

Executive Summary

Background

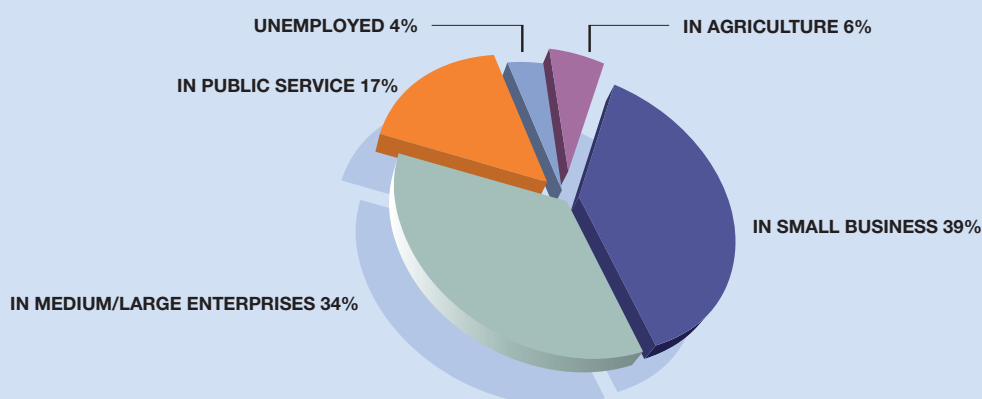
The Small Business Forum was set up in July 2005 by the Minister for Enterprise, Trade & Employment, Micheál Martin T.D., to consider the current environment for conducting small business in Ireland, and to advise on the adequacy and appropriateness of public policy responses.

The Forum based its work on a number of inputs: an extensive review of current literature, 74 submissions from organisations and interested members of the public, a detailed empirical study, and a series of consultation meetings with small business owners and managers.

Why Small Business is Big Business

Over 97 per cent of businesses operating in Ireland today are 'small' – they employ fewer than 50 people. There are approximately a quarter of a million small businesses in Ireland, employing 777,000 people (more than half of the total private sector, non-agricultural workforce).

Distribution of the Irish Labour Force, 2005



In many ways, the health of the small business sector is both an indicator of the condition of the whole economy and a determinant of that condition. Small businesses are important for a number of reasons:

- ▣ They provide regionally distributed employment around the country, deliver a huge range of local services, and contribute to the economic, social and cultural life of the entire population.
- ▣ They account for over 70 per cent of gross value added (GVA) in Construction (around €7.2 billion), over 40 per cent of GVA in Services (€15 billion – excluding financial services), and 34 per cent of GVA in indigenous Manufacturing (€2.1 billion).
- ▣ They pay 50 per cent of VAT on services (over €4 billion), 11 per cent of corporation taxes (around €530 million) and 37 per cent of income taxes (almost €4 billion).
- ▣ They form an essential part of the supply chain for larger firms, and in particular are part of the support infrastructure needed to attract and retain foreign investment.

The performance of the small business sector is thus an important contributor to the overall quality of life and standard of living in the country.

The Seedbed for Future Growth

As the Irish economy becomes increasingly knowledge-based, and as low value-added activities migrate to lower cost economies, a greater proportion of the country's wealth will have to be generated by indigenous companies.

Whereas in the past, Irish indigenous companies have tended to start small and remain small, a new generation of indigenous companies is already beginning to emerge – companies with the potential to grow, and in some cases grow rapidly, to conquer international markets.

The small business sector is the incubating ground for these companies. Some of them will be technology-based companies, who will exploit the State's substantial investment in R&D and help to assert Ireland's position as a knowledge creator and innovator. A greater proportion will be in services (reflecting the growth internationally of the services sector). These businesses will use highly innovative business models to grow and deliver internationally, services that were previously the preserve of small companies trading locally. The majority, however, will continue to deliver local services and to play their important role in the supply chain of larger companies.

Small business owner/managers with the ambition, ability and potential to grow their companies into strong internationally trading entities must be empowered to reach this potential. Those that continue to trade locally largely determine the cost base for both consumers and other businesses, and these must be encouraged to innovate in other ways, in order to maximise their efficiency, quality of product and service, and productivity.

