so as to realise the potential of the indigenous small business sector. The analysis and recommendations of the Forum in relation to these issues are set out in this chapter.

4.1 Broaden Access to Finance

In a survey conducted on behalf of the Small Business Forum, small business managers identified the difficulty of accessing adequate levels of finance as the single greatest barrier to the growth of their businesses.

Companies have two main types of financing needs:

- Finance for investment, expansion and growth; and
- Working capital to finance day-to-day activities.

All small businesses, regardless of their stage of development require working capital; growth capital, however, is needed by companies at the start-up and development stages, as they seek to increase capabilities, assets and market share. In this section, the issues surrounding growth capital are addressed first, followed by those relating to working capital.

4.1.1 Growth capital

There are a number of potential private sources from which businesses can source debt and equity finance for start-up, expansion and growth. In addition, the State (through agencies such as Enterprise Ireland and the City and County Enterprise Boards) provides a range of financial supports, including grant aid and equity investment, to companies in the manufacturing and internationally traded services sectors.

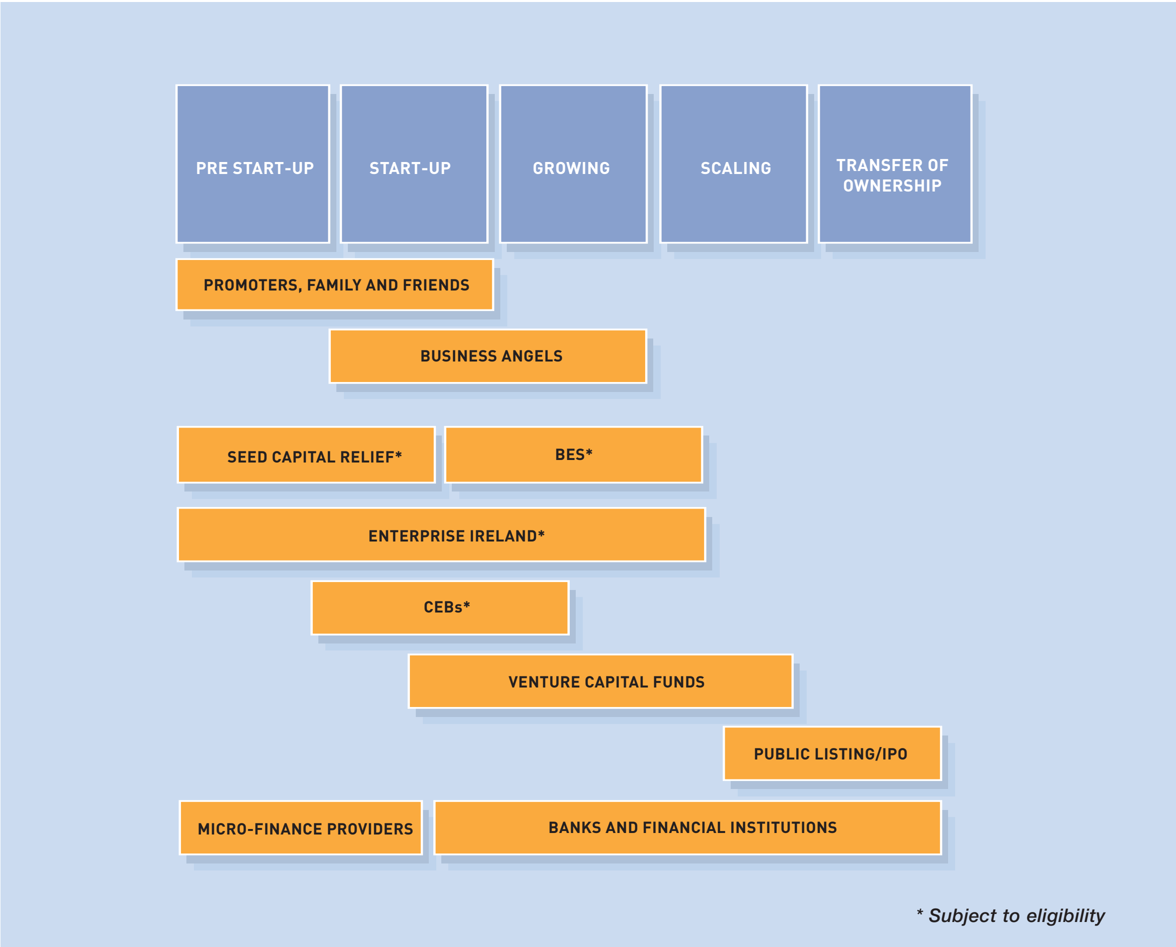
The type of finance that is appropriate for an enterprise, and its ability to raise it, depend largely on its stage of development. Figure 4.1 illustrates the potential sources of finance available to small businesses at different stages of development.

Difficulties in accessing finance

Despite the broad range of finance sources, and the fact that interest rates are at historically low levels, small businesses continue to report difficulties in obtaining sufficient finance for start-up and growth.

Preliminary results from the 2005 SME Finance & Equity Survey indicate that while the finance environment for small businesses has improved significantly, 35 per cent of small businesses were unable to satisfy their financing requirements over the previous three years.[41]

Figure 4.1: Sources of capital at stages of company development



Gaps in finance market

The 2005 SME Finance & Equity Survey indicates that small businesses have difficulty in raising money for start-up and growth, particularly at three levels:

- Amounts of less than €100,000;
- Amounts between €250,000 and €500,000; and
- Amounts over €2 million. While only a small number of small businesses require funding at this level, they are typically seeking to achieve significant growth and scale, and are thus important to the Irish economy.

Anecdotal evidence suggests that these barriers are most pronounced for businesses that are not eligible for development agency assistance (businesses operating outside the manufacturing and internationally traded services sectors), and for businesses with few capital assets.

41 The 2005 SME Finance & Equity Survey - conducted by Forfás on behalf of the Department of Enterprise, Trade and Employment - is based upon a survey of 1,000 clients of Enterprise Ireland and City and County Enterprise Boards

During the Forum's consultation process, it was repeatedly suggested that the availability of equity investment was severely constrained because Irish investors are more likely to choose one of the many asset-backed investment options than take equity stakes in small companies.

Failure to obtain growth capital may result in small business managers resorting to a steady-state or low-growth strategy, and may also result in business owners exiting a company before it has realised its growth potential.

4.1.2 Improving access to finance

The principal sources of private finance and the relative ease of accessing funds from them are discussed below.

