SUBMISSION BY THE

SMALL FIRMS ASSOCIATION

TO THE

SMALL BUSINESS FORUM

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SFA SUBMISSION TO THE SMALL BUSINESS FORUM

Introduction

Irelands 190,000 small businesses have been the foundation of our new found economic strength. The sector now accounts for over 60% of GDP and 51% of private sector employment. Small firms are crucial to the enhancement of competitiveness and growth. For over a decade now small companies have been seen as the main source of future employment with over 550,000 jobs created in that period. About 24,000 new enterprises are being created each year, which makes them a major vehicle for change. As competition increases, the contribution of the sector in terms of its adaptability, its contribution to innovation in products, processes and services and the opportunity it provides for flair and creativity will enable new and existing small businesses to help Ireland keep pace with challenges posed by our competitors. However, this will only be possible if the business environment is such that it encourages success. In particular, our entrepreneurs need to have the right conditions to develop and launch their products and to have the right fiscal and administrative environment in order to encourage reinvestment of their gains when they are successful. While this is a matter of removing the current obstacles to entrepreneurial activity and arranging for appropriate forms of technical and financial support, it is also a question of getting the backing of those who work with entrepreneurs, and of society as a whole.

The contribution of small business to our economy, in terms of their innovative capacity and their employment potential is widely recognised. What is less recognised is the growing influence of small business on all our lives. As there is less employment in large companies and as the public sector increasingly makes use of outside services many more people than in the past will be employed in small business and many more people will be starting their own business. We are moving towards an entrepreneurial society, yet so many of our assumptions and practices reflect the old economic structures and particularly hinder the creation of new enterprises. It is, therefore time that we moved from merely talking about the importance of having the right environment for small businesses to putting the needs of enterprise at the centre of policymaking.

Small businesses are different because they are managed by men and women who take risks with their own money, not on behalf of financial institutions or shareholders. They also create jobs, investment and wealth.

While the economy is structurally very sound there are major frictional issues emerging and the Small Business Forum presents a timely opportunity to focus on the sector and its requirements.

The Small Business Forum presents a welcome and timely opportunity to review the enterprise development strategies being pursued by state agencies, the international comparisons on small business growth, the availability and access to finance for small business and the ability of small firms to engage in R&D activity. However, the Small Business Forum must also look at the cost of doing business in Ireland relative to our competitors. As a trading nation, Ireland must export 84% of everything we produce and input costs are particularly important because Ireland is a price taker, not a price maker on international markets. The price of the goods we produce will determine the amount of goods we sell.

On the plus side, Ireland now has historically low inflation, interest rates, unemployment levels, and high GDP growth relative to our competitors. However, on the negative side Irish wage costs are now 134% of the Eurozone average, VAT is 4% above the Eurozone average, energy costs are 25% above the Eurozone average. Higher insurance costs, higher distribution costs, rigid labour and business markets and waste, water and local authority costs rising by multiplies of inflation are all combining to make Ireland a less attractive and more expensive place to do business Not a winning formula if we are to regain competitiveness. Importantly though, all of these issues are in our own remit to solve and the Small Business Forum should play its part in putting forward recommendations in this critical area.

While it is important to give ourselves praise for achievements, we must also take an honest look at the challenges facing us and the work of the Small Business Forum will be central to the continued success of the sector over the coming years. The old adage that you sow the seeds of your downfall at the height of your success should be borne in mind. Ireland cannot become complacent about its place in the world economic order.

The success or failure of this initiative will be its ability to convince the Government to act on the most pressing issues facing small business. As an economy, Ireland has forgotten how to compete, believing instead that the Irish economy is indestructible and that the world owes us a living. Over the past years, Ireland believed that we could pay ourselves more than anyone else simply by increasing our prices and that no one would notice. We awarded ourselves wage increases three times those of our international competitors. We have infrastructural problems in public transport, telecommunications, waste management and public utilities, all of which are making Ireland an expensive and less attractive place to do business.

These problems are only the tip of the iceberg. Look below the waterline of Irish business and the real pain is evident. Wages in Ireland continue to rise at three times those of our competitors. While currently declining, insurance costs have risen by over 100% in four years. Housing costs are so high that at least two salaries are required to purchase a modest house. Traffic congestion is costing over €2 billion per year as goods and people are caught in gridlock. The lack of progress on competition policy means that our labour and business markets remain among the most rigid in the world. Suddenly, being competitive is important again. But, we have not invested wisely enough to be able to take on the opposition and beat them. The rest of the world has caught up and Ireland needs to go back to competition school.

So much has been achieved in recent years that perhaps we have come to think of economic and social security as being ours as a right. Those with longer memories will remember that the world owes us nothing and nothing is all we can expect in an increasingly competitive global environment if we cannot make goods at the price our customers are prepared to pay for them. It is the quality of our response rather than the threats we face that will determine the future landscape of small business.

The Small Firms Association (SFA) believe that the Small Business Forum represents a real opportunity to have some real debate, realisable proposals and recommendations about the critical issues and challenges facing the small business sector. Premier among those issues is the pursuit of a more rigorous, efficient and equitable means of delivering Local Authority services. The cost associated with local authorities and environmental charges must be tackled rather than simply offset by price hikes, borne mainly by small businesses.

In addition, the Forum should make a greater case to encourage more small companies to engage in research and development (R&D). The environment for R&D must not simply be the preserve of larger companies and universities. Small companies have demonstrated that they are great innovators and must be encouraged, whether through the taxation system or through capacity development to undertake a greater level of R&D and Technology Transfer and Licensing.

Small business has a legitimate expectation to a regulatory environment based on Necessity, Transparency, Consistency, Accountability, Proportionality and Effectiveness. If we are committed to strengthening the small business sector to ensure that its contribution to wealth and employment creation is developed to its fullest extent then reducing bureaucratic costs is a good place to start.

Following consultation with our members the Small Firms Association would like to make the following submission for consideration by the Small Business Forum. The SFA is the largest small business organisation in Ireland representing over 8,000 companies, and 12 affiliated organisations. As “the voice of small business”, it is a full social partner, exclusively representing companies that employ less than 50 people.

This submission is structured into four parts. Part one deals with reducing the cost base of small businesses, particularly in relation to stealth taxes. Part two deals with workplace issues and management capability building. Part three deals with finance for small business and part four deals with innovation and R&D

Part 1

Reducing the Cost Burden of the Small Business Sector

Stealth Taxes, Local Authorities and Regulated Wage Costs

- Energy Costs
- Waste Costs
- Water Charges
- Local Authorities and Commercial Rates
- National Minimum Wage (NMW)

Energy Costs

The Irish energy market is currently undergoing significant transition. The key factors underpinning this are market liberalisation and deregulation. In parallel, Ireland is faced with substantial challenges in meeting its international obligations under the Kyoto Protocol, in respect of greenhouse gas emissions abatement. The high rate of energy demand growth has strained the country's energy infrastructure both in terms of power generation capacity and network infrastructure.

The purpose of this part of the SFA submission is to set down some of the concerns raised by the small business community in respect of recent developments within the Irish energy market and to highlight the key business requirements from a national energy policy.

Consultation Processes

The SFA have major concerns regarding the Commission for the Energy Regulations (CER) general process of public consultation. In essence, this often means that very technical, lengthy and detailed 'consultation documents' are placed on the CER web-site, with a short timeframe for public response. A summary document of responses received is published and a Direction is offered.

In particular, the SFA would stress that from the business perspective, for the vast majority of businesses, energy is not a core function but rather it is one of a series of input costs in terms of the overall operation. In practice, this often means that most companies and even energy-intensive companies do not have relevant full-time staff available to respond to such public consultation documents. The SFA would support a CER initiative to produce a more 'consumer-friendly' web-site. It was suggested that this would summarise key market developments in non-technical language (including PES price movements across all customer categories since September 2000) and that consultation documents, which have direct business impact should be flagged and be easily identifiable to a business consumer who may wish to respond, but currently finds it difficult to decipher the essential from the non-essential consultation documents. It is interesting to note that in some jurisdictions, the Regulatory Authority actually provides a budget for consumer groups to prepare submissions to public consultations and this may be something that the CER could consider going forward.