Transformation of the Business Environment

The last major report on the small business sector was issued by the Small Business Task Force in 1994. At that time, the business environment was characterised by low disposable incomes, high taxation and high interest rates. In the intervening period, the business environment has been radically transformed:

- ▣ The Irish market has grown very substantially: the population – and particularly the number of people in work – has increased. In short, there are more people with more money to spend.
- ▣ The taxation regime has relaxed – for the vast majority of companies, corporation tax has been reduced to 12.5 per cent; the top income tax rate has been reduced to 42 per cent; and the capital gains tax rate has been halved to 20 per cent.
- ▣ Short-term interest rates are considerably lower (currently below 4 per cent, compared with 6 or 7 per cent in the mid 1990s).

In this positive environment, over the ten years since 1995 the small business sector has flourished: the number of small businesses in Ireland has grown by more than 50 per cent, and employment in small businesses has grown by approximately 79 per cent. Economic growth, however, has created a number of difficulties for businesses in Ireland:

- ❑ With the liberalisation of international trade and globalisation of markets, small companies are facing greatly increased competition from companies with lower cost bases.
- ❑ High inflation in recent years has contributed to sharp rises in business costs.
- ❑ The labour market is considerably tighter (unemployment is now around 4 per cent); as a result many businesses have difficulty finding and retaining suitable skilled staff, and wage rates are increasing.

Challenges Ahead

In the years immediately ahead, the pressure on Irish companies to perform to the highest international standards will be heightened by intensifying international competition. Irish companies – whether trading locally or in foreign markets – will increasingly face competition from major international players with highly sophisticated business models, coupled with economies of scale in every aspect of their operation. In this environment, only the strongest and fittest companies will survive.

A number of trends have recently emerged that are of particular concern, and that present significant challenges for small businesses in the years ahead.

Productivity

Productivity in small Irish companies is low in comparison with similar-sized companies in other countries.

In manufacturing, in comparison with nine other EU countries, productivity in small Irish companies ranks:

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

In services, Ireland also compares unfavourably with other countries.

Service Sector	Size of business (Number of employees)			
	1	2-9	10-19	20-49
	Productivity ranking when compared with eight other EU countries			
Hotels and restaurants	5	6	8	7
Transport, storage and communications	6	6	2	8
Real estate, renting and business activities	6	2	6	2

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.

International competition on the local market

Small service companies with a traditional market in their immediate locality have begun to face intense competition from large international competitors in, for example, retailing, personal and professional services, restaurants, hotels and entertainment. Internet-based competition has also begun to affect a number of sectors.

These challenges are already having an impact. Between 1995 and 2000 the number of small businesses grew by an average 6.6 per cent a year, but in the years since then, growth has slowed to 2.6 per cent. The number of small manufacturing firms has been static over the past five years, and the number employed in them has declined. The number of small firms in wholesale, retail and hospitality has also declined.

The Need for Action

A number of issues need to be addressed if the small business sector is to realise its full potential and play the increasingly important role in the Irish economy that will be demanded of it in the years ahead. Addressing these issues will require effort by Government and State agencies, by the education and training institutions, by industry representative organisations, by businesses themselves, and by emerging entrepreneurs. In some cases, this will require redistribution or rebalancing of resources, and in others it will require new investment.

Given the relative health of the economy following the past decade of growth, the Small Business Forum emphasises that it is now both opportune and appropriate to take the necessary initiatives, in order to ensure that the issues identified in this report are addressed promptly, comprehensively and convincingly.

Some of these issues are particularly acute for businesses that are growing, and are of particular concern to the Forum, given the role expected of the small business sector in the future. Some are faced by all small businesses, irrespective of their sector or stage of development; and some are peculiar to businesses in their start-up phase.

Issues that particularly face growing businesses

- ❑ Difficulty in accessing finance
- ❑ Weak management capability
- ❑ Lack of innovation, both technological and non-technological
- ❑ Under-exploitation of Information and Communications Technology (ICT)

Issues that face all small businesses

- ❑ Burdensome and costly administrative regulations
- ❑ Rising local authority charges
- ❑ Poor access to information and advice
- ❑ Inadequate infrastructure

Issues that face start-ups

- ❑ Lack of a systematic approach to entrepreneurship

These issues are discussed overleaf.

Issues that Particularly Face Growing Businesses

Access to finance

While the problem of funding for small business has eased somewhat over the past decade with the improvement in the investment environment and the drop in short term interest rates, small businesses continue to report difficulties in obtaining appropriate levels of finance for start-up and growth. These difficulties appear to be more pronounced for:

- ❑ Businesses in the services sector, with limited capital assets; and
- ❑ Businesses that are ineligible for support from the enterprise development agencies.