Access to bank finance

The core activity of retail banks is supporting creditworthy projects with fixed asset finance and working capital.[42] They perceive new and developing companies as high risk, and thus usually require security in the form of assets and/or personal guarantees before funding such companies. However, many small businesses, particularly those in the early stages and those in the services sector, have few or no capital assets against which to secure bank finance, and thus have difficulty obtaining bank loans.

Furthermore, loan finance is rarely provided for product or process research or market development. Owner/managers seeking R&D finance are encouraged by the banks to approach third-party providers, such as venture capitalists or development agencies, for this type of support, as the banks view such funding as beyond the scope of conventional bank lending.

The barriers to accessing debt finance are less acute at the micro level. Most entrepreneurs and established businesses are able to obtain sums of up to €25,000 from financial institutions. Personal loans, overdrafts and credit cards are often used as start-up capital. In addition, a number of bodies, such as First Step (a private-sector, non-profit body) and some credit unions, make small loans available to individuals setting up new businesses.

Providing guaranteed loans

Difficulty in accessing bank finance is not unique to businesses in Ireland. In other countries, loan guarantee schemes have been established to help overcome market failures and increase bank lending to small and start-up enterprises. For example, the UK operates a Small Firm Loan Guarantee Scheme, under which the UK Treasury covers between 70 per cent and 85 per cent of defaulted balance on loans to small businesses approved under the scheme.

The European Investment Fund (EIF), a subsidiary of the European Investment Bank, operates a range of partial loan guarantee schemes targeted at SMEs. These include an SME loan guarantee scheme, a micro-loan guarantee scheme and an ICT loan guarantee scheme. The EIF also operates a guarantee scheme to cover equity investments in SMEs. By comparison with other EU countries, Ireland has historically underutilised these supports. Over the period 2001-2005, for example, Ireland accessed only €3 million of EIF portfolio guarantees, compared with €170 million in the Netherlands, and €40 million in Denmark.

The State should work with the financial services industry to provide low security loans to start-up firms and entrepreneurs in all sectors. The institution providing the loans should access the EIF SME Loan Guarantee Schemes available under the 2007-2013 Competitiveness and Innovation Framework Programme. The EIF guarantees are intended to mitigate the risk to the institution or body responsible for reviewing applications and administering the loan fund.

The objective of this initiative would be to address the identified gap in the market for growth finance in the €25,000 to €100,000 range, and would be open to businesses in all sectors.

This initiative would have the added benefit of enabling small and start-up businesses establish a credit history with financial institutions.

The cost to the State of such a scheme would be minimal, as the revolving pool of credit would be provided from private sources.

42 Submission of the Irish Bankers Federation to the Small Business Forum

The current Business Expansion Scheme (BES)

The Business Expansion Scheme is underutilised as a channel for investment in small business. The scheme needs to be reviewed and amended in order to ensure that it performs the function for which it was established.

The BES was introduced in 1984 as an income-tax based incentive for private investors to invest long-term equity in companies in certain sectors of the economy – in particular, companies that might otherwise find it difficult to raise such funding. BES relief is available only on investment in approved companies operating in a number of defined sectors, including manufacturing, internationally traded services, tourism, horticulture, and leasing.

The take-up of the BES has been somewhat limited in recent years. For example, in 2004, 320 companies raised a total of €50.1 million through the BES (an average of €156,000 per company).

Several characteristics of the BES have been identified as limiting its attractiveness, both to investors and to businesses seeking investment:

- Under the BES, an individual investor may claim income tax relief on investments up to a maximum of €31,750 a year. In the current economic environment, property investment is generally perceived as lower risk than equity investment, and so individuals with significant amounts to invest are more attracted to property.
- The limit on individual investments means that a company wishing to raise larger amounts has to find and deal with several investors, which not only requires considerable extra effort, but also imposes additional administration costs and professional fees.
- The maximum amount that a business can raise through the BES during its lifetime is €1 million.

Enhancing the Business Expansion Scheme

The Business Expansion Scheme should be enhanced in the following ways, in order to encourage increased investment in small business, particularly for amounts of between €250,000 and €500,000 and for amounts approaching €2 million:

- Extend the lifetime of the BES beyond its current expiry date of 31st December 2006 to 31st December 2013;
- Increase the amount that a business can raise through the scheme from €1 million to €2 million;
- Increase the individual investment ceiling from €31,750 to €250,000 – the limit on the use of specified tax reliefs (including the BES) for high-income individuals as introduced in the 2006 Finance Act;
- Allow businesses to raise one further round of equity investment through the BES scheme (up to €2 million) for the purposes of significant expansion, after a minimum period of three years from the initial BES supported investment. Eligible businesses would have to receive certification from a relevant agency to attest that the investment is for the purposes of expansion; and
- Promote the BES to both potential investors and small businesses.

The current Seed Capital Scheme (SCS)

The Seed Capital Scheme was introduced as an adjunct to the BES in 1993. Its objective is to help employees, unemployed persons and those made redundant to acquire additional funds with which to start their own business. As with the BES, eligibility for SCS relief is restricted to approved enterprises operating in the same sectors. The size of the tax refund depends on the amount of the individual's investment and is limited to the tax the individual has paid in previous years, subject to an investment limit of €31,750 per annum for six years.

Like the BES, take-up of the SCS has been somewhat limited, with approximately 445 companies raising capital through the mechanism since its inception in 1993. A total of 107 investors claimed relief under the scheme in 2004.[43] Take-up of the scheme has been limited by its low public profile and an application process that is seen to be cumbersome.

Neither the BES nor the SCS is well-known among their target companies. The preliminary findings of the 2005 SME Finance & Equity Survey show that only 64 per cent of companies were aware of the existence of the SCS; and of those who were aware of the two schemes, 43 per cent did not know whether they were eligible for BES, and 56 per cent did not know whether they were eligible for the SCS. This is particularly surprising, as all of the companies surveyed operate in sectors eligible to access the schemes.

Enhancing the Seed Capital Scheme

The Seed Capital Scheme should be enhanced in the following way, in order to facilitate entrepreneurship, and help address the gap in the finance market for amounts of less than €100,000:

- Extend the lifetime of the SCS beyond its current expiry date of 31st December 2006 to 31st December 2013;
- Increase the investment ceiling against which tax relief can be claimed to €100,000 per annum over six years;
- Significantly improve promotion and awareness of the scheme; and
- Simplify the scheme where possible, for example by making relief available on all forms of income, not just PAYE income.