Certainty in Budgeting for Energy Costs

The SFA would stress the need for certainty for budgeting and business planning in relation to energy costs. The SFA would stress the importance of business being able to understand that the CER's decision on a particular issue (e.g. the rate of ESB PES tariff increase for 2004), as it was issued in October 2003, is a final decision. In practice, this did not turn out to be the case and CER proposed and introduced mid-year an additional hike in electricity prices, without sufficient notice for business.

Similarly, CER announced rates of increases as they apply to 'average' customers. This is unhelpful to business consumers. For example, the most recent increase was purported to be in the range of 8.5%-9%. Business took this figure and budgeted on that basis. On the ground, the head-line rate ended up being much higher for specific customer types (up to 16% in some instances) and this caused immense difficulty for companies.

The SFA would strongly urge the CER to desist from such practices into the future. These are simply unacceptable from a business consumer perspective. Certainty is what is required for accurate budgeting, business planning and decision-making.

Competition vs Competitiveness

In general, it is the view of business customers that despite electricity prices rising by over 51% since September 2001, there is little or no effective competition in either electricity or gas supply. A number of member companies have reported difficulties in getting competing quotes and that those companies, which are able to get competing offers, find that the offers are generally within 1%-3% of the ESB PES rate**.** In particular, member companies have expressed the view that the CER is intent on introducing competition at the cost of industrial competitiveness and as Ireland moves further and further out of line with our closest trading partner in terms of energy costs, and indeed the EU average, this will become more and more of a business issue.

It is the strong view of the SFA that the CER should also undertake to explain to customers, which elements/drivers of the cost increases are beyond the control of the regulator (e.g. global commodity tariff movements) and which are within the control of the regulator (e.g. the sanctioning of new energy infrastructure spend, the time frames within which such capital spend is recovered.)

Also the CER should actively demonstrate how it is working towards getting **value for money** in all of the areas within their control. Where specific policy issues etc. are outside of the remit of the CER, these should also be highlighted to consumers.

SFA Analysis of Energy Costs

The 4th SFA Annual National Business Costs Survey showed that energy is currently the biggest non-pay cost for Irish industry, followed by local authority charges and insurance The Energy Costs Survey looks at three specific areas, firstly member companies' experience of the energy market and the liberalisation process, secondly, the issue of business cost competitiveness and thirdly, how business currently manages energy costs.

Impact of Energy Costs on Competitiveness

Competitiveness is critical to the success of Irish companies and energy price is a key input indicator, which underpins overall and national competitiveness.

Energy and electricity in particular, is complementary to the rest of the economy. A failure to supply affects not just the energy sector, but the economy as a whole. A failure to do so at competitive prices adds costs to businesses operating in Ireland, with consequential effects on business competitiveness.

Importantly, many of our EU counterparts are starting from a position of excess generation capacity, which enables competitive pressures to be brought to bear on pricing. Steady or falling EU average prices at a time when Irish prices are rising dramatically will be detrimental to Irish competitiveness.

Recent EU-wide comparisons of electricity prices for Irish industry have placed Ireland in the median to high categories in terms of cost while the SFA's recent survey on business costs established that energy prices were increasing at multiples the rate of inflation and the most important cost for business with the exception of labour.

Unless energy policy reacts quickly to unfolding events, the further deterioration of Ireland's competitive position can be expected, particularly for energy-intensive enterprises.

Government and the CER must work together to put in place a market system that simultaneously provides an incentive to minimise operating costs while ensuring efficient dispatch of available generating plant, thus reducing the overall delivered price of energy to consumers.

In addition, Government and the CER must set down a stated energy policy, which encourages competitive generation and supply markets.

The Importance of Security of Supply

Security of supply is the cornerstone of energy policy. This should be delivered in a cost efficient manner, via the adoption of specific national strategies on fuel diversity, fuel security, indigenous sources, and through aiding and encouraging the development of appropriate European policies. These should include the promotion of CHP and renewable energy, in an economically efficient manner.

It is the view of the SFA that current policy and regulatory arrangements have not served to ensure security of supply. This has been demonstrated by the requirement to hire additional generation capacity for each consecutive winter since 2000, at significant cost borne directly by the Irish energy consumer.

There is an urgent need for a policy framework and supplementary regulatory arrangements, where appropriate, to ensure the augmentation of current levels of generation capacity and that an adequate security margin is preserved. This policy framework must also be accompanied by urgent and efficient investment in the electricity networks to reinforce and extend them where necessary.

Investment in energy infrastructure must be financed in an equitable manner to ensure that customers of today are not paying for the benefit that will also be derived by future generations.

Energy and the Environment

In addition to the requirement for full energy market liberalisation, there has been an overall shift in the EU policy agenda in recognition of the EU's dependency on imported fuels, in particular gas for power generation, which has been coupled with policies aimed at constraining greenhouse gas emissions.

This is of particular importance in an economy such as Ireland's which has minimal electricity interconnection to wider markets, a public policy prohibition on the introduction of nuclear capacity and limited capacity in terms of renewable and hydro energy production.

Irish obligations under the Kyoto Protocol could put particular pressure on the energy sector. Under the Kyoto Protocol and the subsequent EU burden-sharing agreement, the Irish Government agreed to a target reduction in greenhouse gas emissions to +13% of 1990 levels by 2008-2012. Irrespective of how this target is to be achieved there will be upward pressure on energy prices.

In overall terms, the SFA recommends that Government design a fully integrated suite of measures for the achievement of Ireland's environmental target at absolute minimum cost to Irish business and the economy as a whole.

Infrastructure

Ireland's infrastructure deficit is well documented. In order to sustain economic growth and competitiveness and to guarantee a better quality of life for all citizens, a much-improved physical infrastructure is needed. Our roads, energy and environmental networks are creaking under the pressure of inadequate investment.

In terms of energy infrastructure specifically, there is an urgent requirement for additional generation capacity. There is also equally urgent requirement for investment in the electricity network infrastructure. Without this, the potential to develop an all island energy market will be severely hampered as will the potential of the BMW region to attract additional investment.

Under the recent review of the National Development Plan, provision exists for the reallocation of certain funds. The level of allocation and apportionment of monies for the energy sector needs to be reviewed and adjusted upwards as appropriate. The SFA recommend that greater priority should be given to enhanced capital investment in the energy sector.

All-island Energy Market

The development of an all-island energy market is consistent with the EU energy policy and legislative framework. The objective of this policy is to create a single liberalised energy market within the borders of the EU, with a view to protecting its international competitiveness. In addition, there are many persuasive arguments for integration of both markets from a competition and regulatory perspective.

Undoubtedly, the future establishment of an all-island energy market will be one of the most significant developments in the regulation of electricity and gas markets on the island of Ireland, in terms of size, infrastructure and market dynamics.

The creation of such a market also presents a number of interesting challenges, which relate ultimately to the appropriation of the economic costs and benefits derived from the harmonisation of market structures North and South. This process must now be pursued with renewed vigour, in consultation with industry at appropriate stages.

Conclusions and Recommendations

Enterprise requires a business-friendly energy policy, which ensures the secure, reliable, efficient and competitively priced delivery of energy, as a key ingredient for successful and sustainable growth of businesses, competing in a global marketplace.

The SFA believe that Ireland needs a clearer, more coherent and strategic national energy policy. The current model of market liberalisation, has added significant costs to Irish business, and has seen only limited entry into either electricity generation or energy supply.