In particular, the Forum believes that financial institutions are reluctant to lend money to businesses that are perceived to be risky or that have limited collateral, while under the current taxation regime Irish investors are more likely to choose one of the many asset-backed investment options than take equity stakes in small companies. The financial support provided by the enterprise development agencies does address this issue to some extent, but only for the limited number of businesses that are eligible for agency support.

A separate issue relates to working capital and cash flow. Small businesses that supply goods and services to large organisations are often compelled to accept long delays in payment, either because of unreasonable contract terms, or because they are afraid to pursue on-time payment for fear of losing business.

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.

Management capability

The performance – and even the survival – of a small business depends in large measure on the competence and capability of its management. The quality of management affects productivity, profitability and sales growth.

Work carried out in Ireland has shown that the level of general management skills in Irish small businesses is relatively poor, particularly in specific functional skills such as human resources, marketing and finance, and in forward planning and strategic management.

Despite these deficiencies, small firms engage in management training and development only to a very limited extent, both for reasons of time and cost, and because the available management training programmes are not perceived to be relevant.

Given that economic progress in Ireland in the years ahead will depend heavily on the performance of the small business sector, it is critical that the management of these businesses be equipped with the knowledge and skills they need to make the businesses perform optimally.

The Small Business Forum recommends:

Raise the standard of **management capability** 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.

At present, resource constraints are not the primary barrier to enhancing management competence in the small business sector. 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.

Innovation

Innovation is imperative throughout the enterprise sector as Ireland progresses towards a knowledge-based society. The type of innovation most often referred to is technological innovation, which is rooted in scientific research and development (R&D), but other types of innovation are also important, and more relevant to the majority of small businesses, particularly in the services sector.

Very few small businesses have the resources or the expertise to engage in R&D. Those that are unlikely to become R&D performers – and particularly companies in the services sector, should be encouraged to use the best available expertise to help them constantly adapt and be innovative in their businesses. This should help them to bring their operations into line with international best practice, to increase productivity and profitability, and to win new markets. The recommendation proposed overleaf will enable them to develop new service offerings, change their business models, improve their customer interface, cut costs, and adopt new technology.

A number of companies, however, have some in-house scientific or technological capacity, but not sufficient to engage in formal R&D activity. These companies should be encouraged and supported in making the transition to R&D performance. The intermediate step for them is to form significant productive relationships with outside sources of knowledge and technology, and in particular with the Institutes of Technology and other third-level institutions. Support should be made available to help such companies to form these relationships and acquire the knowledge they need to develop new products, processes and designs. These supports should stimulate innovation and awareness of innovation throughout the small business sector.

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.

ICT audits for small businesses

The effective use of ICT by the entire small business sector will be critical to sustained productivity and growth in the years ahead. The Small Business Forum agrees with the assessment of the Government's eBusiness Strategy that many SMEs need to make better decisions about Information Technology (IT) investment, to manage the IT facilities they already have, and to make more and better use of these facilities.

The Small Business Forum believes that the low uptake and limited use of ICT by small businesses is due to a low level of awareness of the benefits presented by the technology. Addressing this issue will encourage businesses to adopt and exploit the available technologies in an optimum fashion, and thereby increase their productivity. The Forum recommends that €2 million be provided per annum over the next three years to meet this requirement. 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 allow 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.

Issues that Face all Small Businesses

Better regulation

The Small Business Forum recognises that regulation is necessary and beneficial to society in general, to consumers, to the environment and to businesses themselves. However, regulation carries compliance costs, and much of these are borne by businesses. In recent years, the Government has taken a number of positive initiatives, including the introduction of Regulatory Impact Analyses for new regulations and the establishment of the Business Regulation Forum. However, small businesses are required to bear compliance costs that are disproportionately high, with a resulting loss of competitiveness.

The Small Business Forum found that the most burdensome regulations for small businesses are those relating to health and safety, employment, and tax and VAT administration.

The Small Business Forum recommends:

Existing regulations: Use the Regulatory Impact Analysis (RIA) mechanism to conduct a systematic review over a seven year period, with annual targets, of existing regulations that have greatest impact on small businesses (Taxation, Health and Safety, and Employment) and amend these regulations to reduce the burden of compliance. The review should complement the work of, and be carried out in consultation with, the Business Regulation Forum.