Benefits of proposed enhancements

- By increasing the individual thresholds to €250,000 (BES) and €100,000 (SCS), the current risk-reward imbalance in favour of property investment incentives should be somewhat mitigated. The other proposed measures, such as additional and more effective promotion and simplification of the schemes, should also help boost the flow of investment into business equity and start-ups;
- At present, the individual company investment limit is generally too low to attract a significant number of investment funds. By increasing the limit to €2 million, more investment funds could be attracted to use the scheme to invest in companies; and
- The estimated cost to the exchequer of the complete suite of proposed BES amendments would be an additional €30 million - €40 million per annum. The estimated cost to the exchequer of the complete suite of proposed SCS amendments would be an additional €2 million - €3 million per annum. It is anticipated that these costs would be offset by reduced levels of tax relief granted in other areas and increased PRSI and income tax receipts.

'Business angel' investment

A 'business angel' is a private individual who invests capital in an early-stage business and may also contribute know-how or experience to its operation and development. Such investment is an alternative to bank financing or venture capital, neither of which may be available to the business at that early stage. Business angels typically invest amounts between €25,000 and €300,000.

This type of investment is very often the most appropriate for companies at the earliest stages of development.[44] However, there is currently relatively little business angel investment activity in Ireland, and growth-orientated start-up businesses have little choice but to seek investment from venture capitalists.

Other countries have fostered this type of private investment by setting up business angel networks. These bring together groups of wealthy individuals to consider potential investment opportunities.

43 Data sourced from the Department of Enterprise, Trade & Employment and Revenue Commissioners

44 Review of Seed and Venture Capital Funds Programme, Enterprise Ireland, unpublished

Establishing Business Angel networks

Stimulating increased private investment would help address the gap in the market for early-stage finance.

The Dublin Business Innovation Centre currently operates the HALO Business Angel Partnership, supported by Enterprise Ireland and InterTradeIreland.[45] This initiative acts as a matchmaker between companies and the individual investors on the HALO Business Angel register.

The development agencies should encourage investment by private individuals and syndicates in seed and early stage businesses by stimulating the development of further Business Angel networks, and in particular syndicated business angel networks or clubs.

Syndication is the process whereby a group of business angels co-invest in a business. The benefits of this type of investment include:

- The investment risk is shared between a number of parties;
- Each investor can spread their investments over a number of companies; and
- The companies are more likely to raise the full amount of finance they need.

The long term vision for the business angel community in Ireland would be of a vibrant investment environment where both individual business angels and syndicates or clubs of high net worth individuals regularly consider investments in seed and early stage businesses. Optimally, the business angel community would work closely with venture capital funds to help businesses continue to develop and grow.

The State may need to stimulate business angel investment more actively, for example by co-investing, in a manner similar to that used to stimulate the venture capital market in Ireland. The Scottish Co-investment Fund provides a potential model for such an initiative.

Venture capital

The market for venture capital in Ireland remains immature, and is characterised by a number of structural weaknesses. Accordingly, the Forum would welcome continued support by Enterprise Ireland for the venture capital market, through co-investment and partnerships with the private sector in future seed and venture capital programmes.[46]

4.1.3 Working capital

Successful day-to-day business operations need a predictable, realistic and adequate cash flow. Inadequate cash flow inhibits a business's growth prospects, and at worst can result in business failure. In this regard, payment terms and late payments are significant factors.

Current legislative framework

In August 2002, the EU Directive on Late Payments in Commercial Transactions came into force. This is implemented in Ireland by the European Communities (Late Payment in Commercial Transactions) Regulations 2002, and applies to payments for commercial transactions in both the public and private sectors. (The Prompt Payment Act had previously applied only to payments by public sector organisations.)

The objective of the Directive is to ensure that, unless otherwise contractually agreed, payment from a customer to a supplier for goods or services is made within 30 days of receipt of invoice. The directive also provides that suppliers who are not paid on time are entitled to payment of penalty interest on the amount outstanding, at a rate 7 per cent above the European Central Bank rate.

45 This initiative was established in late 2005, and it is as yet too early to evaluate its progress

46 Enterprise Ireland, through its Seed and Venture Capital programme, has been actively stimulating the development of seed funds to address gaps in the financing of business start-ups. The current Seed and Venture Capital programme runs until the end of 2006

Impact of Late Payments legislation

A Department of Enterprise Trade & Employment survey in June 2003 showed a high level of awareness of the late payment regulations, but very limited application of them. The key findings were:

- Since the regulations came into effect, there had been an increase of 7 per cent in respondents paying their bills within 30 days; and
- Over 70 per cent of respondents believed the regulations had not made any difference to payment periods, either to or from their business.

Respondents to the survey also felt that there should be stronger enforcement of the legislation by the State, and that late payers should be publicly identified.

These findings were confirmed by an ISME survey in June 2005, which found that only a quarter of SMEs were receiving payment within 30 days, and that 33 per cent were experiencing delays of over three months. The survey also showed that the problem of late payments is actually getting worse.[47]

Internal research by the Bank of Ireland shows that 92 per cent of SME customers fail to pay on time and that on average SMEs are owed twice as much as they owe.[48]

Current late payments legislation permits a representative organisation (such as the Small Firms Association, Irish Small and Medium Enterprises, or Chambers Ireland) to take legal action on behalf of its members, in order to prevent large companies applying unfair contractual or payment terms to small suppliers. However, few, if any, such cases have been taken.

Reasons for late payment

There appear to be two main reasons why small suppliers are not receiving payment within the default payment period of 30 days stipulated in the Late Payments legislation:

- In order to secure and/or retain large customers' business, many suppliers reluctantly accept payment terms that are less attractive than these default terms, and
- Many customers are not observing the legislation, and are not being challenged by their suppliers for fear of losing custom.

Improving working capital

The Companies Acts should be amended to require large companies to publish in their annual accounts details of average creditor days.[49]

In the UK, an annual Private Sector Payment Performance League Table is compiled by the Federation of Small Businesses with support from the Department of Trade & Industry and the Better Payment Practice Group.[50]

The publication of audited statistics of creditor days, as outlined above, should:

- Encourage companies to be more prompt in paying their suppliers, and
- Strengthen the position of plaintiffs (individual companies or their representative organisations) against companies that impose unfair terms or breach contractual agreements.