Ultimately, it is the responsibility of Government to produce a sophisticated energy policy, which provides a policy framework within which a suitable 'model of competition' for the energy market can be developed. Such a policy would be reflective of the changed policy agenda of fuel import dependency and environmental constraints and would 'fit' the size and scale of the Irish energy market. In addition, this policy would not act as a barrier to the future creation of an all-island energy market.

The Department of Communications, Marine and Natural Resources must now devote significant effort and resources to devising a national energy policy, which minimise the cost of energy to Irish consumers over the medium term, while ensuring that the supply of energy in its different forms is secure.

Waste Management

Summary

Ireland produces 74 million tonnes of waste each year, of which agriculture is responsible for 57 million tonnes. Of the remaining 17 million tonnes only 1.5 million tonnes is household waste with various industry sectors making up the balance.

Over 90% of household waste is landfilled, while industry rates vary depending on the sector, manufacturing provides an average at 48%. Many EU member states have landfill levels of only 20%

It is clear that we are unable to tackle waste management effectively. We lack the required infrastructural alternatives to landfill. The scandal of illegal dumping continues to blight the countryside. Capacity shortages and lack of competition have resulted in the highest disposal costs in Europe. Business is likely to pay disposal costs of €804 million in 2004 up from €32 million in 1995.

Waste management is an essential service, which impacts seriously on the competitiveness of all Irish enterprises. The existing range of facilities and options are significantly below what is required for a modern economy.

Policy at national and local level has focused on household waste, which accounts for a tiny proportion, 2% of overall waste.

There is vehement opposition to any proposed waste infrastructure developments. The newer facilities, where developed, have proved that waste infrastructure can coexist comfortably in a community.

The current situation has come about due to poor policy decisions, major focus on household waste, poor market structure, a lack of implementation and enforcement, planning and licencing delays, and lack of co-ordination.

Ireland's approach to waste management has provoked considerable disquiet from the business sector in Ireland. A continuing failure to address the problem will damage the economy, environment and reputation as a location of choice for foreign direct investment. Business must continue to campaign for the implementation of sustainable and effective waste management.

Background

Policy

EU waste policy requires that waste generation be significantly reduced by improved prevention initiatives and is de-coupled from economic growth. It sets hugely challenging landfill diversion targets using, recycling, reuse, recovery and thermal treatment. The EU also demands that the impact of waste facilities on the environment must be reduced and the markets for recycled products improved.

Our National response in 1998 was to require local authorities to make waste plans to provide a blueprint to deliver environmentally and economically effective waste management. To provide scale, local authorities were encouraged to adopt a regional approach rather than the existing practice of stand-alone provision of waste services.

The process finally ended in 2001 when 10 regional waste plans were adopted. At the time SFA expressed major concerns regarding the regional approach including the following:

- failure to adequately cater for commercial and industrial waste
- vast underestimation of quantity of waste generated
- no clear implementation mechanism in place
- insufficient capacity planned to allow real competition

The SFA also called for the establishment of a National Waste Authority to co-ordinate and drive the implementation of the plans.

Four years on, Irish waste policy has failed to deliver sustainable and efficient waste management. It is deeply disappointing that the response to this failure is not to develop a new policy, but instead to call for a review of the existing regional waste plans.

Market Structure

Currently both public and private entities provide waste services. Local authorities own all but one of Ireland's 33 landfills while private operators own most recycling and transfer facilities.

A clear conflict of interest exists in the overlapping roles of local authorities as planners, policy makers, regulators, service providers and owners of infrastructure. Landfill fees now provide local authorities with an extremely significant revenue stream.

Current policy is that each waste plan should provide for self-sufficiency in that region. Therefore, neither regions, facilities nor technologies compete. As the plans were drawn up using underestimated waste data, designed without excess capacity and poorly implemented, capacity shortages access constraints and artificially high prices are the inevitable consequences.

Disposal costs in Ireland reflect the market structure and not the cost of providing the service. Local authorities do not compete with each other, but when in competition with the private sector, do so on an unequal basis. Current structures provide local authorities with little incentive to provide better services and could actually disincentivise the move from landfill to reuse, recovery and recycling.

Lack of Progress

Over the past 4 years, there have been a number of developments, both positive and negative:

- two major Government waste policy documents
- significant consolidation in the private waste industry

- landfill levy and plastic bag tax introduced
- roll out of household collection of recyclables
- bring banks and bottle banks extended
- the National Hazardous Waste Management Plan published
- packaging recycling increased from 200,000 to 450,000 tonnes
- commercial and industrial packaging banned from landfill
- the Office of Environmental Enforcement established

Despite these advances, from a business perspective the situation has worsened with increasing costs and restricted access.

The ten regional waste plans identified the need for 46 major national waste facilities; 12 biological treatment plants; 17 materials recovery facilities; 7 thermal treatment plants and 10 landfills. To date only a handful of the facilities are operational.

Despite the enormous costs, we have not achieved the corresponding environmental benefit. Recent European Court judgements against Ireland for "general and structural" failures in implementing EU waste legislation may leave us liable for large daily fines.

Illegal dumping continues to blight our countryside and we have been unable to prevent sham recovery occurring. The recently established Office of Environmental Enforcement must address these issues.

Ireland trades on its green image. Our inability to manage our own waste, court judgements and continued illegal dumping has damaged both our environment and our reputation. It has reduced confidence of both existing companies and potential investors and a failure to address the issues will have serious and long-term economic consequences.

Delays in the planning and licencing of infrastructure still remain. The long awaited Critical Infrastructure Bill has yet to be published.

Lack of Co-ordination

The lack of co-ordination between and within the ten regions is a significant barrier to the development of a network of integrated waste management facilities.

Recovery and recycling are more successful in countries with integrated waste management policies. All available options including prevention, minimisation, recovery, reuse, recycling, thermal treatment and disposal systems must be utilized

The needs of business have not been recognised as no entity has been designated with responsibility for commercial and industrial waste. Local authorities have responsibility for household waste but not for commercial and industrial waste.

Costs

As waste management costs apply to practically every firm, negative impacts of spiralling price rises are both severe and universal. Irish producers pay the highest disposal costs in Europe. Comparisons with the UK shows that in 2004, Irish disposal prices exceeded those in the UK by over 460%.

Figure 1 Comparison of UK and Irish Disposal Costs

Country	Average Cost €	Landfill Levy €	Total €
Ireland	165	15	180
Sweden	60	30	90
United Kingdom	17	22	39

Disposal charges have risen dramatically and constantly since 2000 with dramatic variations in levels and rate of increase throughout the country. Charges, including the landfill levy at €15 per tonne, vary from €125 in Cavan to €230 in Cork County Council and average €180 per tonne. Over the same period the level of price rises range from 45% in Dublin to over 400% in Donegal.

Figure 2 Comparison of Disposal Costs in 2000 and 2004

County	Disposal Cost 20(€	Disposal Cost 2004 €	% Increase
Cavan	64	125	97
Cork County Council	50	230	360
Louth	70	145	107
Donegal	24	125	418

Disposal charges now represent a serious burden on business. Despite commercial and industrial waste volumes rising only 17% between 1995 and 2002, disposal costs have risen by 1,680% from €32 million to €538 million. The current annual cost on business is estimated to be €804 million.

Commercial waste (tonnes)	Industrial waste (tonnes)	Total (tonnes)	Average cost per tonne (€)	Estimated total cost (€)
403,739	3,387,215	3,790,954	8.5	32 million
560,068	5,771,166	6,331,234	60.58	383 million
737,193	4,887,419	5,624,612	76.54	430 million
607,803	3,861,061	4,468,864	120.55	538 million
607,803*	3,861,061*	4,468,864*	180.00	804 million*

The huge differential in costs between North and South of Ireland has made illegal dumping and sham recovery very lucrative.

Solutions

Managing waste in a manner that is sustainable, cost-effective, co-ordinated and protects the environment, is undoubtedly challenging, however it is possible and has the potential to offer significant business opportunities.

