

The Irish Enterprise  
Funding Environment  
April 2012



|   |    |
|---|----|
| Executive Summary   | 2  |
| 1. Introduction   | 9  |
| 2. Importance of Funding to Economic Growth                                   | 9  |
| 3. Current Situation with Respect to the Supply, Demand and Cost of Financing | 12 |
| 3.1 Introduction - Sources of Finance   | 12 |
| 3.2 Availability of Bank Finance  | 13 |
| 3.2.1 Outstanding Debt Levels to Enterprise                                   | 14 |
| 3.2.2 Flows of Bank Finance   | 17 |
| 3.2.3 Demand for Finance  | 18 |
| 3.2.4 Cost of Finance   | 20 |
| 3.2.5 Developments Within the Banking Sector                                  | 22 |
| 3.3 Equity and Other Funding Sources  | 23 |
| 3.4 Agency Supports   | 25 |
| 3.5 European Supports   | 27 |
| 4. Current Policy Context   | 27 |
| 4.1 Build Better Business Banking Relationships                               | 27 |
| 4.2 Increase Lending  | 28 |
| 5. Policy Issues Arising  | 29 |
| 5.1 Banking Sector  | 30 |
| 5.2 Building Business Banking Relationships                                   | 30 |
| 5.3 Increased Lending   | 31 |
| 5.4 Equity  | 31 |
| 6. Conclusions  | 32 |

# Executive Summary

## Introduction

Finance is the life-blood of every business. This requirement materialises from the development of a business concept, to setting up a business and through to the growth and expansion stages.

Even before the current financial crisis emerged, a number of structural issues were evident. Innovative exporting small and medium enterprises (SMEs) traditionally experience difficulty in accessing external credit finance. The reasons may be that newer technology and business models might not neatly fit into existing lending criteria of financial institutions; a lack of collateral or a lack of track record. 54 per cent of SMEs are a decade or less old - they account for 34 per cent of total SME employment. The importance of supporting young innovative SMEs can therefore not be underestimated. Traditionally, the market for raising equity in Ireland has also been challenging.

While the EU/IMF package means that there is secure funding in place to meet the State's current borrowing needs and the on-going support of the ECB and the Irish Central Bank has provided a lifeline to the Irish banks (€138.1 billion at end-January 2012), concerns over credit availability to enterprise remain. The crises and the resulting credit constraints are also impacting on non-banks funding sources.

## Potential Impact

An International Monetary Fund (IMF) working paper indicates that there is a stronger risk that our recovery could be 'creditless' (i.e. the economy could recover while there would be a continuing real fall in credit or zero credit growth) as Ireland has experienced an exceptionally strong credit boom, a major property boom and bust cycle, and a major banking crisis, the conditions in which creditless recoveries are most likely to occur<sup>1</sup>. Creditless recoveries are on average substantially weaker than normal recoveries and take longer to recover from - output growth is on average one third lower<sup>2</sup>. IMF evidence suggests that the absence of credit growth in these relatively weak recoveries generally arises from problems with the availability of credit rather than because credit is not required.

The IMF working paper notes that during creditless recoveries, policy measures aimed at restoring financial intermediation (i.e. the banking system) will lead to higher growth (e.g. recapitalising banks). However, the lack of credit growth can also result from an over-indebted private non-financial sector. Even in the presence of relatively healthy banks, the existence of previous debt may inhibit the private sector from accessing credit for potentially profitable investments. In this regard, it is notable that the Credit Review Office indicates

---

<sup>1</sup> Abiad et al. (2011) Creditless Recoveries, IMF Working Paper 11/58, 2011.

<sup>2</sup> Capital investment in business sectors remains low, with some tentative signs of recovery. While not possible to distinguish an SME from large companies, capital investment in some key sectors where SMEs are predominate remain below 2006 levels, including other market services, construction and manufacturing.

that the legacy of previous debt is a major constraint on new lending in Ireland<sup>3</sup>. In Ireland, problems are arising from both weak demand for credit and weak supply of credit. Where both demand and supply are an issue, the IMF working paper notes that the policy response is much more complex.

## Findings<sup>4</sup>

One of the key sources of funding for enterprise, the banking system, is currently undergoing comprehensive change in terms of recapitalisation, deleveraging and restructuring. In March 2011, Bank of Ireland and Allied Irish Bank accounted for 63 per cent of outstanding SME lending in Ireland. These two pillar banks along with a third bank, Ulster Bank, are likely to dominate new lending.

- The stock of credit has fallen dramatically. The total amount of credit outstanding to Irish private-sector enterprises on the balance sheet of resident credit institutions excluding property-related and financial sectors was €40.3 billion at the end of December 2011, down from €59.6 billion at its peak in December 2008. The figure for December 2011 is similar to levels last experienced in June 2005<sup>5</sup>.
- Credit advanced to core SMEs declined by 6.4 per cent in the year ending December 2011. Credit advanced to Irish private-sector enterprises excluding financial intermediation and property related sectors in the year to December 2011 declined by 7.2 per cent compared to a decline of 5 per cent in the year to December 2010 and a decline of 2 per cent in the year to December 2009<sup>6</sup>.
- There was an increase in short term loans (these include the use of overdraft facilities), while the volume of medium and long-term loans continued to fall in the year ending February 2012<sup>7</sup>. While the divergence was far less pronounced than in 2010, it remains a concern that long term lending durations continue to decline. This may reflect an enterprise need for working capital in the short term and a lack of investment opportunities (i.e. survival mode) and/ or a lack of willingness of the banks to invest for the long term. The Mazars SME Lending Demand Study, November 2011 reflecting the six months to October 2011 showed the most common reasons for requesting new credit were for working capital and cash flow purposes<sup>8</sup>.
- Gross new lending (i.e. draw-downs of new facilities, excluding restructuring or renegotiations of existing facilities) to non-property, non-financial SMEs totalled €579 million in December 2011. This figure does not include overdraft facilities or revolving loans. This lending was concentrated in the agriculture sector (€144 million), the

<sup>3</sup> Credit Review Office (2011) Fourth Quarterly Report from John Trethowan, Credit Reviewer.

<sup>4</sup> Analysis of the data and its conclusions is complex. There is no single comprehensive database comprising the supply of and demand for credit. As flows of financing are driven both by supply and demand factors, drawing definitive conclusions from the data is challenging. A decrease in credit does not necessarily always indicate a supply constraint from banks, for example lower economic growth and reduced investment opportunities can also lead to a decrease in the demand for credit. This paper draws data from a range of available sources.

<sup>5</sup> Central Bank (2012) Trends in Business Credit and Deposits: Q4 2011.

<sup>6</sup> Central Bank (2012) Trends in Business Credit and Deposits: Q4 2011.

<sup>7</sup> Central Bank (2012) Money and Banking Statistics: February 2012.

<sup>8</sup> Mazars (2011) SME Lending Demand Study, November 2011.

wholesale/retail trade sector (€110 million), business and administrative services (€97 million) and manufacturing (€50 million)<sup>9</sup>.

Problems also arise from weak demand for credit.

- The Mazars SME Lending Demand Study shows that trading conditions continue to be difficult, in particular for micro and small businesses. Mazars highlights that trading activity and in particular, profitability has a strong impact on bank loan application decline rates with higher rates of decline associated with poorer profitability levels.
- Of those businesses that did not seek credit, 85 per cent attributed their decision to company specific reasons only, such as the fact that they did not require credit and 10 per cent indicated that they did not request credit because of bank specific factors only, such as their perception that banks were not lending. Overall, the demand for credit appears to be reducing based on previous surveys undertaken by Mazars, though the period covered by the current survey excluded months of high seasonal lending and the duration and timing of the survey also differed to previous surveys<sup>10</sup>.
- The rate of decline of applications for credit was higher for micro enterprises. Mazars key finding was that the micro enterprise was impacted to a greater level than small and medium enterprises across a range of indicators<sup>11</sup>. In 2009, 90.4 per cent of businesses were microenterprises with less than 10 persons engaged<sup>12</sup>.
- While fully successful applications for credit have decreased, partially successful applications have increased.
- The main reasons given by banks for wholly or partially refusing loans in 2007 were lack of capital and insufficient or risky potential. However, in 2010 the most common reason identified was that enterprises already had too much debt. The Credit Review Office also notes that the legacy of previous debt is a major constraint on new lending in Ireland<sup>13</sup>.
- The cost of finance also continues to be an issue for Irish enterprises and there are concerns that cost competitiveness will weaken further as the banks need to rebuild profitability and as competition has reduced. Interest rates on new loans to non-financial corporations (NFCs), applied by resident credit institutions, were generally increasing throughout 2011. However, interest rates on the stock of outstanding NFC loans remained broadly unchanged over the last three months of 2011, across all maturity categories, reflecting the subdued levels of new lending<sup>14</sup>.