47 www.isme.ie/press-page8995.html#Monday%201st%20August%202005

48 Bank of Ireland submission to the Small Business Forum

49 'Creditor days' is calculated by dividing the total for trade creditors shown in a company's accounts by the cost of sales and multiplying by 365. The result indicates the average number of days taken by the company to pay its creditors

50 www.creditscorer.com/sites/PaymentScorer/index.cfm

4.1.4 **Recommendation:** Improve access to finance

The Small Business Forum recommends:

For Growth capital: Encourage financial institutions to provide European Investment Fund-guaranteed loan finance to small businesses.

Enhance the Business Expansion Scheme (BES) and the Seed Capital Scheme (SCS) as follows:

- Extend the lifetime of both schemes to 2013;
- Increase the individual investment ceiling for the BES to €250,000 and for the SCS to €100,000;
- Increase the BES/SCS investment ceiling to €2 million per company; and
- Simplify the operation of both schemes, and promote them more actively.

Further develop networks of 'Business Angels' in order to encourage investment by private individuals in seed and early-stage businesses.

For Working capital: Amend the Companies Act to require large companies to publish in their annual accounts details of their average creditor days.

Responsibility: Department of Finance; Department of Enterprise, Trade & Employment; financial institutions; Enterprise Ireland.

4.2 Develop Management Capability

Economic progress in Ireland over the coming decades will depend heavily on the performance of the indigenous sector, which consists largely of small businesses. It is thus critical that these businesses achieve their full potential.

4.2.1 Labour Supply and Skills

As the Enterprise Strategy Group pointed out in 2004, raising education levels and upskilling the existing workforce are critical. The benefits of investing in human resource training, in terms of increased productivity and revenue, are well proven.

However, SMEs in Ireland have traditionally invested proportionately less in education and training for their employees than larger companies.[51]

A number of focused, short-term initiatives aimed at increasing enterprise investment in training and development are already underway. These include the accelerated roll-out of FÁS and EU co-funded training programmes and the expansion of the Skillnets scheme facilitating industry-led training networks.

The Department of Enterprise, Trade & Employment, in conjunction with the Expert Group on Future Skills Needs (EGFSN), is currently developing a National Skills Strategy. The strategy will outline

- A description of the Irish economy in 2006 with associated skills profile;
- Projected skills gaps by sector and occupation to 2010;
- Economy scenarios in 2020 with associated skills profiles; and
- Prioritised skill development targets to meet the needs of the economy to 2020.

51 White Paper on Human Resource Development, 1997; Continuing Vocational Survey 1999, Fox, 2001; Hannon, McCoy & Doyle, 2003

Along with policy aimed at upskilling the existing and future workforce, the strategy will also deal with ways of drawing upon external labour resources to address Ireland's current and future skills and labour shortages. The Government is currently considering the implementation of a National Economic Migration Policy based upon that recommended by the EGFSN.

The Small Business Forum endorses these initiatives. Given that these issues are already being addressed in these major policy reviews, the Forum is not making any recommendations in the area of labour supply and training, except in the area of management development, where the needs of the small business sector are particularly acute.

The performance of a small business depends in large measure on the competence and capability of its management. Recent research conducted by McKinsey and Company, in conjunction with the Centre for Economic Performance at the London School of Economics has highlighted this relationship.[52] The work – which analyses management practice in medium-sized companies across Europe and the US – illustrates a strong association between management practice and firm performance in terms of productivity, profitability and sales growth.

4.2.2 Benefits of management development

A 2003 assessment by the OECD of management development in SMEs found a positive relationship between the degree of management development and the bottom-line performance of a firm.[53] This study drew on a range of research into the effects of management competence and management training on small and medium firms. While 'inexperienced management' was cited as a principal cause of bankruptcy in Canada, the positive effects of management training were also demonstrated: work in the US illustrated that formal management training programmes – embodying specified training techniques – were associated with increased company profits of $4,000 per employee per year; and in the UK, formal management training was found to reduce small business failure rates by up to half.

4.2.3 Management competence in Ireland

There is considerable scope for improving the level of management competence in Irish small businesses. Survey work by the Expert Group on Future Skills Needs showed that the level of general management skills in Irish small businesses is perceived to be relatively poor.[54] It identified deficiencies in specific functional skills – particularly human resources, marketing and finance – and weakness in forward planning. Strategic management skills were assessed as 'very weak'.

4.2.4 Barriers to development

Despite the deficiencies identified by the Expert Group on Future Skills Needs, the survey found that small firms are engaging in management training and development only to a very limited extent. Three principal reasons are offered for this:

- **Time:** the many demands on the owner/manager of a small business leave little time for attendance at training courses; absence from the business for prolonged periods is perceived to be near impossible; and even outside normal 'office hours' it is difficult for the owner/manager to commit to regular attendance on a training programme;
- **Cost:** the available management training programmes are often seen to be too expensive; the participation fees are more affordable and justifiable for large companies; and
- **Relevance:** in many cases the available management training programmes are not perceived to be relevant to the needs of small businesses, and, again, seem to be more appropriate for management in large companies.

In this respect, Ireland is not unique. OECD research has shown that smaller firms are less likely than larger enterprises to provide external training to all grades of workers, including managers, due to financial constraints and lack of awareness of the benefits of management training.[55]

52 Management Practices across Firms and Nations, McKinsey & Co, London and the Centre for Economic Performance, London School of Economics, June 2005

53 Management Training in SMEs, OECD, Paris, 2003

54 SME Management Development in Ireland, Expert Group on Future Skills Needs, 2006

55 Management Training in SMEs. OECD, Paris, 2003

The supply side – providers of management training – has been relatively unresponsive to the types of management training demanded by small business managers. Whereas supply is concentrated on the provision of generic courses, often of long duration, delivered in a classroom setting, the demand among small enterprises is for short, practical, business-specific and individualised interventions, delivered, where possible, at the place of business.

4.2.5 Training preferences of small business managers

Provision of management training programmes must meet the needs and learning styles of owner/managers. Recent research, including interviews with small firm owners and managers, found a clear preference for:

- Informal peer group management support activities;
- Peer group management development courses involving periodic structured learning sessions supplemented by mentoring;
- Short basic courses in specific applied management skills;
- One-to-one mentoring; and
- Continuous integrated company interventions by training consultants over longer periods.

Future programme development and delivery should attempt to address these preferences. The first two imply that delivery through networks of small businesses would be particularly useful.[56]

4.2.6 Demand for training

Demand for management training is low among small businesses in Ireland, and this is due largely to a lack of awareness among owner/managers of the business benefits to be derived from such training.