Increasing diversion from landfill will see outdated disposal facilities replaced by modern recovery infrastructure bringing substantial economic and environmental benefits to all of society. We must grasp the real and sustainable commercial and employment opportunities that exist.

Ireland’s heavy reliance on landfill and lack of integrated options has hindered recovery and recycling options. We must adopt an integrated approach and utilise all available options and introduce prevention, minimisation, recovery, reuse, recycling, thermal treatment and disposal systems.

Thermal treatment is used in practically all developed countries to manage between 20-40% of waste.

Local authorities require private sector capital and expertise to deliver the heavier waste infrastructure. We must encourage private sector involvement by removing the regulatory uncertainties.

Ireland must improve enforcement of waste legislation by giving resources to agencies tasked to deal with those whose waste activities pose a major environmental threat and damage Ireland’s international image.

We must create a competitive market for waste services. It is evident that changes are required to bring competition and capacity on stream.

Our approach to the waste problem must be co-ordinated as current policy is disconnected from the facts. Infrastructure must match populations and therefore inter-regional co-operation must be permitted. We must ensure solutions are long-term, effective, efficient, and sustainable and protect Ireland’s environment.

Water Costs to Business

Summary

- To comply with very stringent EU water quality standards, member states will need sophisticated wastewater treatment plants in all urban areas by 2008. Unsurprisingly, the quantity and nature of Ireland’s treatment facilities are well below what is required and therefore the cost of necessary infrastructure will be significant.

- To compound the issue, Ireland’s water collection and supply infrastructure also needs radically increased investment. To address both these deficits **Local Authorities will spend over €5 billion from 2003 to 2005 on water infrastructure**. In addition, increased operational costs for such installations must also be met.

- While water infrastructure predominantly serves the domestic sector, the proportional usage by non-domestic customers is between 10% and 20%. Government policy requires full cost recovery from all non-domestic customers in line with the ‘polluter pays’ principle. **This could result in business facing a bill of between €500m and €1 billion in capital charges alone**

- Increases, in water costs averaged 47% between 2001 and 2003 (2 years) while an SFA survey of local authorities water charges showed average increases of 90% since 2000 (4 years).

- Domestic water charges were abolished in 1987 and the exchequer pays the domestic share of capital and operational water costs to local authorities. **Ireland is the only OECD country where householders do not pay for water.**

- The impact on the non-domestic sector, including commercial and industrial enterprises, hospitals, schools and farms, will be universal and costly as most connect to the mains for water supply and to the sewer for wastewater treatment. Most companies will see very large increases in their water bills.

- The SFA supports user charges that are equitable, transparent, cost effective and developed in consultation with the business sector. Unfortunately, the situation to date regarding water and wastewater charges has given rise to many concerns.

Background

A huge investment campaign is underway throughout the state to upgrade our water supply infrastructure and to meet very onerous EU legislative discharge limits on wastewater by installing modern treatment plants.

Current revenue from the non-domestic sector for water is not sufficient to meet these significant capital and operational costs. Therefore, the business sector will face substantially increased water bills in coming years.

Business currently pays for water services through rates, development levies, metered water supply charges to companies with environmental licences and flat rate charges to all other business users.

Business water bills have lacked consistency and transparency of methodology in calculating charges. **This situation will improve as business customers will be metered for supply by 2006 and local authorities will provide full details of the costs and how they are derived.**

Future bills will have a water supply capital charge, water supply operational charge, wastewater capital charge and wastewater operational charge. Capital charges will normally be spread over the 20-year plant lifetime and ongoing operating costs will be based on usage.

Treatment costs will be based on the strength and volume of effluent, so companies with small volumes of low polluting potential effluent will have lower charges than those emitting large volumes of high strength effluent.

In terms of wastewater treatment, businesses will, in future, be divided into two categories, significant or general users. Significant users discharge either high volume or high strength effluent and must individually negotiate a legal contract and the quantity and nature of their output will be metered. **It is unlikely that the number of significant users will exceed 100 companies.**

General users' water consumption and wastewater production will be relatively small and similar to domestic wastewater in quality. General users will pay a consolidated charge, which covers both capital and operational costs, based on metered usage.

While consistency between local authorities should improve, discretion still exists in the definition of a significant user and the exact charging mechanism applied. Comparisons between different local authorities are difficult as each started from a different point with regard to existing infrastructure and nature, level and coverage of charges for the non-domestic sector.

Business Concerns

While SFA supports efficient and cost-effective water charges, a number of very real and significant concerns have arisen.

The extent of increases, shown below, are alarming and deeply worrying as they impose real and unwanted costs on doing business in Ireland. They will have a major negative impact on competitiveness and employment for companies affected (see also Appendix II).

Water Charges	2000 € per m3	2004 € per m3	% Increase
Sligo County Council	€0.56	€0.62	10%
Mayo County Council	€0.48	€0.94	95%
Longford County Council	€0.50	€1.75	247%
Average	€0.49	€0.93	90%

- A substantial portion of income derived from rates, also only applied to the non-domestic sector, were intended to fund water services. Therefore the massive increases in water bills without a corresponding decrease in rates seems to indicate disproportionate contributions from business.

- The lack of transparency in the charging mechanisms has led to genuine concerns regarding equity between sectors. Clear, transparent and available information regarding charges would remove any suspicion of cross subsidisation of the domestic sector by the non-domestic sector.

- Given how critical the issue is, the consultation has to date been most disappointing. Some companies have received retrospective bills for 2003 with no indication of charges for 2004 or 2005. Well-managed businesses require strict planning and budgeting and it simply is not possible to operate where substantial cost outlays are unknown.

- The information from local authorities has to date been inadequate regarding timescales, charging structures, treatment levels, billing frequency and cost breakdowns. Indicative charges have been arbitrary and lack transparency or backup data. Business needs information on how charges are calculated to ascertain if they are warranted and equitable.

- The value for money of water charges for business must be justified. As local authorities have a monopoly in this essential service the normal checks of competition are not present. Incentives to construct or operate at optimum efficiency must be present as all costs can be passed through. Any future increases should follow consultation with industry.

Local Government

Local Government current expenditure has increased dramatically over recent years. In 1996 current expenditure by Local Government totaled €1.6 billion. In 2005 expenditure will be almost €4 billion In 2003 user charges accounted for 62% of Local Government income, the vast majority of which is levied on the business sector. **Small business now pays €27 out of each €100 spent by Local Authorities.** These increases have resulted in increases in public sector wage costs, not better quality, higher efficiency or productivity. When public sector inefficiencies are passed on to the business sector in the form of tax increases and administrative charges, competitiveness deteriorates and jobs are lost.

A new approach to Local Government financing is required. The burden placed on the business community by the current system is not equitable, efficient, effective or economical. Reform is required and business and should not be expected to countenance additional Local Authority funding unless accompanied by significant improvement in services, accountability and value for money.

Over the past three years, Local Authorities have responded to the squeeze exerted by central Government by loading additional burdens on business. A specific example is the payment of the benchmarking awards that are being financed through additional charges.

The following principles should guide Local Authority Reform:

- In terms of equity, rates have for many years been levied solely on industrial and commercial premises. The business community underwrites the difference between expenditure of a local authority and receipts from all sources other than rates. **A more equitable approach is required to deal effectively with the current problems of commercial rates.**

- A major review of the efficiency of structures and systems in local authorities should be carried out.

- Local Authorities should be statutorily obliged to seek tenders for service provision and outsource where better value for money can be achieved - elimination of the 21% VAT imbalance between in-house and out-sourced services is very relevant.

- Charges for water services should be community wide – despite the political difficulty in achieving this.

- Commercial Rates must not be seen as the residual source for Local Authorities shortfall in funding.

- Since business will continue to be a major source of Local Authority funding, accountability to the sector and interaction with it must improve.

- The general services of Local Authorities, which are provided for the public good and are available to the entire community, should be funded by the Exchequer.