New regulations: During Regulatory Impact Analysis, explicitly consider amendments or exemptions for small businesses. Provide Government departments with specific guidelines on the treatment of small business in that context.

Implementation:

- Wherever possible, use a risk-based approach to regulatory implementation and enforcement.
- Allow new regulations to come into effect on only two dates each year to facilitate small businesses to keep track of regulatory change.

Specific, immediate actions: The following actions should be taken immediately to benefit small businesses:

- Increase the turnover threshold above which businesses are required to be audited from €1.5 million to the EU limit (currently €7.3 million);
- Increase the turnover thresholds for VAT exemption from €55,000 to €70,000 (on goods) and from €27,500 to €35,000 (on services);
- Allow the preliminary payment of corporation tax to be based on the previous year's assessment where the tax for the previous year is less than €100,000 (currently €50,000); and
- Raise the threshold for using the cash basis of accounting for VAT (for non-retail businesses) to at least €1 million.

Responsibility: All Government departments; Business Regulation Forum.

Balanced Local Authority charges

The rapid growth in the number of households and businesses in recent years has brought about a greatly increased demand for local authority services. Local authority current expenditure increased by 114 per cent between 1996 and 2004, and to fund this increase, commercial rates were increased by 111 per cent and local charging for goods and services (most of which is contributed by the business sector) grew by 112 per cent.

Continually increasing local authority charges are a significant issue for all businesses, but particularly for small businesses. Increased charges – commercial rates, service charges (water and waste), planning and development fees and development charges – are impacting negatively on competitiveness, and stifling growth.

While recognising the Government's reluctance to increase the contribution of households to local authority funding, the Small Business Forum stresses that it is unreasonable – and ultimately economically counter-productive – to expect the business sector to absorb sustained increases in local authority charges.

The Small Business Forum recommends:

Collect from the business community only its **fair share** of local authority funding by:

- ▣ Rebalancing the contributions of business, central government and domestic sources by introducing base broadening measures and applying a 'User Pays' principle; and
- ▣ Providing greater transparency and clarity in the preparation of local authority accounts.

Specific, immediate actions: The following actions should be taken immediately to benefit small businesses:

- ▣ Base development charges to small businesses on the incremental costs that are directly attributable to the proposed development.
- ▣ Establish a Business Users' Forum in each local authority area to improve consultation with and responsiveness to businesses.

Responsibility: Department of the Environment, Heritage & Local Government; Department of Finance; Local Authorities.

Access to information and advice

Despite having access to a very wide range of information sources, far too many entrepreneurs and small business owner/managers in Ireland are without a readily available single point of contact to answer the questions that inevitably arise at each stage of business development. As a result, they are frequently referred from one organisation or individual to another, and may ultimately get advice that is inappropriate or sub-optimal. At best, this can lead to frustration and wasted time; at worst it can lead to missed opportunities, poor performance and business failure.

A coherent strategy on information provision would mean that entrepreneurs and small business owner/managers would have a single, well-publicised point of contact to deal with all their enquiries at each stage of developing their business.

The Small Business Forum recommends:

Develop, launch and promote a first-stop '**Knowledge Base**' – a comprehensive central resource of relevant, up-to-date, user-led business information for entrepreneurs, owner/managers and their advisers.

This Knowledge Base will be available to businesses by telephone and over the Internet, and will support a wide range of information channels, including the development agencies and other business advisors.

The Knowledge Base as envisaged will be substantially different from anything currently available from public or private sources, but it will build on the best of those sources.

Responsibility: Department of Enterprise, Trade & Employment.

Infrastructure

The very success of the Irish economy over the past ten years has put a huge strain on our physical and social infrastructure. The National Development Plan (2000-2006) has played a significant role in closing many infrastructure gaps, but despite these investments, deficiencies remain. Infrastructure developments continue to lag behind demand in many parts of the country, particularly in four key areas:

- ❑ **Broadband:** while the Forum recognises that broadband connectivity and penetration are increasing and costs are falling, broadband take-up in Ireland is significantly slower than in many other OECD countries.
- ❑ **Transport:** An efficient transport infrastructure is essential for enterprise development. The Forum welcomes the Government's *Transport 21* plan. However, components contained in the Plan's framework will require prioritisation and must be subject to cost-benefit appraisal to ensure that value for money is achieved.
- ❑ **Energy:** Noting that electricity costs increased by 40 per cent between 2001 and 2004, the Forum is concerned that liberalisation of the energy market is not having the desired effect in reducing prices or improving quality of service. It also notes that very significant investment is needed in order to cater for predicted economic growth.
- ❑ **Waste management:** Waste costs are a major issue for Irish business; the total cost of waste disposal for business in Ireland has risen from €32 million in 1995 to over €800 million in 2004. Lack of access to suitable recovery and disposal outlets has a negative impact on every enterprise in Ireland.