Similar issues arise in other countries. For example, in the UK, the Council for Excellence in Management and Leadership was established in 2000 to create a strategy for developing world-class leaders and managers. From the report of the Council's SME Working Group,[57] it appears that attitudes to management training in the UK are broadly similar to those in Ireland. The Working Group recognised the importance of both raising the demand for management training and simultaneously providing training solutions that meet the demands of owner/managers. The Working Group made a number of recommendations, including:

- Stimulate the demand for management training and development, by encouraging entrepreneurs to undertake preliminary diagnostic assessments of their management competence and by promoting business success stories founded on management development;
- Enable entrepreneurs to assess their own management development needs, by developing and testing a self-administered diagnostic tool; and
- Guide entrepreneurs towards appropriate management development solutions.

In order to implement this strategy, the Working Group recommended that intermediaries, including small business representative organisations, become involved and that a major marketing campaign to inform both entrepreneurs and training providers be undertaken.

In the case of Ireland, there may be considerable merit in pursuing a similar strategy to raise awareness of the benefits of management development and drive demand for training.

56 SME Management Development in Ireland, Expert Group on Future Skills Needs, 2006

57 Joining Entrepreneurs in their World: Improving Entrepreneurship, Management and Leadership in UK SMEs, SME Working Group, Council for Excellence in Management and Leadership, London, 2002

4.2.7 Public funding for management development

At present, resource constraints are not the primary barrier to enhancing management competence in the small business sector. Research undertaken on behalf of the Small Business Forum shows that approximately €35 million per annum in public funding is available between 2006 and 2008 to support management training and development (including non-financial supports, such as mentoring), particularly in SMEs.[58]

The public money available for in-company training under the National Development Plan 2000-2006 has so far been substantially under-spent. It is not clear what level of funding will be available for in-company training after 2008, but in the meantime, the existing funds represent a major opportunity for management development in small companies.

The available resources for 2006 include:

- FÁS has budgeted €12 million in public funding for management development. This has been driven in part by a series of strategic alliances with small business representative organisations and training providers;
- Enterprise Ireland will provide some €8 million for training almost 3,000 managers; and
- An estimated €9 million will be available to the 35 City and County Enterprise Boards to support entrepreneurial and capability development in micro-enterprises and business start-ups. A high proportion of these resources goes towards enhancing the management capability of owner/managers.

A similar level of expenditure is expected in 2007 and 2008.

In addition to these resources, Skillnets – the enterprise-led training network funded outside the NDP envelope – has recently been allocated €55 million in public funds for the years 2005-2010. This will effectively enable Skillnets to double its annual financial supports for network training in the years to 2010. Over 80 per cent of Skillnets grants support network training in SMEs, and some 55 per cent is provided to managerial, supervisory and professional workers.

4.2.8 **Recommendation:** Develop management capabilities

The Small Business Forum recommends:

Raise the standard of management in small Irish businesses to the level of best international practice, by:

- Stimulating demand among small business owner/managers for management development initiatives; and
- Establishing a Management Development Council to ensure that the supply of management programmes meets the needs and learning styles of owner/managers, through continuous monitoring and evaluation of the available programmes.

Responsibility: Department of Enterprise, Trade & Employment.

The two aspects of this recommendation are elaborated overleaf.

58 Research undertaken for the Small Business Forum by Tansey, Webster, Stewart and Company, Economic Consultants

Case Study

Case Study:

Management Development

Advance Pneumatic Technology – a small family-run business – was set up by John Hughes in 1990. The company manufactures, distributes and installs pneumatic transport systems which are used for a range of purposes, such as carrying cash from tills to safes in retail outlets, transporting blood samples and other materials around hospitals, and a range of other purposes. Currently based in Balbriggan, the company employs 16 staff.

From its establishment in 1990 until about 1995, the company enjoyed moderate success, but lacked any real strategic direction. This prompted executives in the firm to participate in management courses centered on writing business and marketing plans, delivered through Meath County Enterprise Board. The results were immediate: after an internal reorganisation of business functions, the company experienced significant sales growth, and new staff were hired.

In 2003 the company again took stock of performance and sought tailored, firm-specific services from training providers Constructive Intervention, in conjunction with FÁS. Areas of lost opportunity were diagnosed, and training in relevant areas – particularly sales and customer care – was undertaken. Again the benefits were striking: turnover grew by €1 million in the following two years. The same staff levels were maintained during this time, so as far as the company is concerned, this growth is solely attributable to the identification of a gap in management competence and remedial action in the form of training.

While the company's management does recognise the time commitments required for training and development, bottom-line indicators clearly show that benefits have far outweighed costs. In terms of financial costs, outlays have been negligible when compared with sales and profit growth, and the company has benefited from some support from FÁS.

John Hughes, Managing Director of Advance Pneumatic Technology, is now taking his management development one step further. Like many successful entrepreneurs, John has no third-level qualifications. Through participation in the Biz-Path programme however, he is now eligible to enrol on a targeted MBA programme delivered at Dundalk Institute of Technology commencing in September 2006.

4.2.9 Stimulating demand for training

Owner/managers will participate in training only if they see a clear connection between specific programmes and the success of their business. This may be difficult to achieve, as it requires the owner/managers first to recognise the areas in which their knowledge or skills are deficient, and then to identify suitable ways of rectifying the deficiency.

A significant awareness campaign will be needed to generate demand for management development programmes. This should be organised by the Department of Enterprise, Trade & Employment, in concert with the major State training providers and the small business representative organisations.

Small business owner/managers also need help in assessing their management development needs, so that they can identify and participate in the most appropriate programmes. Assessment methods could range from management quizzes in the business and sectoral press to customised, interactive diagnostic toolkits delivered on CD-ROM or over the Knowledge Base (see chapter 3). The content and form of these assessment instruments should be agreed with the small business representative organisations, and a budget of €2 million should be provided for this purpose.

4.2.10 Ensuring an adequate and appropriate supply of training

Many small business owner/managers feel – rightly or wrongly – that the available training options are not relevant to their needs. This perception must be seriously examined: there is little point in stimulating demand for management training if the supply is inadequate or inappropriate.

To ensure a good match between supply and demand – or, initially, between supply and need – a Management Development Council should be established under the aegis of the Department of Enterprise, Trade & Employment to ensure that the available training programmes adequately cater for the needs of small business owner/managers. This may involve actions such as a review of existing programmes and delivery mechanisms, and signposting to appropriate offerings.