Bank finance, while important is just one source of finance. The Mazars SME Lending Demand Study, November 2011 showed that 11 per cent of businesses sought non-bank finance. This included:

---

<sup>9</sup> Central Bank (2012) Trends in Business Credit and Deposits: Q4 2011.

<sup>10</sup> Mazars (2011) SME Lending Demand Study, November 2011.

<sup>11</sup> Mazars (2011) SME Lending Demand Study, November 2011.

<sup>12</sup> CSO (2012) Business in Ireland 2009.

<sup>13</sup> Credit Review Office (2011) Fourth Quarterly Report from John Trethowan, Credit Reviewer

<sup>14</sup> Central Bank (2012) Quarterly Bulletin, Q1 January 2012.

- Government financial support, which was the most popular form of non-bank finance. A number of agencies provide funding and other supports to businesses, particularly small businesses including the City and County Enterprise Boards, Enterprise Ireland, Bord Iascaigh Mhara, Fáilte Ireland and Údarás na Gaeltachta. A number of additional supports were developed to help business through the economic crises.
- Loans from family, friends or others. Enterprises rely heavily on owners own resources and finance from friends and family in the early years and on retained profits as the business gets older. Given the difficult trading environment of recent years, many businesses have eaten into their reserves.
- Equity finance, which comprises business angels and private investors, venture capital, private equity and government equity. Both CSO and Central Bank data show an increasing percentage of enterprises seeking equity investment and an increased reliance on equity investment. However, there are concerns that potential investors are also facing capital constraints (e.g. venture capital investors) as a result of the economic crises.
- Off-balance sheet financing sources such as lease financing, hire purchase and factoring.

## Policy Issues Arising

A range of initiatives have been developed to support the flow of credit to enterprises in the past three years. In addition to initiatives to support the banking sector, measures have been developed to build business banking relationships (e.g. the ‘Code of Conduct for Business Lending to SMEs’<sup>15</sup> and the establishment of the Credit Review Office), train bank staff and increase lending (e.g. setting lending targets for the two recapitalised banks). As well as providing direct financial support, Enterprise Ireland has broadened its clients’ access to different sources of finance by investing in new seed and venture capital funds, matching domestic business angel and international venture capital managers with investment opportunities in client companies, and through enhanced co-operation with the main banks<sup>16</sup>. Enterprise Ireland also has a role in supporting banks as they develop knowledge around new economy sectors. Additional support is provided through workshops and engagement by Enterprise Ireland on individual cases.

Section 5 sets out actions to support a return to funding growth. An earlier draft of this paper fed in to the Action Plan for Jobs 2012. It is welcome that the Plan<sup>17</sup> sets out agreed and time bound actions to address many of the issues raised in this paper. A full list of measures relating to access to finance from the Action Plan for Jobs 2012 is contained in Appendix I. Policy actions recommended and actions agreed under the Action Plan are briefly summarised as follows:

<sup>15</sup> Updated code contains revised requirements for the handling of SME financial difficulties cases by lenders.

<sup>16</sup> Enterprise Ireland disbursed financial supports to industry in 2010 amounting to €356.9 million. This included €44.5 million in share capital investment, €15.6 million in seed and venture capital funds, €77.7 million in R&D, training and other capability building support, €17.4 million in capital and employment support for capacity expansion, and €65.2 million in third level research. Financial payments to companies in 2009 amounted to €156 million. This included €74 million in share capital investment, €62.8 million in R&D, training and other capability building support, and €19.2 million in capital and employment support for capacity expansion.

<sup>17</sup> Department of Jobs Enterprise and Innovation (2012) Action Plan for Jobs 2012.

## 1. Banking Sector

- Considerable uncertainty remains over the impact of the banking crisis on banks' ability to raise funds and support lending. There is a need to ensure that the efficacy of measures put in place to improve credit flows through recapitalisation, deleveraging and restructuring of the banks can be assessed and action taken if required.
- There is a need for a cultural shift in Irish bank lending to align with the strategic economic growth targets of the economy. In this regard, a move towards a banking system with an in-depth understanding of innovative sectors (e.g. software, telecoms, digital content, medtech and life-sciences) and a pro-active overseas banking network are required in the medium term. More immediately, there needs to be a focus on supporting internationally trading businesses in terms of both the provision of credit and the bank facilities/products. In particular, concerns have been raised about the availability of products such as international invoice discounting, performance bonds and specialised leasing, amongst others. For example, banks can be reluctant to provide leases for specialist equipment where there is no obvious resale market in Ireland or to provide international invoice discounting to exporters in markets the banks are not familiar with.
- The collapse of the domestic banks and the withdrawal of many foreign banks (e.g. Bank of Scotland Ireland, Halifax, and Bank of America's MBNA) raise concerns over the levels of competition in the banking sector. There is a need to encourage existing foreign banks to retain lending operations in Ireland and to attract new entrants in the medium term. Potential may also exist for Enterprise Ireland and the Irish banks to work with clients to establish business banking relationships with banks in export markets.
- While data on the supply of credit has improved significantly since 2010, further improvements would be welcome, in particular, classification of the supply of credit by the principle purpose of the credit e.g. in a situation where farmers take out loans for property development, the credit supplied would be captured under the agriculture sector and not construction.

Building on this report, the Action Plan for Jobs 2012 commits to monitoring the lending targets for the pillar banks, with a particular focus on new lending; conducting a follow-up survey on demand for credit from SMEs and engaging with stakeholders on the findings to address blockages identified. These measures will be implemented and monitored over the next twelve months.

## 2. Building Business Banking Relationships

Efforts have been made to strengthen business relationships between banks and enterprise by putting in place a code of conduct for business lending to SMEs, establishing and developing the Credit Review Office and training bank staff. Further efforts are required to:

- Encourage businesses to talk to their banks and to apply formally for credit. It has been argued that negative publicity has led many businesses to believe that their banks are 'closed for business'. The Mazars SME Lending Study showed that 7 per cent of businesses that did not apply for credit gave the reason that they thought banks were not lending.



- Banks are increasingly returning to becoming prudent cash flow lenders rather than focusing on collateral. Efforts are required to support businesses in improving their cash flow planning.
- Train bank staff to support lending to viable, cash flow based businesses.
- Potential exists to enhance the code of conduct to SMEs by the Central Bank.

Building on this report<sup>18</sup>, the Action Plan for Jobs 2012<sup>19</sup> commits to working with the banking sector to focus on and understand the key sectors of growth in the economy; to help SMEs improve the quality of their loan application; to ensure businesses are notified of their right of appeal through the Credit Review Office if they have been refused credit; to ensure sufficient training and development procedures are in place to enable bank staff to make more informed lending decisions; and assess the Credit Review Office to ensure SMEs are getting the support on bank lending they require.

### 3. Increased Lending

Increasing lending is a critical challenge. Actions include:

- The timely implementation of announced initiatives such as the partial credit guarantee, micro-finance fund and Enterprise Ireland's development capital scheme.
- Continued monitoring of the agreed lending targets and their effectiveness. While new lending is critical, it is also important that existing lending and restructured (e.g. continuation of overdrafts, restructuring of overdrafts into term loans, etc.) lending is maintained.
- Investigate measures that may aid overleveraged businesses, which can demonstrate future viability through a recovery plan such as debt/equity swaps or restructuring.

The Action Plan for Jobs 2012 commits to rolling out the temporary partial credit guarantee scheme; rolling out the micro-finance fund to provide loans of up to €25,000, targeted at start-up, newly established, or growing micro enterprises across all industry sectors; and assessing the feasibility of introducing a new structured and non-judicial debt settlement and enforcement system to meet SME needs - 'Examinership Light'.

### 4. Equity

Encouraging equity investment represents a mechanism to help some over-indebted but viable businesses to rebalance their balance sheets. Data from the Central Bank indicates the NFC sector continued to use shares and other equity as its main source of funding in Q3 2011, at 54 per cent<sup>20</sup>. Actions are required to:

---

<sup>18</sup> Earlier drafts of this report were available during the development of the Action Plan for Jobs.

<sup>19</sup> A full list of finance related recommendations along with the Departments/Agencies responsible is listed in Appendix I.

<sup>20</sup> Central Bank (2012) Quarterly Bulletin Q2, April 2012.