- Specific services that can be precisely identified which are amenable to measurement, and which are delivered for the benefit of an individual or corporate entity should be charged on the "user-pays" principle.

- Payment requests for Commercial Rates should be accompanied by a detailed analysis of expenditure and benefits which accrued to the individual business. Customer performance targets should be published.

- Future rate increases must not be in excess of inflation and tied to agreed performance targets.

Regulated Wage Costs - The National Minimum Wage

Having undertaken extensive economic research into the review methodology as set out in the National Minimum Wage Act 2000, namely movement in earnings of employees; relevant exchange rate movements; level of unemployment and employment; inflation and national competitiveness, it is the SFA's firm conviction that it is imperative for the competitive position of Ireland that wage levels are decided in a competitive labour market. The Government in introducing the minimum wage sought to increase social equity by tackling the related issues of marginalisation, poverty and exclusion. However, the SFA contends that it is not the job of business to redistribute wealth, but to create the wealth, which can be redistributed by Government. It was only in Budget 2005 that those on the minimum wage of €7 per hour were eventually taken out of the tax net (representing an actual benefit of 8%). The SFA believes that the formula of allowing business to operate in a competitive environment, thereby increasing returns to the Exchequer, and consequently allowing the Government to adapt taxation and welfare systems to match perceived social needs, is to be recommended over simply increasing the cost of production, which has a negative economic impact. What the average worker is concerned about is his/her take-home pay, and not how this is achieved.

In an environment where pay increases are agreed upon between Social Partners and Government, in the form of National Wage Agreements, it makes no sense at all that the statutory minimum rate should increase by anything other than the cost of living (i.e. rate of inflation). This rate is generally the entry rate into employment, after which the national wage agreement increases apply, as with all other employees. Curtailing National Minimum Wage (NMW) increases to that of inflation also will have a very positive impact in not adding inflationary pressures to the economy.

Furthermore, it is interesting to note that the ESRI 2003 Report showed that of the 4.6% of private sector workers on or below the NMW, some 49% of these were aged 18 or below. The SFA is concerned that any future increases in the NMW will encourage more young people to leave school early, without the necessary qualifications for advancement in the labour force. If we are to achieve the Government's stated ambition of becoming a high-skilled economy, we certainly need to implement policy measures to ensure that young people stay in education for as long as possible, and not entice them into the workforce for short-term gain due to a high NMW.

Labour costs now account for on average 38% of the operating costs of most small businesses. In the SFA's Annual Business Cost Survey, conducted in January 2005, labour costs displaced insurance costs as the single biggest problem facing small businesses for the first time in three years. Some 82% of small businesses cited labour costs as a major business problem, with 17.3% citing it as their single biggest problem. The NMW specifically was cited by 35% of businesses as a significant problem, and this was before it was increased to €7.65.

Given these difficulties, and in line with the EU BEST Initiative and the Report of the SMI Working Group on Regulatory Reform, the SFA would contend that in this and all future reviews of the NMW, the Labour Court or the Department of Enterprise, Trade & Employment should undertake a "cost-impact" analysis on business in advance of any recommendations. This is particularly important from the perspective of smaller companies, as they cannot match the wage rates of larger enterprises and multinationals, which benefit significantly from economies of scale. To date, the NMW has impacted much more heavily on smaller firms.

The introduction of the NMW has not enhanced flexibility or increased competitiveness. If current experience is any indicator, a further increase in the NMW will result in one of the following outcomes:

- Employers will replace workers whose skills do not merit such wages leaving the low skilled permanently locked out of employment.

- Employers who cannot increase prices will maintain overall payroll costs at existing levels. As the NMW increases costs, the employers will be forced to either reduce staff numbers or working hours or both.

It is no surprise that in the ESRI survey, 40% of companies in the Hotel/Restaurant/Bar sector and 24% in the Retail sector, stated that the NMW had increased labour costs, sectors of the economy which have been accused of contributing substantially to inflation. Similarly, 34% of Manufacturing companies experienced increased labour costs, which can be directly linked to the loss of 30,000 jobs in that sector since 2000.

From an international perspective, Ireland is still facing up to the challenge of diminishing competitiveness. Gross pay in Ireland has increased by more than three times the Eurozone average since 2000; the NMW itself is amongst the highest in the EU, and in net terms comes out first in the EU.

Part 2

Management Development and Training in a Growing, Flexible Labour Market

The Irish labour market has changed dramatically over recent years. Unemployment has fallen, employment levels have risen and the profile and demands of labour market participants has changed. Female labour market participation rates have increased to above EU average levels. Employees are engaging with the labour market in a more diverse way than was traditionally the case, as evidenced in the increased levels in part-time work as well as the emergence of new forms of work organisation such as *e*working. However, there remains a significant pool of untapped labour in our economy, including women, older workers and those with disabilities to name of few. In the context of a tightening labour market, developing effective means to unlock the potential sources of new labour is critical.

Maintaining flexibility and increasing productivity in the workplace is an important contributory factor to Irish competitiveness. Ensuring that labour legislation is clear and strikes the right balance between flexibility and security is imperative. In this context, bureaucratic and complex legislative approaches to labour legislation should be resisted, at national and EU level. The best protection that can be provided to employment is to ensure that the workforce is flexible, adaptable and that employees are employable.

The availability of high quality, flexible and affordable childcare should be given equal priority as the improvement of hard infrastructure such as roads and public transport. Lack of choice in childcare provision and childcare costs remains one of the most significant barriers to female participation in the labour market. Specific measures to assist working parents to meet such costs, including targeted tax allowances and social welfare payments for those on low income, need to be adopted. Major public and private investment is needed in childcare facilities and the provision of high quality childcare should be given a much higher priority in all planning and development.

Targeted training and recruitment campaigns for marginalised workers should be co-ordinated by FAS operating in co-operation with employers in sectors where there are job opportunities.

A transparent immigration and work visa policy should be adopted to reflect the growing labour needs of the economy. The adoption of a quota-based system, similar to examples in other developed countries, should be considered. This must be accompanied with a recognition that it is not only a question of attracting people to Ireland to fill jobs, but that we must have an appropriate infrastructure to support such workers – in terms of housing, public transport, schools and other amenities.

Greater and more strategic consideration should be given to the impact of changes to labour legislation, particularly in relation to the impact, such changes have on competitiveness and attractiveness as a location for investment. Specifically, we should be careful not to adopt EU directives that have the effect of further regulating an already inflexible European labour market.

Much more can be done in the area of flexible working, which can offer benefits to both employers and employees.

Upskilling the Small Business Workforce

In the face of global competition and relatively high domestic costs, Ireland needs a workforce with higher skill levels. Upskilling through training contributes positively to the development of human capital. The economic and social returns to investment in life long learning are similar in magnitude to the returns from schooling. Life long learning also aids social mobility and inclusion by offering opportunities to those who suffered from educational disadvantage in the past. Continual development also allows existing skill levels to stay abreast of technological and other development.

The importance of life long learning is underlined by current labour market and demographic trends. The ESRI's forecast for economic growth rates of 5-6% in the medium-term implies total demand for new workers of 421,000 over the period 2001-2010. Of these, 300,000 are expected to require third-level qualifications, Ireland cannot rely on sourcing these individuals exclusively from the output from second level education or through immigration; they can also be sourced from within the existing labour force, through up-skilling.

The latest available data suggests that participation by Irish workers in formal training compares poorly with workers in other European countries. Ireland is ranked 12th in the EU in terms of adult participation in lifelong learning below the Lisbon target of 12.5% and far behind leading countries such as Sweden and Denmark which achieve over 25% participation.

There have been numerous reports and studies aimed at promoting life long learning in Ireland. These include the Report of the Commission on the Points System (1999), the White Paper on Adult Education (2000), the Task Force on Life Long Learning (2002) and the more recent 'One Step Up Initiative' proposed by the Enterprise Strategy Group (2004).