The Council should include representatives of the main providers of management training – public and private – and of the small business organisations who will have a particularly important role in filtering through the training needs of owner/managers. The primary purpose of the Council will be to bring together the 'suppliers' and 'demanders' of management training to ensure that appropriate training programmes are available.

4.3 Stimulate Innovation

Technological progress is a key driver of economic growth, and this depends to a large extent on research and development (R&D). Accordingly R&D strategies and supports form a fundamental pillar of modern enterprise policy.

This is true of policy at both national and European level: under the Lisbon Agenda, the EU has set comprehensive targets for substantially increasing overall R&D spend in the years to 2010, and as part of this focus, the Irish Government has set a target for R&D spending of 2.5 per cent of GNP.[59] The Government has also recognised the centrality of R&D to future prosperity by establishing Science Foundation Ireland in 2003 and committing €2.48 billion to R&D under the National Development Plan, 2000-2006.[60]

However, R&D in this sense is tightly defined, and in order for an activity to be classified as such, it must satisfy very specific criteria. Potential R&D projects must contain elements of novelty and problem resolution. In short, R&D is creative work undertaken on a systematic basis in order to create new or improved products, processes, services or other applications. The Small Business Forum acknowledges that R&D and technological innovation are critical to the further development of the economy, and that businesses that can conduct in-house R&D, and those that can effectively exploit R&D carried out elsewhere, will be a particularly important segment of indigenous industry in the years immediately ahead.

However, relatively few small businesses in Ireland have either the technical expertise or the financial resources to develop, absorb or exploit new scientific or technological knowledge. The remaining small businesses – and these are the vast majority – are still operating in a market where their competitors are constantly introducing new products, new processes, new services, new customer interfaces and new business models. To maintain their market position, small Irish companies must use existing knowledge, existing technologies and current best practices to boost productivity and enhance performance – in short they must innovate. Broadly, innovation is the commercial application and exploitation of existing knowledge in a new context.

Innovation can take a variety of forms. While technological innovation is the type most widely recognised, other forms of innovation are important drivers of business growth. For example, organisational innovation can involve adapting business models through new methods of distribution, finance or supply chain management, and presentational innovation includes innovative activities in areas such as design and marketing.

59 Building Ireland's Knowledge Economy: The Irish Action Plan for Promoting Investment in R&D to 2010, Forfás, August 2004

60 The majority of publicly funded R&D is performed in the higher education system. Of the total public R&D expenditure of €585 million in 2004, €395 million (68%) was spent in the higher education sector, €128 million (21%) in government bodies, €50 million (9%) in private enterprise and €11 million (2%) in 'extramural' projects. (Forfás Science Budget)

4.3.1 Innovation in small businesses

Innovation in the small business sector, and particularly in services, is seldom based on scientific R&D. It is more often based on making incremental improvements to business processes, improving service levels or delivery methods, or applying well-proven technologies or techniques. These kinds of innovation – where the business does something new, or does something old in a new way – will be the basis for enhancing the performance and productivity of the majority of small businesses.

Innovation in services

The need to enhance the performance and productivity of the services sector is of particular relevance to the work of the Small Business Forum, given the preponderance of small services businesses in the economy.

Innovation in the service sector can take a variety of forms, any of which can have technological and non-technological dimensions:[61]

- New business models/concepts: Services businesses can sometimes innovate in ways that involve a substantial change in the way they generate revenues and profits. Business model innovations can give a firm a strong and sustainable competitive advantage. This implies, however, that services companies must continuously rethink their organisational arrangements in order to accommodate new business models, as value migrates within and between sectors or players in a sector;
- New customer/delivery interfaces: Companies can innovate by improving the dynamic exchange of information with their customers – a key element of any service function. The customer interface may be face-to-face, remote, or entirely electronic; in all cases, it depends heavily on the staff employed, the technology used and the timing of the exchanges. Technology may be a key enabler of such innovations, although it is rarely a driver in its own right; and
- New service-product offerings: This type of services innovation is the most analogous to traditional manufacturing innovation. Services companies need to introduce new services in order to respond to customer demand or competitor pressures, in much the same way as a manufacturing company.

Innovation Vouchers

As part of a new innovation awareness initiative, owner/managers should be made aware of the positive impacts that innovation can have on business performance, and thereby encouraged to pursue innovation and productivity-enhancing opportunities. The Small Business Forum recommends that a pilot Innovation Voucher scheme should be set up in Ireland to enable small businesses to avail of external sources of advice, expertise and information. The proposed scheme would operate in a way that is similar in many respects to one recently introduced in the Netherlands (see case study).

Under the proposed pilot scheme, vouchers - worth approximately €5,000 - would be allocated on a semi-competitive basis to small businesses with proposals meeting basic criteria. The vouchers could then be exchanged for knowledge and expertise from accredited providers (for example, private firms providing eligible services and expertise, Institutes of Technology, public research organisations), or for related purposes.

The types of innovation targeted by this initiative include:

- New business model development;
- New service delivery and customer interface;
- New service development;
- Training in innovation management; and
- Innovation/technology audit and strategy development.

61 Services Innovation, Forfás, 2006

If the scheme is well publicised and successful case studies highlighted, it will help to engender a broad culture of innovation across the economy.

The types of activities eligible under this initiative could include any kind of innovation, including the forms listed above. The types of knowledge that small businesses are expected to use the vouchers to obtain include:

- Efficiency audits, process change, supply chain management and logistics;
- Strategic intelligence gathering;
- Design and branding; and
- Product and service testing and economic impact assessment.

For this scheme to be a success, application and compliance procedures must be kept simple, while simultaneously minimising scope for abuse. Some structural features to achieve this may include:

- A brief application form detailing the proposed use to which the voucher would be put;
- Basic qualification criteria which must be satisfied – for example, the proposed project must conform to guidelines regarding the types of activities eligible; the 'innovation partner' or knowledge provider must be clearly identified; expected benefits of the project must be understood and must demonstrate commercial applicability; and
- Responsibility of compliance would lie primarily with knowledge providers, who would be bound by guidelines and subject to spot-checks.

To foster an innovation culture across the economy, small businesses that meet the basic qualifying criteria should be allocated vouchers on an equitable basis.

For larger proposals, groups of up to five firms may apply in concert for a pooled voucher valued at up to five times the normal rate.

Evaluation mechanisms should be built into the pilot scheme from the outset, and control, evaluation and measurement of impact could be aided by allocating vouchers on a broad sectoral basis.