- Seek approval for the extension of the Employment and Investment Incentive Scheme (EIS) beyond its current deadline of 31st December 2013 to ensure certainty for enterprise, investors and fund operators.
- Make legislative amendments to support venture capital investments in companies engaged in R&D and innovative activities. The Programme for Government commits to supporting the development of a more dynamic, venture capital industry in Ireland by seeking to attract top tier venture financing and investment companies to Ireland.
- Undertake further research to assess the use of equity, its realistic potential to rebalance business balance sheets and the policy options available.

The Action Plan for Jobs 2012 commits to designing and launching a new Enterprise Ireland development capital scheme to address a funding gap for mid-sized, high-growth, indigenous companies; launching a second call under the Innovation Fund; developing the mandate of the Strategic Investment Fund; a Forfás review of the equity landscape in Ireland with a view to introducing measures to support equity investment; establishing a working group to ascertain the need and approach for the State to continue committing capital to support the continuing development of the domestic venture capital sector; and promoting the Employment and Investment Incentive Scheme (EIS). It is important that the timelines for delivery of these recommendations are adhered to.

## Conclusions

Finance is vital for enterprise to survive and at present bank lending is a central element of the funding environment. Analysis of bank lending data and its conclusions is complex. There is no single comprehensive database comprising the supply of and demand for credit. Credit advanced to core<sup>21</sup> Irish private-sector enterprises experienced an annual decline of 7.2 per cent in the year to December 2011 with outstanding credit to private-sector enterprises reflecting June 2005 levels. While very limited data is available on non-bank funding sources, it is clear that non-bank sources are also adjusting to the financial and credit crises. Therefore a wide range of actions are required to improve access to finance (not just bank lending), as discussed in this paper, with the implementation of the finance measures in the Action Plan for Jobs 2012 a vital part of this process.

---

<sup>21</sup> Core sectors exclude property-related and financial sectors.

## 1. Introduction

Finance is the life-blood of every business. This requirement materialises from the development of a business concept, to setting up a business and through the growth and expansion stages. Access to funding is a key issue for enterprise given the challenges facing the economy and our banks.

Finance can be sourced from a number of avenues depending on the size, age and sector of the firm. Different sources of finance attach different terms and conditions. One of the key sources of funding for enterprise, the banking system is currently undergoing comprehensive change in terms of recapitalisation, deleveraging and restructuring. In March 2011, Bank of Ireland and Allied Irish Bank accounted for 63 per cent of outstanding SME lending in Ireland<sup>22</sup>. These two pillar banks along with a third bank, Ulster Bank, are likely to dominate new lending. These changes are affecting and will continue to affect the funding environment in terms of availability and cost of finance.

Even before the current financial crisis occurred, a number of structural issues were evident in the banking sector in Ireland. Innovative exporting small and medium enterprises (SMEs), whose technology and business models are not fully understood by many financial institutions, and lack a track record and collateral against which to raise finance, traditionally experience difficulty in accessing external finance. 54 per cent of SMEs are a decade or less old, this is 34 per cent of total SME employment. The importance of supporting young innovative SMEs can therefore not be underestimated.

## 2. Importance of Funding to Economic Growth

The importance of credit to facilitating economic recovery is critical. While the EU/IMF package means that there is secure funding in place to meet the State's current borrowing needs and the on-going support of the ECB and the Irish Central Bank has provided a lifeline to the Irish banks (€138.1 billion at end-January 2012 ), concerns over credit availability for enterprise remain.

An International Monetary Fund (IMF) working paper suggests that creditless recoveries (i.e. an economy could recover while there would be a continuing real fall in credit or zero credit growth) are not uncommon - creditless recoveries follow about one in five recessions across the world or about one in ten recessions in advanced economies. International research indicates that there is a stronger risk that our recovery could be 'creditless' as Ireland has experienced an exceptionally strong credit boom, a major property boom and bust cycle, and a major banking crisis, the conditions in which creditless recoveries are most likely to occur<sup>23</sup>.

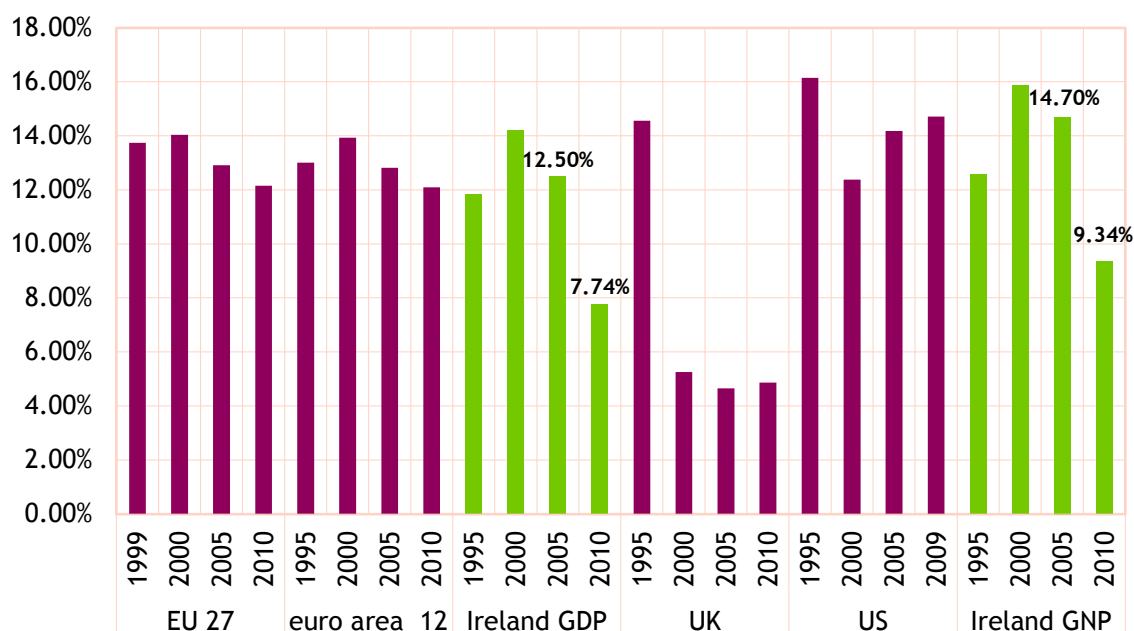
---

<sup>22</sup> The Financial Measures Programme Report for March 2011 shows Allied Irish Bank and Bank of Ireland accounting for €36.5 billion of SME exposure. Central Bank Business Credit statistics estimate total SME lending at €58.2 billion.

<sup>23</sup> Abiad et al. (2011) Creditless Recoveries, IMF Working Paper 11/58, 2011.

Creditless recoveries are on average substantially weaker than normal recoveries and take longer to recover from - output growth is on average one third lower. Economic recovery is particularly constrained by weaker growth in investment (e.g. property, machinery and equipment, etc.) and to a lesser degree by weaker growth in consumption on final goods and services. Reduced investment is a particular concern - investment in productive assets allows firms to undertake their operations in a more efficient and effective manner and can lead to improved cost competitiveness and higher rates of innovation<sup>24</sup> and productivity (see Figure 1). While foreign owned companies present a long established route of attracting foreign capital<sup>25</sup>, a capability to source domestic capital is essential to indigenous owned firms.

**Figure 1: Productive Sector Investment as a % of GDP**



Source: National Competitiveness Council 2011

<sup>24</sup> Access to internal and external finance hampers innovation to a greater extent for Irish over non Irish SMEs. Access to finance was reported as highly important in hampering innovation for 21 per cent of small innovating Irish enterprises in comparison to 14 per cent of small innovating foreign enterprises. There is also a significant differences in the proportions of both Irish and foreign SMEs engaging in innovation, with foreign SMEs much more likely to innovate and spend more on innovation. Exporting firms also experience financing constraints for innovative purposes to a greater extent than non-exporting firms. Also the data clearly highlights that Irish exporting enterprises are hampered to an even greater extent than foreign exporting SMEs. Forfás (2011) SME Finance and Innovation in Ireland, January 2011 - Gerry McGuinness.

<sup>25</sup> Central Bank data indicates that there were substantial direct investment transactions over the quarter to March 2011, with inward investment of €15.9 billion by foreign-owned companies. These inflows comprised reinvested earnings of €6.4 billion and intercompany borrowings of €10 billion.

A recovery can be creditless because credit is not available and/or because it is not needed. International evidence suggests that the absence of credit growth in relatively weak recoveries generally arises from problems with the availability of credit rather than because credit is not required. The international evidence also indicates that industries more reliant on external finance grow disproportionately less during creditless recoveries.