The Forum stresses the critical importance of addressing these issues, noting that their importance is already widely recognised, and that they have been the subject of a number of other reports. Rather than re-analyse these issues in depth and make new recommendations, the Forum emphasises the need for sustained action and accelerated delivery on plans and recommendations already formulated.

Encouraging More and Better Start-ups

A National Entrepreneurship Policy

While the State operates many initiatives aimed at inspiring entrepreneurship and supporting start-ups, these supports and initiatives are generally uncoordinated and do not amount to a coherent policy.

As Ireland develops as a knowledge-based society over the coming decade and indigenous businesses assume a more significant role in the overall economy, it is imperative that entrepreneurship be nurtured, so as to maximise the number of new business start-ups and to ensure that they realise their potential for growth and development.

Despite a relatively high rate of new business start-ups generally, levels of entrepreneurship among women are significantly lower in Ireland than in other countries. There are also a number of other sources of entrepreneurship that are relatively untapped.

The Small Business Forum recommends:

Government should formally adopt a **National Entrepreneurship Policy** focused on optimising the number of start-up businesses, and in particular on maximising the number of start-ups aspiring to and achieving high growth.

This policy should build upon three specific platforms:

- Stimulating latent entrepreneurial potential, particularly among women and the immigrant community;
- Reinforcing entrepreneurship in the education system; and
- Enhancing the culture for entrepreneurship.

The range of existing initiatives aimed at stimulating entrepreneurship should be incorporated into this policy, to ensure a cohesive, coordinated approach.

Responsibility: Department of Enterprise, Trade & Employment; Department of Education & Science.

Data on the Small Business Sector

Public policy in relation to small business in Ireland is conducted without the benefit of comprehensive, up-to-date statistical information. The statistical information in this report had to be gathered especially for the Small Business Forum, and much of it was extrapolated from a range of sources, which were often inconsistent or incomplete. This situation is unsatisfactory.

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.

Focus of Enterprise Support Agencies

To date, the focus of the enterprise support agencies has been on manufacturing companies and those engaged in internationally traded services. This focus is clearly correct, as these companies are the most significant wealth generators for the Irish economy.

However, as service companies trading on the local market are such a vital part of the overall economy, and as developed economies across the world now typically derive 70 per cent of their wealth from the services sector, it is now essential to ensure that the services sector – including that part of it that trades domestically – performs optimally and that it maximises its contribution to the economy.

In addition, the pace of internationalisation of services needs to be recognised. In recent years, Irish towns and cities have seen the arrival of international chains in retailing (food, clothing, hardware, music, books, stationery, furniture, etc.), in personal and professional services, in restaurants (particularly fast food), in hotels, and in entertainment. These international companies present indigenous companies with intense competition. Such competition is both welcome and necessary, but enterprise policy should now take cognisance of this trend and recognise the potential for Irish services companies to pursue similar strategies and deliver their services locally in foreign markets. The number of Irish companies that are capable of doing this will not be great – at least initially – but with the right support framework, more international players could emerge.

The Small Business Forum proposes that the Government should consider broadening the policy focus of the enterprise support agencies, so that they can meet the needs of locally trading services companies that have the potential to expand to trade locally in foreign markets. The benefits to the economy could include profit repatriation, headquarter operations, sub-supply access and exposure to international trading best practice.

Implementation

A body should be established to monitor implementation of these recommendations. This body should meet regularly with both the Minister and the Secretary General of the Department of Enterprise, Trade & Employment. Given the experience, interest and involvement of the Forum members, the Small Business Forum is the most appropriate body to serve this implementation role. A member of the Enterprise Advisory Group (established by Government following the report of the Enterprise Strategy Group) should be invited to join this body to help drive implementation of the recommendations regarding the evolution of enterprise policy.

The small business sector is vital to the sustained economic and social development of the country. The recommendations in this report are designed to create a better environment for small businesses, to stimulate their growth aspirations and enhance their capabilities, and to inspire entrepreneurship. Delivery of the recommendations should ensure the continued growth and prosperity of this important sector.