The Small Business Forum recommends that a budget of €2 million a year for three years be allocated to operate the pilot scheme, subject to annual review. When viewed in the context of the State's substantial financial commitment to R&D, this level of spending would represent significant value for money in promoting a culture of innovation, and in particular in the services sector.

Case Study:

Lessons for Operation: Dutch Innovation Voucher Scheme

In the Netherlands, a similar scheme – although focused primarily on technological innovation – has recently been put in place by SenterNovem, the Dutch Innovation Agency. For our purposes, the mechanisms for allocating vouchers and the general operation of the scheme may be worthy of consideration.

Under the initiative, eligibility is confined to SMEs who – for the purposes of conforming to state aid guidelines – have not received more than €92,500 in subsidies in the previous three years. Companies apply for vouchers by means of a very simple application form, and vouchers are allocated by means of a lottery.

The vouchers – which can be used with approved knowledge providers – are worth €7,500 and can be used by individual firms or groups of up to 10 firms for larger collaborative projects.

While the full scheme is not long in place (it was established as a structural measure in 2006), evaluations of pilot programmes in 2004 and 2005 show positive results, the key conclusion being that it does stimulate enterprises to engage in innovative activities. It was found that out of every ten vouchers, eight were used for a project that would not otherwise have been undertaken, one was used for a project that would otherwise have been conducted, and one was not used.[62]

4.3.2 R&D and small businesses

Very few small businesses are engaged in R&D: in 2003/04, 395 small businesses – most of them in high-tech sectors such as software and electronics – performed R&D costing in excess of €100,000.[63]

Government policy must continue to support the existing small business R&D performers, as well as seeking to augment their number by encouraging more small businesses to become R&D performers.

In *Transforming Irish Enterprise*, Enterprise Ireland set out plans to double the number of indigenous businesses engaged in 'meaningful' R&D (that is, spending more than €100,000 per annum on R&D) and to treble the number of firms conducting 'significant' R&D (spending more than €2 million annually)[64]. Such moves are essential if Ireland is to make the transition to a knowledge-driven economy as articulated by the Enterprise Strategy Group in 2004.[65]

The scale of many small businesses acts as a considerable barrier to their performing R&D and restricts their capacity to absorb and apply new technologies. Nonetheless, there is a significant cadre of companies with some scientific or technological capacity engaged in sophisticated commercial activity. These companies should be encouraged and supported in making the transition to R&D performance.

The intermediate step for such companies is to form significant productive relationships with outside sources of knowledge and technology such as public research facilities, large private enterprises, and in particular with the Institutes of Technology and other third-level institutions. At present the Institutes of Technology – a publicly-funded resource – are seriously under-utilised by industry in Ireland. This situation must be addressed so that the enterprise sector reaps the benefits of knowledge and expertise in the higher education system, and so as to derive greater commercial and societal value from the substantial public investment involved.

62 Do innovation vouchers help SMEs to cross the bridge toward science? CPB Netherlands Discussion Paper No. 58, February 2006

63 Forfás Business Expenditure on R&D (BERD) Database

64 Transforming Irish Enterprise: Enterprise Ireland Strategy 2005-2007

65 Ahead of the Curve – Ireland's Place in the Global Economy, Enterprise Strategy Group, July 2004

Knowledge Acquisition Grants

The Small Business Forum recommends that Knowledge Acquisition Grants be provided to enable small businesses in the manufacturing and internationally traded services sectors to access existing technology or knowledge from higher education institutions, research bodies and large private enterprises. Grants of up to €20,000 are envisaged,[66] covering a maximum of 60 per cent of the total cost involved, subject to State aid parameters.

The Institutes of Technology operate research centres that specialise in a broad range of activities, such as knitwear technology, bioanalysis, food product development, software technology and multimedia design. Many of them actively seek collaborative work with local enterprise, and this scheme would promote such linkages.

The small businesses targeted by this initiative are those that lack the capability and capacity to carry out R&D in-house, but that have the potential to benefit from advancements made outside their own firms. Eligibility for the grants should therefore be confined to firms not already in receipt of State supports for R&D.

The types of activities supported here could include:

- Product and process design and prototyping;
- Information and communications technology development;
- Engineering services; and
- Industrial design.

While there may be scope for this type of activity under existing schemes, such as Enterprise Ireland's Innovation Partnerships programme, this action is a targeted, specific measure aimed at drawing existing technological knowledge out of the education and research bodies and large firms, and into small business.

4.3.3 **Recommendation:** Stimulate innovation

The Small Business Forum recommends:

- Make Innovation Vouchers available to small businesses in every sector, to be exchanged for advice, expertise and information from accredited knowledge providers. A budget of €2 million should be provided for these vouchers each year for three years.
- Provide Knowledge Acquisition Grants to enable small businesses in the manufacturing and internationally traded service sectors to gain access to research-based knowledge, expertise and facilities in higher education institutes, research bodies and large private enterprises, on a co-funded basis.

Responsibility: Department of Enterprise, Trade & Employment; Enterprise Ireland; City and County Enterprise Boards.

66 Indicative funding level, based on rate of intervention in comparable schemes

4.4 Drive Adoption of ICT

Information and communications technology (ICT) is a key driver of productivity growth and economic progress. It is an essential component in the pursuit of a high-value, knowledge-based economy.

Around the world, studies have shown a positive relationship between the use of ICT and growth in productivity,[67] and there is evidence to show that differences in the rate of ICT take-up were responsible for differences in labour productivity between Europe and the US in the 1990s.[68] The productivity gains to be reaped from ICT stem both from the levels of fixed investment in hardware and software, and from the proportion of the workforce that is ICT-enabled.

The effective use of ICT across the entire population of Irish small businesses will thus be critical to sustained productivity and growth in the years ahead.

4.4.1 The eBusiness Strategy

The Department of Enterprise, Trade & Employment's eBusiness Strategy *Optimising Usage of ICTs by Irish SMEs and Microenterprises* is aimed at encouraging and assisting SMEs, including micro-enterprises, across all sectors of the economy, to use ICT to maximise their competitive advantage.

The Strategy identifies several factors that are important for the development of eBusiness, including:

- An appropriate level of ICT management skills and ICT user skills in the workforce;
- Good telecommunications infrastructure;
- A good legal framework, including effective enforcement of rules against fraudulent or malicious behaviour online; and
- Effective IT security policies at the level of the firm.