This finding is relevant from a policy standpoint. The IMF working paper notes that during creditless recoveries, policy measures aimed at restoring financial intermediation (i.e. the banking system) are likely to lead to higher growth (e.g. recapitalising banks). The lack of credit growth could result from an over-indebted private non-financial sector. Even in the presence of relatively healthy banks, the presence of previous debts may inhibit the private sector from accessing credit for potentially profitable investments. In this regard, it is notable that the Credit Review Office indicates that the legacy of previous debt is a major constraint on new lending in Ireland<sup>26</sup>. In Ireland, it is likely problems are arising from both the weak demand for credit and the weak supply of credit. In this case, the IMF working paper notes that the response would be much more complex. In addition to restoring the financial system to health, the IMF suggests that this would have to entail policies to facilitate deleveraging or possibly debt restructuring in the private sector.

In examining the Irish case, much of the focus to date has been on restoring financial intermediation, however with activity in the domestic economy expected to remain depressed in 2012, the ESRI forecast GNP to contract by 0.3 per cent and GDP to grow by 0.9 per cent, it is important that other aspects of credit supply are examined to ensure their proper functioning. As noted by the National Competitiveness Council's Ireland's Competitiveness Scorecard 2011, the stimulus for growth is coming from the export sector as domestic producers seek to replace lost domestic demand with new business from abroad, while the multinational sector continues to perform well on global markets. In order for this to occur, the funding needs of the exporting sector need to be supported.

---

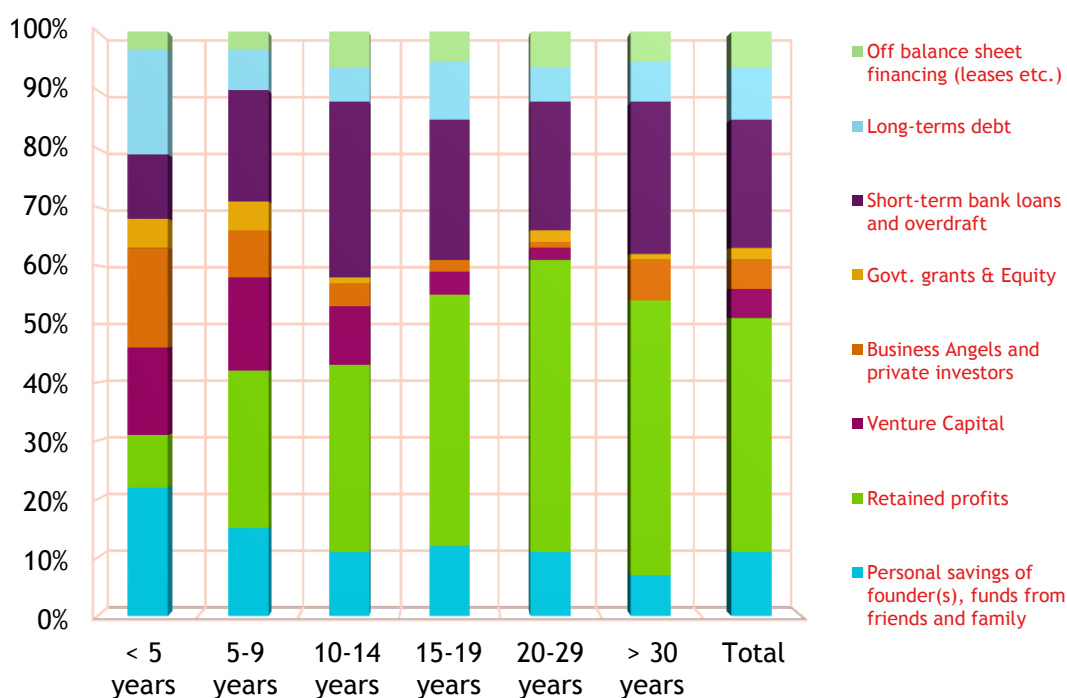
<sup>26</sup> Credit Review Office (2011) Fourth Quarterly Report from John Trethowan, Credit Reviewer.

### 3. Current Situation with Respect to the Supply, Demand and Cost of Financing

#### 3.1 Introduction - Sources of Finance

There are a number of sources of finance for enterprises, which can be categorised as internal and external finance. These are not perfect substitutes due to differences in availability, cost, and other terms and conditions<sup>27</sup>. As can be seen from Figure 2, funding sources vary according to firm characteristics - predominantly firm age, size and sector in which they operate. In terms of internal finance, enterprises rely mostly on owners own resources and finance from friends and family in the early years and on retained profits as the business gets older. In terms of overall financing, younger firms are more reliant on external finance than internal finance.

Figure 2: Source of Financing Employed by SME Respondents across Age Categories (%)



Source: Mac an Bhaird (2010), Resourcing Small and Medium Sized Enterprises: A Financial Growth Life Cycle Approach<sup>28</sup>.

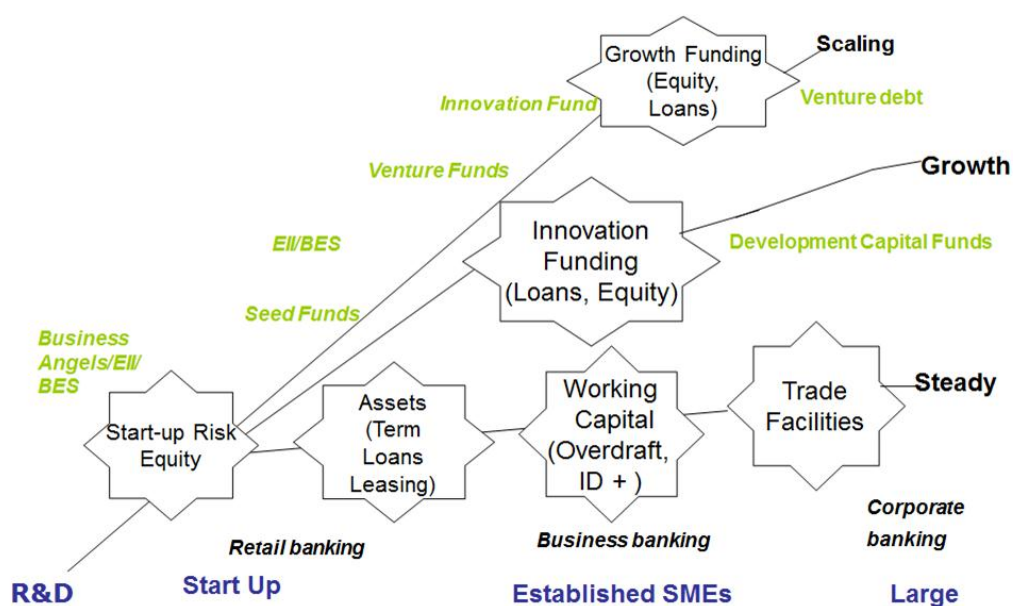
<sup>27</sup> Holton and O’ Brien (2011) ‘Firms’ Financing During the Crisis: A Regional Analysis’ in Central Bank Quarterly Bulletin 01, January 11.

<sup>28</sup> Based on a sample size of 299 out of an eligible population of 702.

Irish and international experience suggests that in most EU countries, start-ups, very young firms and innovative SMEs, whose technology and business models are not understood by many financial institutions, and lack a track record and collateral against which to raise debt finance, traditionally experience difficulty in accessing external debt finance<sup>29</sup>. This finding has been reaffirmed by Enterprise Ireland. Appendix II sets out an overview of potential funding options.

In summary, Figure 3 presents an overview of the funding environment for indigenous exporting firms. It would be important to point out that not all sources are available to all enterprises, as some sources of finances are directed towards incorporated entities.