Training initiatives should primarily target those with lower levels of educational attainment. Training should also be directed at sectors most vulnerable to labour market shocks such as lower value-added manufacturing and construction.

Greater use should be made of networks to support life long learning. Enterprise led training initiatives should be developed further in the future. These approaches ensure that the training designed meets the specific needs of those attending, and supports the strategic direction of their organisations. By involving a broad array of stakeholders (e.g. firms, unions and industry bodies, education and training bodies, certification bodies, etc.) it can also help promote a greater awareness of the necessity of training for employees and employers. Networks can also usefully disseminate best practice and create a stronger culture of training and upskilling.

Management Development

To maintain employment and business expansion in the current era of global competition requires that all small businesses are competitive in every aspect of their activities. This competitiveness environment for small business is all embracing and due of the size of the domestic economy, many small companies are highly dependent on export markets. Competitiveness is a day to day reality for business, embracing economic and physical infrastructures, management expertise, labour costs, productivity, innovation, education, training, marketing, design, cost control, and a variety of other factors, which combined, create the environment for business and ensure the profitability necessary for enterprises to survive, invest and expand.

Those capabilities, which are essential to long term success, include the ability of small companies to:

- Innovate - to develop and exploit new products, services and operating processes.

- Maximise operating efficiency - to produce products and services of the highest quality at the lowest cost with the maximum flexibility.

- Make structural adjustments - to respond effectively to changes in the competitive environment.

The role of the manager in developing appropriate strategies for their individual enterprises, taking account of the strengths and weaknesses of the Irish economy is crucial. Also, in this context the Government has a responsibility to foster a climate, which is conducive to positioning Ireland at the top of the world competitiveness league. Therefore, the development of indigenous management capacity is a critical impediment, which must be overcome if Ireland is to regain lost competitiveness.

Overcoming the problems of management development in SMEs is, given the preponderance of small companies in Ireland, fundamental to improving the capability and capacity of Irish owner managed businesses. Research, in both Ireland and the EU has identified that small businesses face common problems in management development and training provision, despite sectoral and regional differences.

A fundamental and clear factor inhibiting small Irish business is a lack of management competency, both in training and personnel development and a lack of awareness of the need for management development, particularly in indigenous industries where standards are set by local and short-term considerations rather than by international “best practice” standards and competition. SMEs have traditionally turned to the labour market for their supply of qualified staff rather than training and development. However, recent research by the SFA suggests that small companies do understand the contribution management development and training can make to business growth, to high quality product and generally to company success, but that they often lack the practical means to put that recognition into action. There are a characteristic set of problems, which make it difficult for SMEs to establish adequate measures for capability building and value capture of good management practices.

- The tight financial margins within which SMEs operate and the small number of their employees makes it difficult for companies to release employees to attend off-the-job training courses and to resource training. Recent SFA research shows that, whilst a large majority of companies identified management skill deficiencies and said that management training and development would improve the quality of management in their company, they also identified time constraints and training (as well as location and a lack of relevant courses) as being barriers to training action.

- The fact that management personnel in small firms have multiple responsibilities, makes it difficult for them to attend lengthy off-the-job training courses.

- SMEs often lack the capacity both to:
  - Define their real training needs in the context of company modernisation and to
  - Plan and organise their own training and assess its effectiveness.

- Small companies are less likely to have training departments or qualified trainers than large companies.

- Decisions on training fall to management who often find it difficult to assess the merits of training courses on offer and have difficulties in communicating their needs to training providers.

- Producing customised and in-house courses for a few managers is too expensive for providers, and conflicts with their need to maximise the utilisation of training centre and college facilities.

The management development needs of small firms have long presented training agencies and training institutions with a challenge to provide new kinds of services and methods of delivering services, to achieve well planned, structured and relevant training.

Recognition of the need for new training approaches to meet the particular problems of small firms is not new. The 1988 Galvin Report recommended that providers of training services should be encouraged to offer consultancy services in management development aimed specifically at small firms and also to develop distance learning approaches. The Galvin Report concluded that the level of management development in Ireland was unacceptably low. This stems primarily from:

- Inadequate company resources and

- Insufficient understanding of the nature of management development in SMEs.

Galvin stated:

> *'In national economic policy a growing role is foreseen for small business, particularly in regard to job creation. If they are to play this role in an increasingly competitive and sophisticated world, managers in small businesses will require as high a level of skills as those in bigger organisations.*
>
> *Despite this need, such managers are the least likely to receive adequate management development. The off-the-job training, not alone in money but also in time lost to the immediate needs of the business, are serious deterrents to adequate commitment to management development in small business. Awareness of the need is particularly low in small business and in the past it has proved uneconomic for most providers of management training to service this sector effectively.'*

Since 1988 there have been many efforts but few successes in developing an indigenous management base. Galvin's primary recommendation namely - the formation of an Action Group for Management Development with a mandate to promote the principle of best practice in management - was never implemented. Consequently, the three national institutions *(IMI, IPA and FAS)* advancing management policies report to different governing bodies, operate from different agendas and draw on a limited resource in pursuing their goals. The net effect has been to seriously diminish the effectiveness of management and training policies.

The SFA believe that the scope for improving the performance of SME's through enhanced management capability within small firms is considerable. This requires new structures and delivery mechanisms, particularly with regard to the needs of owner managed enterprises in the delivery of management development. A new agenda, which will secure the commitment and enthusiasm of owner managers is required.

Part 3

Provision of Working Capital Finance

Better Regulation for Small Business

Provision of Working Capital

The lack of provision of working capital is one of the main constraints placed on the small business sector by financial institutions. Currently there are 40 institutions involved in the provision of financial services to small businesses, yet only six provide working capital. The general definition of Working Capital is the difference between Current Assets and Current Liabilities. Working capital is the investment required to fund the purchase of stocks, raw materials and the provision of credit to customers. Working capital requirements will vary depending on which sector the business is operating within. In the main the working capital requirement will depend on the level of credit extended, the frequency of stock turnover and cost of buying stock. Working capital in a manufacturing business will be entirely different to a service or retail company, which receives cash at point of sale. There may also be seasonal issues for some businesses such as hotels, tourist related industries or agri business. Seasonality issues are a large factor for many small businesses particularly for the payment of VAT and PAYE.

For most small businesses working capital comes from a number of sources. Owners' equity among small companies has historically been weak, but with a higher incidence of inheritances this source is likely to increase into the future. Reductions in Corporation Tax, Capital Gains and Capital Acquisitions Tax will, over time help reduce the traditional "debt overhang" of start ups and early stage companies.

In its National Late Payment Survey the SFA found overdraft as the most often used form of working capital, used by 77% of respondents, followed by term loans at 41%, trade credit 37%, invoice discounting 9% and factoring 4% (companies will use a mix or all of these options).

The distinguishing features of working capital loans are to fund short-term or seasonal capital requirements of the business generally on an annualised basis having regard to the working capital requirements. The interest rate, which applies to working capital, is usually of a variable nature and should reflect upward or downward movements in interest rates. For early stage or start up small companies the availability of finance can sometimes be more important than the price. This is a structural weakness of the small business sector in Ireland. Term loans are generally secured by the assets of the business or third parties. The extent of security sought, and working capital or loan granted will often depend on the accuracy of financial analysis, debt collection history and management competency within the business. In this regard no two companies are the same. Because of the susceptibility of the Irish economy to sudden shocks, the risk profile of certain sectors at that time may influence the risk profile of individual companies trading in that sector, e.g. Foot and Mouth Disease (FMD) had a severe impact on tourism, hotels and event management companies. This can cause further problems for small business because they are then in a “captive market”. Although there are over 40 credit institutions offering services they do not all provide working capital loans or overdraft facilities.