The Strategy also contains several recommendations designed to drive the uptake of ICT and eBusiness by SMEs, including:

- Building awareness of the legal framework for online trading;
- Establishing a database of all relevant training courses in ICT management skills;
- Exploring the feasibility and desirability of developing further third-level courses in the area of ICT management skills; and
- Promotion of ICT and eBusiness development supports as part of an overall approach to enterprise development.

The Strategy is currently being implemented by a cross-departmental/agency implementation group and the Small Business Forum recognises and supports the ongoing work of this group.

The eBusiness Strategy found that SMEs need to:

- Make better decisions about IT investment;
- Better manage the IT facilities they already have; and
- Make more use of these facilities.

The Strategy pointed out that anecdotal evidence suggests that these issues apply also to micro-companies. Encouraging better use of ICT will ultimately increase ICT engagement levels. Companies that make the most of the IT facilities that they already have will also be more likely to invest further in IT when their business environment warrants such investment. The Small Business Forum agrees with this assessment.

67 ICT and Business Productivity: Finnish Micro-level Evidence, Maliranta, M. and Rouvinen, P., Office for Economic Co-operation and Development 2004; IT Use by Firms and Employees: Productivity Evidence across Industries, Shikeb Farooqui, British Office for National Statistics, 2005; It Ain't What You Do It's the Way that You Do I.T. – Testing Explanations of Productivity Growth Using U.S. Affiliates, Nick Bloom, Raffaella Sadun and John Van Reenen 2005

68 Fostering Productivity: Pattterns, Determinants and Policy Implications, Gelauff, Klomp Raes and Roelandt, 2004

4.4.2 Uptake in Ireland

However, the use of ICT among small business is low, particularly amongst micro-enterprises. It is true of basic applications, such as e-mail, as well as more sophisticated uses.

Table 4.1, for example, based on 2003 data, shows the proportion of micro-enterprises (employing fewer than ten people) in manufacturing and services that use different ICT applications.[69]

Table 4.1: : Uptake of ICT Applications in Irish Micro-enterprises, 2003

Application	Manufacturing	Services
Use e-mail	63%	34%
Have a website	32%	12%
Able to accept e-commerce orders	24%	5%

Source: CSO data

4.4.3 Stimulating the adoption of ICT by small businesses

The low uptake and limited use of ICT by small businesses are due to three main reasons:

- Owner/managers don't fully appreciate the contribution that ICT systems can make to their businesses;
- Small businesses often lack the skills to evaluate, implement and fully exploit ICT; and
- The costs associated with ICT are perceived to be too high.

The Small Business Forum believes that solving the first of these issues will overcome the second two: the main problem is that small business owner/managers are unaware of the potential benefits of ICT adoption. Consequently, there is a need to raise awareness amongst small businesses of the productivity-enhancing benefits of the effective use of ICT systems.

4.4.4 **Recommendation:** ICT audits for small businesses

The Forum believes that awareness of the benefits of ICT usage could be heightened by the introduction of an ICT Audit Scheme intended to enable small businesses to access professional advice on how to use ICT more effectively and strategically. Clearly, such a scheme will be limited in the number of companies supported, but it should be structured and promoted in a manner which will highlight to a much larger number of small companies the benefits of ICT usage to their businesses.

The Small Business Forum recommends:

Drive awareness and understanding of the role of ICT in improving business performance, by creating a subsidised scheme costing €2 million a year for three years to help small businesses to avail of an ICT audit. This audit will enable businesses to access customised, independent, professional advice on the use of ICT to improve productivity and foster growth.

Responsibility: Department of Enterprise, Trade & Employment; Enterprise Ireland; City and County Enterprise Boards.

The proposed ICT audits are intended to enable small businesses to access independent professional advice on how to use ICT – and particularly their existing ICT investment – effectively and strategically over a range of business functions, such as accounts, stock management, customer relationship management, communications, and graphics. The proposal is designed to complement the objectives and recommendations of the eBusiness Strategy.

69 Information Society and Telecommunications 2005, Central Statistics Office, February 2006

The objective of the scheme is to raise awareness of how the effective use of ICT can drive productivity improvements within the small business sector, and to stimulate a significant and permanent behavioural shift in the manner in which small businesses think about and use ICT across their business functions. It is also designed to help such companies make better decisions around ICT investments in the future.

The Forum recommends that €2 million be provided for the scheme per annum over the next three years. It also recommends that the scheme be co-funded, to ensure that the companies applying for funding are those who wish to grow and have a willingness to invest their own resources in that growth.

Case Study

Case Study:

Information and Communications technology

Conor Geoghegan Jewellers – a small family business – was established in Wexford in 1982.

In 2005, the firm sought to enhance efficiency and productivity through better use of information and communications technology. Staff and management felt that there were significant benefits to be made from reorganising a range of routine business tasks, such as stock management and ordering, accounting and point-of-sale.

As with many small businesses, the company already owned a PC, but felt that it was not being used to its full potential. After some initial web research into available technology, and attendance at a trade fair in Birmingham, the firm settled on an electronic point-of-sale package that it felt would suit their purposes and lead to improvements in performance and productivity.

Along with the necessary software, some new hardware was required – a specialised cash drawer, barcode scanner and receipt printer – but the investment has proved entirely worthwhile in terms of efficiency gains. The new system is fully integrated with the shop's accounts and payroll, allows for maximum/minimum stock control, automatically generates orders, provides customer records, and tracks best performing products and suppliers.

4.5 Campaign to stimulate growth aspiration and potential

The key recommendations made by the Small Business Forum in this chapter have the fundamental objective of stimulating both the aspiration and the capability of small businesses for growth. The implementation of these recommendations should be backed by an integrated awareness campaign to promote new and existing supports.

The State should launch a campaign to promote the range of new and improved services and supports for small businesses, such as the Innovation Voucher scheme, the Knowledge Acquisition grants, the enhanced Business Expansion Scheme and Seed Capital Scheme, the ICT Audits, as well as the range of available management development opportunities. It should include widespread dissemination of best practice, and case studies of successful innovations, and direct interested parties to the new business Knowledge Base.

The campaign should specifically target small business owners and potential entrepreneurs. It should use a variety of media, for example, national, local and trade press, local and national radio, in order to reach as broad a small business audience as possible.

Work carried out on behalf of the Small Business Forum by Tansey, Webster, Stewart & Company, and independently verified by a leading advertising agency, estimated the cost of an advertising campaign promoting management development at €3 million. The Forum believes that the campaign should be broadened to cover all the elements mentioned above.