Figure 3: Finance Continuum for Indigenous Innovative Exporting Firms



Source: Enterprise Ireland (2012)

### 3.2 Availability of Bank Finance

Assessing difficulties in the funding environment is not clear-cut, as stocks and flows of financing are driven both by demand and supply factors. A decrease in credit does not necessarily always indicate a supply constraint from banks, for example lower economic growth and reduced investment opportunities or confidence can lead to a decrease in the

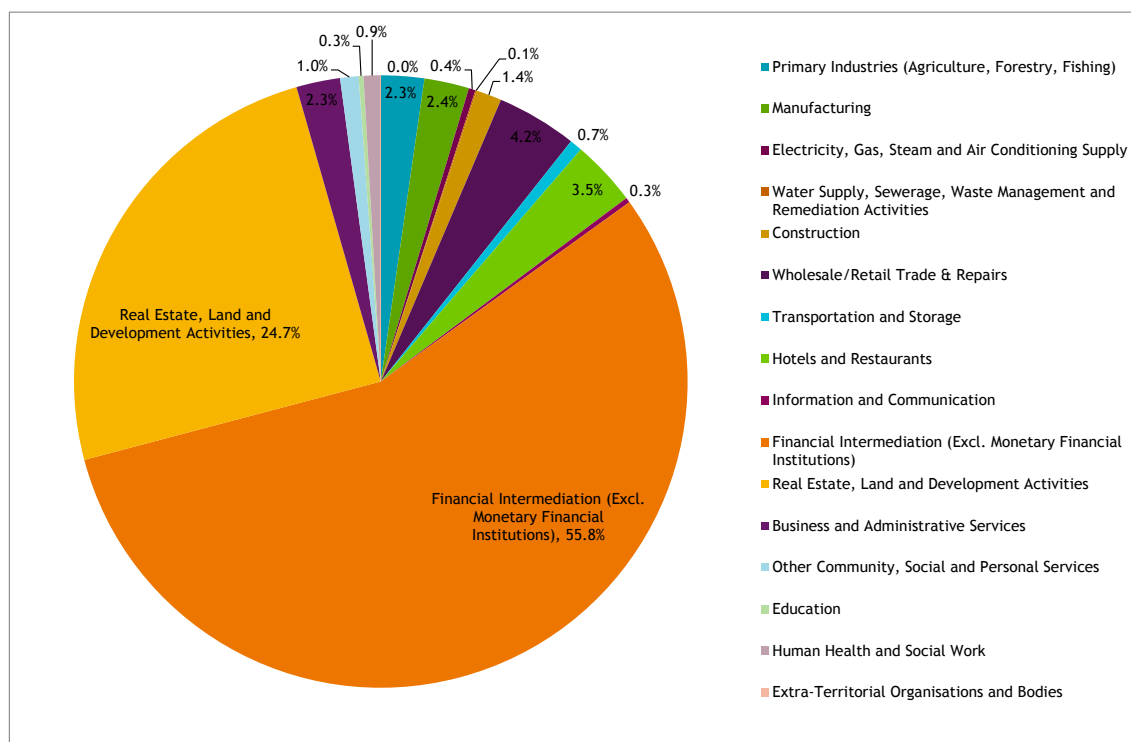
<sup>29</sup> European Commission (2009) Cyclicity of SME Finance, May 2009.

demand for credit<sup>30</sup>. This section assesses the levels and flows of bank finance in turn. It also assesses demand for bank finance, its cost and developments in the banking sector.

### 3.2.1 Outstanding Debt Levels to Enterprise

The total amount of credit outstanding<sup>31</sup> to Irish private-sector enterprises<sup>32</sup> on the balance sheet of resident credit institutions<sup>33</sup> was €222.4 billion at the end of December 2011. Figure 4 shows the distribution of this credit by sector.

**Figure 4: Outstanding Credit Advanced to Irish Resident Private-Sector Enterprises by Sector, December 2011<sup>34</sup>**



Source: Central Bank (2012)

<sup>30</sup> Holton and O’ Brien (2011) ‘Firms’ Financing During the Crisis: A Regional Analysis’ in Central Bank Quarterly Bulletin 01, January 2011.

<sup>31</sup> As of December 2010, the outstanding amount of loans is reported at nominal value i.e., the gross position owed on loans by the credit institutions’ counterparties. Prior to December 2010, the book value of loans is reported, which reflects the carrying value of these loans on credit institutions’ balance sheets and are net of impairment provisions recognised against these loans. As a result, the outstanding amount of loans and related series increased substantially in December 2010. The underlying transactions and growth rates in loans when comparing December 2010 with previous periods have been corrected to adjust for the impact of this change in methodology and reflect underlying business activity.

<sup>32</sup> Private sector enterprises include incorporated and non-incorporated enterprises such as sole-traders and partnerships.

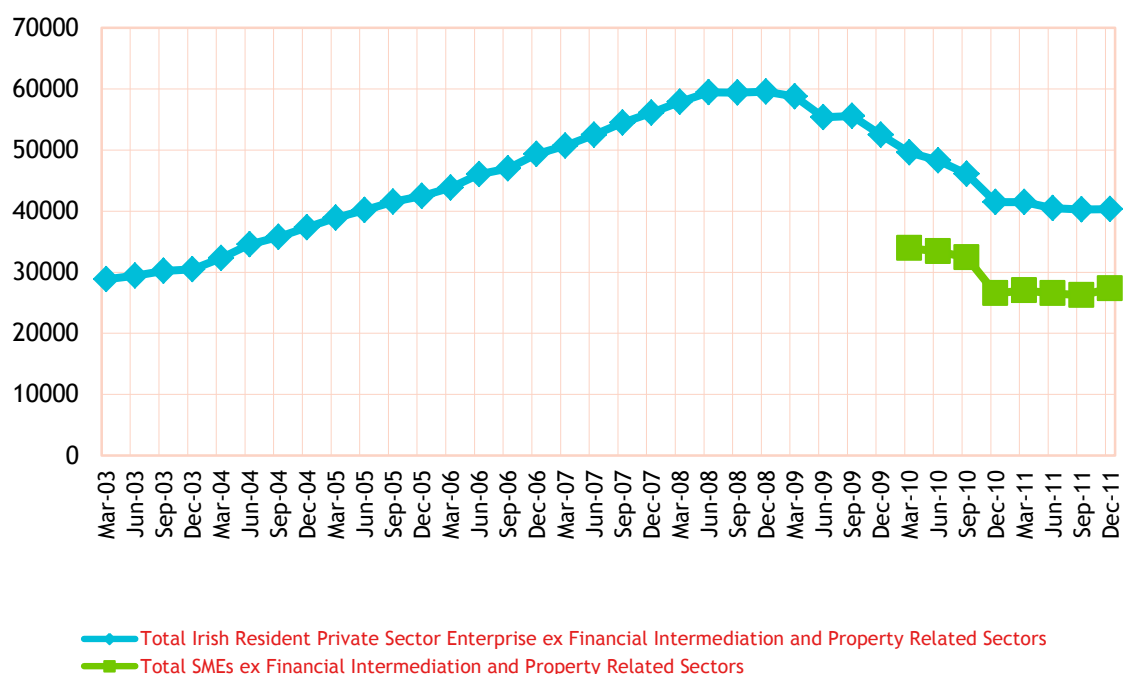
<sup>33</sup> The reporting population which is covered are all credit institutions resident in Ireland. A full list is available on the Central Bank website: <http://www.centralbank.ie/polstats/stats/cmab/Documents/Credit%20Institutions%20resident%20in%20the%20Republic%20of%20Ireland.pdf>

<sup>34</sup> Financial Intermediation includes holdings of debt securities issued by the NAMA Master Special Purpose Vehicles and other financial vehicle corporations.



As can be seen from Figure 4, financial intermediation and real estate, land and development activities account for 80 per cent of the total. Therefore to get a more accurate reflection of ‘core business activity’, these two sectors are stripped out in the remainder of the analysis. The total amount of credit outstanding to Irish private-sector enterprises on the balance sheet of resident credit institutions excluding property-related and financial sectors was €40.3 billion at the end of December 2011, down from €59.6 billion at its peak in December 2008. The figure for December 2011 is similar to levels last experienced in June 2005<sup>35</sup>. See figure 5.

**Figure 5: Outstanding Credit Advanced to Irish Resident Private-Sector Enterprises and SMEs Excluding Financial Intermediation and Property Related Sectors (€m)<sup>36</sup>**



Source: Central Bank Business Credit and Deposit Statistics (2012)

In terms of the distribution of credit across sectors, the stock of credit advanced to the wholesale/ retail trade sector (23.4 per cent) and hotels and restaurants sector (19.2 per cent) dominate, followed by manufacturing (13 per cent), business and administrative services (12.7 per cent) and agriculture (12.6 per cent).