In the case of term loans, they are generally used for the purchase of fixed assets, expansion or business acquisitions. Term loans are an alternative because they allow the company to spread the payments over long periods and take pressure off working capital. Typically term loans are used by small business for medium or long-term investments. They are not repayable on demand unlike overdrafts or working capital loans.

When a small business fails, often it is not because it runs out of customers, ideas or products. It simply runs out of money. The guiding principle of running a small business is to never close a line of credit! Small business depends on the availability of short, medium and long-term credit. Availability, price and need will determine the substitution of capital loans, term loans and leases for any small business. The interaction of different forms of finance will often be determined by time and type of purchases.

For instance overdraft facilities will generally be of a 12 month period, cars, trucks or equipment will often be leased on a 3-5 year basis and premises over a 20 year commercial mortgage. The ability to switch or substitute is greater in the areas of leasing or commercial mortgages simply because there are more providers in this area than in the area of those providing current account and overdraft facilities.

The SFA is of the view that the Small Business Forum should recommend that the provision of working capital must form part of a financial institutions offering to its small business customers.

Small Business Regulation

Every industrialised society needs regulations covering aspects of industrial, economic and social activity. Such regulations are designed to ensure the safety of the public, set a framework for the employer/employee relations, protect individuals from health and safety hazards at work, protect the environment and regulate business activity. The Governments policy in this area should be to balance the needs of business against all the other needs and concerns of society. It is the strongly held view of small business that enterprise development in Ireland is unnecessarily and severely handicapped by the amount of bureaucratisation and the costs associated with it. The effectiveness and quality of regulation and the institutions that enforce it are a major determinant of a country’s prosperity. Well-designed and efficiently enforced, business regulation can improve the functioning of markets and achieve environmental and social policy goals without imposing a significant compliance costs on firms or weakening the ability of businesses to adapt to changing economic conditions, technologies and consumer preferences.

Regulations that restrict competition, by inhibiting the entry of new players or the actions of existing players and damage consumer choice. SFA analysis of the views of small businesses reveals perceptions of rising regulatory compliance requirements, weak competition in the domestic market and ineffective competition legislation. There are major concerns about the impact of recent corporate governance legislation in particular. The SFA believes that there needs to be a greater recognition in our political culture of the costs of regulation, and their impact on competitiveness.

Achieving environmental or social goals through regulation may seem politically and administratively easier and less expensive than other forms of intervention, but it may have higher costs for society at large. For example, research carried out by the SFA shows that a small firm in Ireland employing just eight people devotes half of one person's time to filling out forms. Much of the administrative burden is unnecessary, consisting of duplicated information requests from different state bodies; any company wholly engaged in business within Ireland can have as many as 80 core forms to complete, many requiring submission a number of times a year. In addition to red tape, many of the costs of regulation are less visible. Regulation can result in higher prices and costs, a reduction in consumer choice, and a reduction in flexibility and innovation. For this reason, the SFA views as crucially important the Government's programme of better regulation, as laid out in the Regulating Better White Paper (2004). The White Paper sets out a template for examining the benefits and costs of regulation – known as Regulatory Impact Assessment (RIA) – and for assessing whether regulations are needed at all. The subsequent Report on the Introduction of Regulatory Impact Analysis (RIA) outlines the steps necessary for developing full regulatory impact assessments while the recently announced Business Forum on Regulation will provide a mechanism for dialogue between policy makers and business. The Government has promised significant resources will be devoted by all departments to the RIA system, and that these reviews where necessary, will include quantified cost-benefit analysis.

The SFA recommends a number of additional policy directions that would bring Ireland to the level of best international practice in terms of better regulation:

- The development of a transparent and independent system of assessing the quality of regulatory impact assessments prepared by Government departments;
- The development and frequent publication of regulatory indicators to better measure the cumulative administrative and compliance cost on firms from regulation;
- Increased consolidation of information requests to industry from Government department and agencies through the use of technology.

The SFA looks forward to the outcome of the review by the Company Law Review Group (CLRG) of the impact of the Companies (Auditing and Accounting) Act 2003 on enterprise competitiveness. The SFA is of the view that both the Company Law Enforcement Act (2001) and the Companies (Auditing and Accounting) Act 2003 created difficulties for start-up and expanding companies in attracting skilled and experienced non-executive directors.

Part 4

Research and Development

The Research and Development (R&D) tax credit announced in Budget 2004 was a welcome tax initiative that goes some way towards promoting R&D activity in Ireland. R&D and innovation are essential for the creation of a competitive knowledge-based economy. In March 2000, the European Union summit in Lisbon adopted the US economy as their model. The overall target was to make the EU into *"the most competitive region in the world"* by 2010. In its response to the European Lisbon Strategy, Ireland has recognised that a substantial increase in business investment in R&D is an essential foundation towards developing as a knowledge-based economy within the European Research Area. The Governments decision in June 2004, to establish a Cabinet Committee on Science & Technology [S&T] supported by the appointment of Ireland's first Chief Science Adviser, demonstrate the commitment of the Government to a coherent strategy on science and innovation policy in Ireland. However, improving the levels of innovation and creativity in the economy is not solely the job of Government. Policy makers also have an important role to play. Whilst recognising that innovation stems from a number of factors, such as competition, education and a deep understanding of international markets and customer needs, the SFA believe that the challenge for policy makers should be to balance fiscal responsibility with the public investments.

The following targets and recommendations are proposed to realise this vision:

- Business expenditure on R&D should increase from €917 million in 2001 or 0.9% GNP to €2.5 billion in 2010 or 1.7% GNP

- The number of indigenous companies with minimum scale R&D (in excess of €100,000) activity should double, from 525 in 2001 to 1,050 in 2010

- Gross expenditure on R&D should increase to 2.5% of GNP by 2010

- The number of researchers should reach 9.3 per 1,000 of total employment by 2010, from 5.1 per 1,000 in 2001.

Regarding the level of BERD as a % of GDP, Ireland is ranked 11th of 16 countries surveyed, with BERD estimated at 0.81% of GDP in 2001. This level of business investment in R&D in Ireland is low for an economy whose output and exports are dominated by high technology sectors.

An estimated 978 indigenous companies had some expenditure on in-house R&D in 2001. This equates to one third of the relevant indigenous base (approx. 3,000 Irish owned enterprises in manufacturing and internationally traded services.) Some 286 foreign owned enterprises had some expenditure on in-house R&D in 2001. 452 companies spent less than €100k while a further 375 had R&D spend of between €100k-€500k.

Table 1 Expenditure of Indigenous Enterprises on R&D (978 enterprises), 2001

Annual R&D Spend	**Less thar €100k**	**€100k-50(**	**€500k-€2**	**€2m-€5n**	**Over €5m**
Number of Indigenous R& Performers	452	375	124	24	2
Share of Indigenous R&D Performers	46.30%	38.40%	12.70%	2.40%	0.20%
Share of Indigenous Expenditure on R&D	5.60%	25.90%	35.40%	22.60%	10.50%

BERD Survey, Forfas 2003

Innovation Policy – Low Patent Registrations

As product and process innovation is a cornerstone of competitiveness in a knowledge-driven economy, Ireland's poor innovation performance, as measured by patent registrations and other indicators, is a major cause for concern.

Number of patents per head of population

Table 1. Triadic patent families per million population according to the residence of the inventors, 1991-2000 (est)				
	1991	**1995**	**1998**	**2000**
US	40.34	45.3	52.2	53.11
Japan	71.78	74.3	80.9	92.63
EU	24.85	30.9	35.9	36.24
Ireland	**7.60**	**9.1**	**11.7**	**11.91**

Ireland had an estimated 11.9 patents per million of population in 2000. Ireland had 51 patent applications at the European Patent Office per million of population in 2000 - a decrease over the 1999 figure of 57.5. (1998 unavailable)

Table 2 Number of EPO patent applications per million population				
	1991	1995	1999	2000
United States	68.7	78.9	100.7	103
Japan	95.3	97.1	137.8	160
Ireland	18.1	26.6	57.5	51.6
European Union	73.0	82.4	125.0	131

The 2004 Finance Act introduced a new incentive to companies to carry on R&D, in Ireland, by way of a 20% tax credit to stimulate business investment in R&D. The introduction of this tax credit for *incremental* R&D expenditure is a very important move towards ensuring that Ireland would not be at a disadvantage as a location for foreign direct investment [FDI].