### Irish SMEs

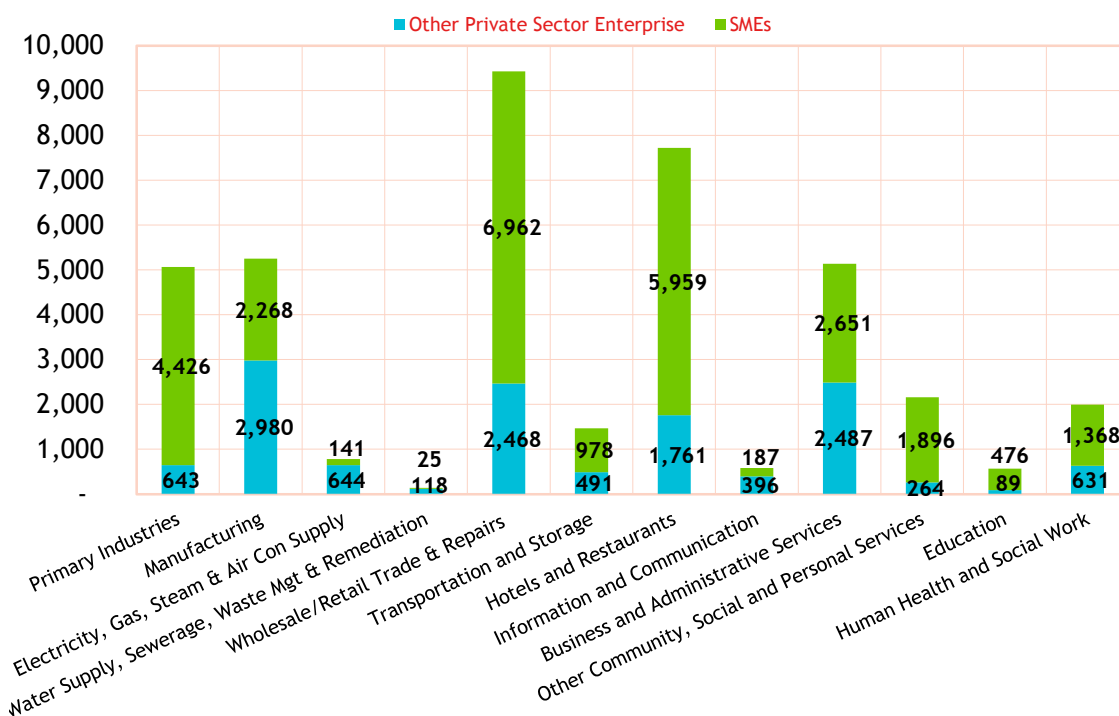
The outstanding amount of loans advanced to Irish SMEs<sup>37</sup> by resident credit institutions was €73.6 billion at the end of Q3 2011. Excluding the financial intermediation sector and

<sup>35</sup> Central Bank (2012) Trends in Business Credit and Deposits: Q4 2011.

<sup>36</sup> Data is only available for SMEs back to March 2010.

property-related sectors, the credit outstanding amounted to €27.3 billion (as represented by the green bars in Figure 6), which accounts for 67.8 per cent of total credit to non-property, non-financial private-sector enterprises in December 2011. This is marginally below SMEs contribution to private sector employment (69 per cent) and above its contribution to value added (51 per cent)<sup>38</sup>. Capital investment in business sector remains low, with some tentative signs of recovery. While not possible to distinguish an SME from large companies, capital investment in some key sectors where SMEs are predominate remain below 2006 levels including other market services, construction and manufacturing. Monitoring the financing conditions of SMEs is, therefore, an important feature in determining the prospects for the economy more widely<sup>39</sup>.

**Figure 6: Outstanding Credit Advanced to Irish Resident SMEs and Other Private-Sector Enterprises Excluding Financial Intermediation and Property Related Sectors by Sector**



Source: Central Bank 2012

Gross new lending (i.e. draw-downs of new facilities, excluding restructuring or renegotiations of existing facilities)<sup>40</sup> to non-property, non-financial SMEs totalled €579

<sup>37</sup> As per EU definition of SME.

<sup>38</sup> CSO (2012) Business in Ireland 2009.

<sup>39</sup> Holton and O' Brien (2011) 'Firms' Financing During the Crisis: A Regional Analysis' in Central Bank Quarterly Bulletin 01, January 2011.

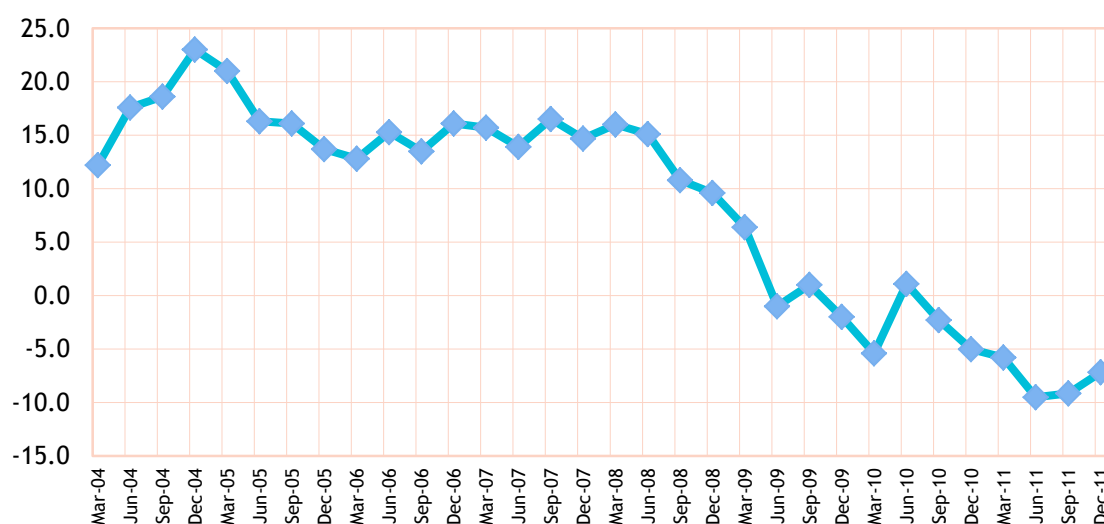
<sup>40</sup> New sanctions or agreements relating to restructuring may be higher than the amounts of new facilities drawn-down by customers in a given period. Gross new lending would include, however, funds drawn-down following a restructuring or renegotiation of an existing facility that were not included in credit advanced at the end of the previous quarter. The Credit Review Office has reported that loan sanctions to SMEs, including a restructuring of existing business was €8 billion in the year from 1st April

million in December 2011. This was concentrated in the agriculture sector (€144 million), the wholesale/ retail sector (€110 million), business and administrative services (€97 million) and manufacturing (€50 million)<sup>41</sup>.

### 3.2.2 Flows of Bank Finance<sup>42</sup>

The annual growth rate for credit advanced to SMEs excluding property-related and financial sectors was a decline of 6.4 per cent in the year ending December 2011. Credit advanced to Irish private-sector enterprises excluding property-related and financial sectors experienced an annual decline of 7.2 per cent in the year to December 2011<sup>43</sup>. This compares to a decline of 5 per cent in the year December 2010 and a decline of 2 per cent in the year to December 2009.

**Figure 7: Annual Growth Rates in Credit Advanced to Irish Resident Private-Sector Enterprises March 2004-December 2011: Flow (%)**



Source: Central Bank Business Credit and Deposit Statistics 2011

2010 to 31st March for the credit institutions under its remit (Allied Irish Banks and Bank of Ireland). Subsequent to this target, the second target period was December 2010 to December 2011 to coincide with the calendar year.

<sup>41</sup> Central Bank (2012) Trends in Business Credit and Deposits: Q4 2011.

<sup>42</sup> The Central Bank provides data on finance flows calculated from quarterly differences in outstanding credit amounts adjusted for reclassifications, other revaluations, exchange rate variations and any other changes, which do not arise from transactions. These quarterly changes are in turn used to derive annual rates of change in credit advanced to private sector enterprises.

<sup>43</sup> Central Bank (2012) Trends in Business Credit and Deposits: Q4 2011.

Credit advanced to large sectors including the wholesale/ retail trade (-3.5 per cent), hotels and restaurants (-2.0 per cent), manufacturing (-1.3 per cent) and business and administrative services (-14.3 per cent) declined in the year to December 2011<sup>44</sup>.

The duration of loans is also changing. There was an increase in short term loans, while the volume of medium and long-term loans continued to fall. This may reflect an enterprise need for working capital in the short term and a lack of investment opportunities (i.e. survival mode) and/or a lack of willingness of the banks to invest for the long term<sup>45</sup>. The Mazars Lending Study would support this view as it showed the most common reasons for requesting new credit were for working capital and cash flow purposes. Internationally, concerns have been raised that the international banking regulations, Basel III, may increase the capital provisioning requirements of loans (i.e. bank capital required to advance loans), which would in turn increase the cost of capital and potentially lead to credit rationing. In Ireland, the impact of recapitalisation and SME lending targets for the banks may motivate short loan duration. The Central Bank's Money and Banking Statistics release allows for an examination of the maturity structure of credit advanced to enterprise. The release shows lending to the non-financial corporate (NFC) sector declined by 2.3 per cent in the year ending February 2012<sup>46</sup>. This was underpinned by the following changes in loans:

- Loans with an original maturity of over five years fell by 0.4 per cent.
- NFC lending between one and five years original maturity declined by 8.5 per cent.
- Short-term loans to NFCs with an original maturity of up to one year continue to grow on an annual basis, increasing by 2.7 per cent.

It is welcome that the divergence in maturity structure was far less pronounced in February 2012 than in February 2011 (annual growth in short term loans of 2.7 per cent in February 2012 versus 11.1 per cent 12 months previously/ annual decline in long term loans of 0.4 per cent to February 2012 versus a decline of 7.1 per cent 12 months previously). However, it remains a concern that long term lending durations continue to decline.

### 3.2.3 Demand for Finance

As highlighted earlier, lower economic growth and reduced investment opportunities or confidence can lead to a decrease in the demand for credit. Data in relation to demand for

---

<sup>44</sup> Central Bank (2012) Trends in Business Credit and Deposits: Q4 2011.

<sup>45</sup> McElligott and O' Brien (2011) Irish Money and Banking Statistics: A New Approach in Central Bank Quarterly Bulletin 01, January 2011.

<sup>46</sup> Non-financial corporation's (NFCs) are defined as corporations which are not engaged in financial intermediation but are active primarily in the production of market goods and non-financial services. They exclude non-incorporated enterprises, sole-traders and partnerships which are not large enough to be considered quasi-corporations. Consequently the NFC credit series in the Central Bank monthly Money and Banking Statistics is not directly comparable with the quarterly credit to enterprises in Trends in Business Credit and Deposits, although there is a significant overlap between the two categories, Money and Banking Statistics: May 2011.

credit comes from the Mazars SME Lending Demand Study, November 2011<sup>47</sup>. Key messages include<sup>48</sup>:

- Of the 1,506 respondents, 36 per cent made one or more requests for credit. This represented a reduction in the demand for credit from the previous Mazars survey, however, the time series was not directly comparable. The rate of decline of applications for credit was 23 per cent across all requests, with the rate of decline highest among micro enterprises at 35 per cent. In 2009, 90.4 per cent of businesses were microenterprises with less than 10 persons engaged<sup>49</sup>.
- Of those requests for credit, 70 per cent of applicants made a formal request. 11 per cent indicated that they had applied for a non-bank form of finance<sup>50</sup>. The most requested products were the renewal or restructuring of an existing overdraft.
- On an overall basis, 85 per cent of businesses attributed their decision not to seek credit to company specific reasons only, such as the fact that they did not require credit. 10 per cent of businesses indicated that they did not request credit because of bank specific factors such as the perception that banks were not lending (7 per cent).
- In 52 per cent of cases involving an unsuccessful application, the respondent was of the view that a 'change in bank lending policy' was one of the reasons that their application was refused. Mazars highlighted that trading activity and in particular, profitability has a strong impact on bank loan application decline rates, with higher rates of decline associated with poorer profitability levels. Trading conditions continue to be difficult in particular for micro and small businesses. In total 48 per cent of businesses reported a decrease in turnover. However, 72 per cent of businesses reported that they would break even or make a profit in the period to September 2011.

The CSO<sup>51</sup> also examined the demand for finance<sup>52</sup>. Key messages include:

- Enterprises applying for bank finance were successful in 55 per cent of cases in 2010, which was a significant drop from 95 per cent in 2007<sup>53</sup>. The number of fully successful applications decreased, however the number of partially successful applications increased. When asked about their outlook for the period 2010 to 2013, 60 per cent of enterprises indicated that they would need financing to maintain their business.
- The main reasons given by banks for wholly or partially refusing loans in 2007 were lack of capital and insufficient or risky potential. However, in 2010 the most common reason

---

<sup>47</sup> The survey was carried out in October 2011 and was based on businesses experience in the previous six months. There were 1,506 responses which were considered representative of the population of SMEs in economic value terms.

<sup>48</sup> Mazars (2011) SME Lending Demand Study, November 2011.

<sup>49</sup> CSO (2012) Business in Ireland 2009.

<sup>50</sup> Non-bank finance includes government financial support, venture capital finance, business angel or investor finance, loans/equity from family or friends, loans/equity from business partners and other non-bank finance.

<sup>51</sup> CSO (2011) Access to Finance Survey, May 2011.

<sup>52</sup> It is important to keep in mind when comparing different demand surveys that methodological differences exist between them e.g. some surveys record information on informal applications etc.

<sup>53</sup> The Credit Review Office have highlighted the abnormally high level of sanctioning activity in 2007 and have noted that a level of decline in sanctioning activity indicates a more prudent and healthy banking system.

identified was that enterprises already had too much debt. The Credit Review Office also notes that the legacy of previous debt is a major constraint on new lending in Ireland<sup>54</sup>.

- Enterprises that sought equity finance represented 4 per cent of respondents in 2010, while 31 per cent applied for loan finance. This compares to 3 per cent and 37 per cent respectively in 2007.

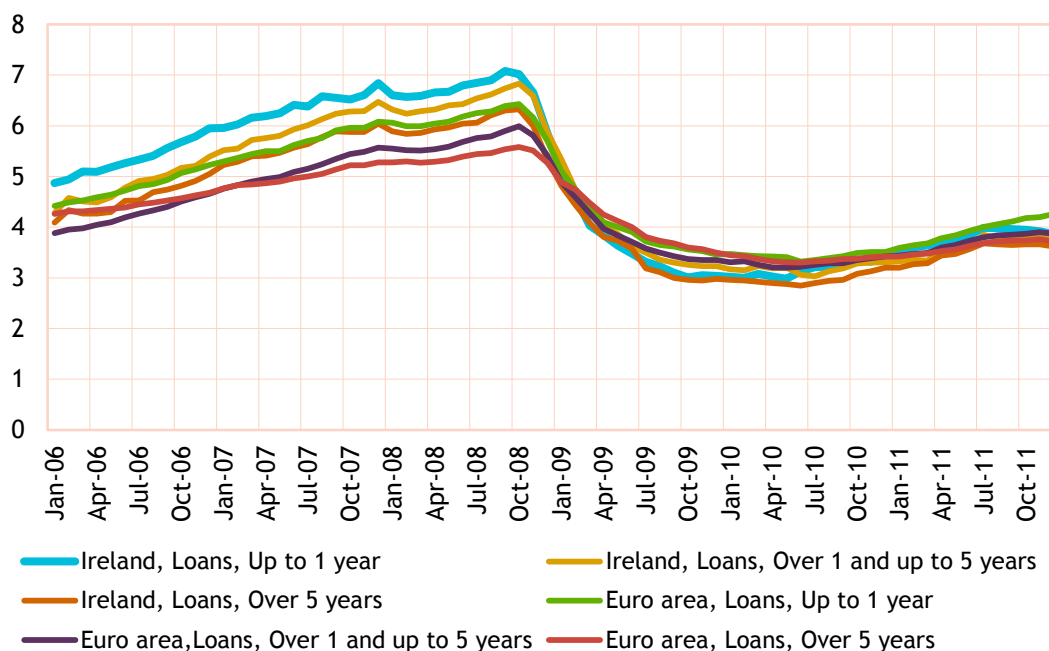
The Action Plan for Jobs 2012 has committed to conducting a follow-up survey on demand for credit from SMEs.

### 3.2.4 Cost of Finance

#### Outstanding Loan Amounts - Retail Interest Rates

As can be seen from Figure 8, interest rates on outstanding loans rose steadily across the euro area and in Ireland up to mid-2008 before falling sharply and levelling off by mid-2009 and gradually beginning to rise again by mid-2010. It is worth noting that Irish interest rates for the three categories of outstanding loans examined were more expensive than the euro area average in December 2006. However, as interest rates began to drop across the euro area in mid-2009, interest rates in Ireland began to converge with the euro area and were marginally lower than the euro area in December 2011. These three categories of loans accounted for €88.7 billion in outstanding loans in December 2011.