Fiscal incentives are increasingly used to support private R&D because these schemes reduce the costs of R&D for a wide variety of firms, including SMEs. If well designed, fiscal schemes raise the overall level of investment in business R&D. Most EU-15 countries operate some form of tax measure to stimulate business R&D, as do Australia, Canada, Japan, the US and China. Seventeen OECD countries offer tax credits, or enhanced tax allowances, for R&D.

Corporation tax schemes based on volume are already offered by Italy, UK and Canada. In Singapore, enhanced deductions for qualifying R&D and capital allowances are also available, including accelerated depreciation on prescribed equipment.

By reducing the net cost of R&D, fiscal relief raises the net present value of prospective research projects. Incremental R&D can help address the problem of windfall gains, but also confront the difficulty of defining a base period or base level of R&D to determine the increment or increase. Incremental approaches can cause distortions in enterprise behaviour in order to maximise access to credits. A volume based approach can stimulate SMEs to perform new R&D which is key to productivity and growth performance. The volume based tax incentive can be restricted exclusively to SMEs to reduce the cost to Government. ***There is a need for immediate reassessment of the scope and value of the 20% tax credit which is geared to benefit the larger companies. The incremental nature of the tax credit should be extended to a volume-based approach.***

SME-Specific Fiscal Schemes

Because of the incremental nature of the 20% tax credit the benefit will accrue to larger firms who invest heavily in R&D. However, this will disadvantage the small firms and will not have the necessary catalytic effect to stimulate small firms to perform R&D. Many OECD Governments are now redesigning their R&D tax incentives to make them more effective and to further policy goals such as assisting small, innovative firms or encouraging joint public-private research.

Canada found that compliance costs for small firms equalled 15% of the value of the R&D credit compared to 5.5% for larger firms (Finance Canada, 1998). The Irish Government must simplify and streamline forms and processes as well as develop advisory programmes for first-time and smaller claimants of R&D tax incentives. Smaller firms may benefit more from tax allowances, which lower their taxable income.

Japan, Canada and Denmark give tax incentives for basic research conducted by the private sector, while Korea is attempting to increase investment in R&D facilities. In the UK earlier this year, relief for current spending on qualifying R&D was increased from 100 per cent to 150 per cent for SMEs. Most countries limit the tax incentives to expenditure incurred in the country in question (for instance Canada, France, the Netherlands and the US). The UK on the contrary allows overseas R&D expenditure to be eligible for their SME tax allowances.

In addition to this, some countries give tax incentives on the cost of subcontracting R&D. In the UK, a small to medium-sized company that subcontracts its R&D will be able to claim an R&D tax relief provided it retains the ownership rights to the knowledge. As a result, the contractor cannot claim the R&D tax relief. A unique feature of the UK system is that it rewards certain types of research with high social rewards. A similar type of policy can be found in Belgium, where the environment-friendly R&D activities are encouraged through tax deduction on investments.

Special Incentives for SME's to Boost Innovation

The SFA recommends to the Small Business Forum the following approach to increasing the scope, extent and impact of R&D spending in indigenous SME's.

- The Government should reassess their fiscal incentives and modify their existing R&D tax measures to increase their effectiveness in achieving policy goals

- Specific SME-incentives in line with other OECD countries with high levels of IP should be introduced

- A Volume based approach should replace the current incremental method of the application of the 20% tax credit

- A tax allowance of 150% should be available only to SME's on R&D spending

To get the most out of the scheme this requires the following:

- Clear definition of SME
- Keep it simple
- Focus on activities with high externalities (R rather than D)
- No maximum limits on single companies

Appendix 1
Water Costs
Capital Expenditure Per County
from 2003-2005

County	Expenditur €M	Business Cost @ 10% €M	Business Cost @ 15% €M	Business Cost @ 20% €M
Carlow	43.3	4.33	6.50	8.66
Cavan	48.4	4.84	7.26	9.68
Clare	185.3	18.53	27.80	37.06
Cork	636.2	63.62	95.43	127.24
Donegal	307.7	30.77	46.16	61.54
Dublin City Council	734.5	73.45	110.18	146.9
Dun-Laoghaire-Rathdown	74.5	7.45	11.18	14.9
South Dublin	97.7	9.77	14.66	19.54
Fingal	237.5	23.75	35.63	47.5
Galway	464.5	46.45	69.68	92.9
Kerry	85.4	8.54	12.81	17.08
Kildare	216.5	21.65	32.48	43.3
Kilkenny	42.3	4.23	6.35	8.46
Laois	69.2	6.92	10.38	13.84
Leitrim	48.6	4.86	7.29	9.72
Limerick	349.0	34.9	52.35	69.8
Longford	39.8	3.98	5.97	7.96
Louth	53.7	5.37	8.06	10.74
Mayo	304.7	30.47	45.71	60.94
Meath	155.3	15.53	23.30	31.06
Monaghan	44.4	4.44	6.66	8.88
Offaly	109.8	10.98	16.47	21.96
Roscommon	84.6	8.46	12.69	16.92
Sligo	62.6	6.26	9.39	12.52

Nth. Tipperary	68.5	6.85	10.28	13.7
Sth. Tipperary	69.7	6.97	10.46	13.94
Waterford	222.8	22.28	33.42	44.56
Westmeath	218.7	21.87	32.81	43.74
Wexford	202.1	20.21	30.32	40.42
Wicklow	148.8	14.88	22.32	29.76
Total Spend	**5,426.2**	**542.62**	**813.93**	**1,085.24**

Appendix 2: Consolidated Water Charges - € Per m3 per County from 2000-2004

County	2000	2001	2002	2003	2004	% Increase
South East						
Waterford	.59	.63	.70	.88	.97	65%
Kilkenny	.62	.67	.73	.77	.80	29%
Carlow		.62	.67	.73		18% *
Sth. Tipperai		.64	.68	1.0	1.08	69% +
Cork						
Cork City	.62	.66	.70	.80	.80	30%
Cork County	.55	.59	.63	.69	.69	27%
Mid West						
Clare	.60	.64	.69	.82	.82	37%
Limerick Cit	.50	.53	.63	.94	1.19	135%
Limerick County	.56	.56	.72	1.05	1.1	96%
Tipp North	.51	.53	.73	.80	.88	74%
West						
Galway	.56	.56	.56	.56	.73	30%
Roscommon	.63	.66	.70	.81	.86	37%
Mayo	.48	.51	.68	.90	.94	95%
Galway City	.45	.49	.57	.83	1.05	133%
Northwest						
Donegal	.65	.65	.65	.83	1.05	61%
Sligo	.56	.56	.56	.62	.62	10%
North East						
Louth		.44	.50	.60	.80	82% +
Monaghan	.64	.67	.67	.67	.72	11%
Meath	.50	.62	.70	.79	.88	75%
Cavan	.70	.70	.70	.70	.70	0%
Midlands						77%
Offaly	.52	.56	.67	.88	.93	79%
Laois		.78	.86	.95	.95	22% +
Longford	.50	.50	.53	1.28	1.75	247%

Dublin						
Fingal	.57	.67	.80	1.08	1.18	106%
Dun Laoghaire/Rathdown	.77	.91	1.13	1.31	1.44	87%
South Dublin	-	-	.91	1.03	1.12	23% *
Dublin C. Council	.83	.91	1.0	1.15	1.26	52%
Wicklow	.75	.80	.84	.84	.84	11%
Kildare	.57	.59	.81	.87	.93	63%

* 2 years only
+ 3 years only