**Figure 8: Retail Interest Rates (%) - Loans, Outstanding Amounts by Loan Size January 2006 - December 2011**



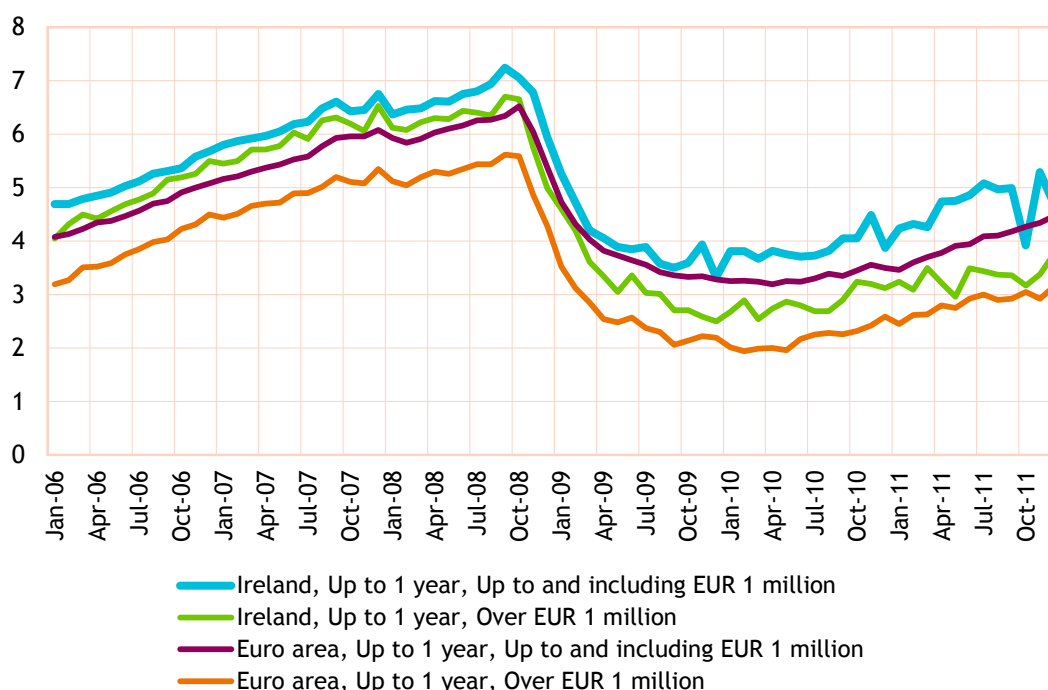
Source: ECB (2012) Euro area and national MFI interest rates (MIR)

<sup>54</sup> Credit Review Office (2011) Fourth Quarterly Report from John Trethowan, Credit Reviewer.

### New Business - Retail Interest Rates

Figure 9 shows interest rates on new loan agreements for NFCs. This encompasses all financial contracts, terms and conditions that specify for the first time the interest rate of the loan and all new (re)negotiations of existing loans. Retail interest rates for new business lending followed a similar trend to that of outstanding loan amounts in Figure 8. Rates rose steadily across the euro area and Ireland up to mid-2008 before falling sharply and levelling off by mid-2009 and gradually beginning to rise again by mid-2010. These two categories of new lending accounted for €1.4 billion of new business loans in Ireland in December 2011. Costs are higher in Ireland than in the Euro area.

**Figure 9: Retail Interest Rates - New Business by Loan Size and Rate Fixation January 2006 - December 2011**



Source: ECB (2012) Euro area and national MFI interest rates (MIR)

Interest rates on new loans to NFCs, applied by resident credit institutions, have generally been increasing throughout 2011. However, interest rates on the stock of outstanding NFC loans remained broadly unchanged over the last quarter of 2011, across all maturity categories, reflecting the subdued levels of new lending i.e. there is not enough volume of new lending relative to the previous period stock to make an impact of any magnitude on the outstanding amount interest rates<sup>55</sup>.

<sup>55</sup> Central Bank (2012) Quarterly Bulletin, Q1 January 2012.

### 3.2.5 Developments Within the Banking Sector

Clearly, the health of the banking sector is critical to their ability to lend funds to other businesses. There has been huge change in the Irish banking sector since 2008. Despite progress, it is unlikely that the Irish banks will return to health in the near term given their dependence on official financing, weak deposit performance, weak loan performance and poor credit ratings. Key developments are outlined below:

- The recapitalisation of Allied Irish Bank, Bank of Ireland, Irish Life and Permanent and EBS Building Society was substantively completed at end-July 2011. Domestically owned banks have been recapitalised at a significantly lower-than-earlier anticipated cost to the State. The merger of Anglo Irish Bank and Irish Nationwide Building Society (INBS) to form the Irish Bank Resolution Company (IBRC) was completed on 1 July 2011; its primary role will be the recovery of the maximum value possible from the assets of Anglo Irish Bank and INBS over time for the taxpayer. The legal merger of Allied Irish Bank and EBS Building Society was completed on 1 July 2011. The assessment of options to strengthen the submitted restructuring plan for Irish Life & Permanent has begun. Direct state support provided to date for Ireland's domestically owned banks amounts to some €62.8 billion, equivalent to more than 40 per cent of 2010 GDP, almost 74 per cent of which was injected before end December 2010<sup>56</sup>.
- The Credit Unions were inspected between July 2010 and March 2011 to complete an assessment of their loan portfolios and progress has been made in dealing with remaining weaknesses in the credit union sector. The Interim Report of the Commission on Credit Unions noted that 56 out of 400 plus Credit Unions are undercapitalised, with 27 of these seriously undercapitalised<sup>57</sup>.
- Banks have been engaged in capital liability management exercises with a view to limiting the amount of public funds that will have to be committed to ensure that all institutions meet the capital requirements set out following the 2011 Prudential Capital Adequacy Review (PCAR) results published at the end of March 2011<sup>58</sup>. A recapitalisation need of €24 billion was identified in the PCAR, including €5.3 billion in additional capital buffers designed to shore up market confidence<sup>59</sup>. The results of the July 2011 European Banking Authority (EBA) stress tests on Allied Irish Bank, Bank of Ireland and Irish Life and Permanent showed that the Irish banks met the stress requirements and did not require additional capital beyond the requirement set in the Financial Measures Programme published in March 2011<sup>60</sup>.
- The banks have also been engaging in a process of de-leveraging whereby they are disposing of non-core assets over time, in order to bring down their loan-to-deposit ratios and reduce their dependence on central bank funding. In the aggregate, domestic banks' deleveraging has exceeded the programme's targets for 2011 as a whole<sup>61</sup>.

---

<sup>56</sup> European Commission (2011) European Economy Occasional Papers: Economic Adjustment Programme for Ireland - Autumn 2011 Review.

<sup>57</sup> European Commission (2011) European Economy Occasional Papers: Economic Adjustment Programme for Ireland - Autumn 2011 Review.

<sup>58</sup> Central Bank (2011) Quarterly Bulletin Q3, July 2011.

<sup>59</sup> European Commission (2011) European Economy Occasional Papers: Economic Adjustment Programme for Ireland - Autumn 2011 Review.

<sup>60</sup> Central Bank (2011) 2011 EU-Wide Bank Stress Test Results for Irish Banks Published, Press Release 15th July 2011.

<sup>61</sup> European Commission (2012) European Economy Occasional Papers: Economic Adjustment Programme for Ireland - Winter 2011 Review.



- Significant wholesale funding transactions with market counterparties have been executed by domestically owned banks, whilst reliance on Central Bank funding has stabilised. Domestically owned banks have continued to make good progress towards diversifying their sources of funding, while reducing reliance on central bank financing. Despite the very challenging market conditions, deposit inflows were recorded in the third quarter of 2011, interrupting sustained quarterly deposit outflows that had continued from the first quarter of 2010 until the end of the second quarter in 2011<sup>62</sup>.
- Significant progress has already been achieved with respect to the Central Bank of Ireland's continuous efforts to strengthen supervision of credit institutions. All actions identified as priorities in the Bank's 2010 strategy for banking supervision have been taken and additional initiatives for 2011 and 2012 continue to be developed and implemented. These include new provisioning requirements, new public disclosure requirements, a new risk assessment framework, rollout of a new performance management system and an enhanced training programme for all credit institutions' supervision staff. Preparatory work on the PCAR 2012 programme has already started with a view to ensuring high quality standards for the 2012 stress test exercise<sup>63</sup>.
- Irish Government debt and government-guaranteed debt of the Irish banks have been downgraded a number of times. In July 2011, Moody's downgraded the government-guaranteed debt of five Irish banks from Baa3 to Ba1 with a negative outlook<sup>64</sup>. This action follows Moody's downgrade of Ireland's government bond ratings from Baa3 to Ba1 with a negative outlook. In April 2011, Moody's downgraded by two notches the long-term bank deposit ratings of Allied Irish Bank, Bank of Ireland, EBS Building Society and Irish Life & Permanent. As of March 2012, Bank of Ireland is rated Ba1. Allied Irish Bank, EBS and Irish Life & Permanent are rated Ba2. The shift from Baa to the lower Ba ratings signals a change in perception that the lenders have moved from medium investment grade, with 'some speculative elements and moderate credit risk' to being judged to 'have speculative elements and a significant credit risk'. This has implications for the banks access to funding as well as the cost of funding.

### 3.3 Equity and Other Funding Sources

Bank finance, while important is just one source of finance. Based on the Mazars SME Lending Demand Study, November 2011 and the CSO Access to Finance Survey, May 2011 a number of non-bank finance sources are being utilised and these include:

- Equity finance which comprises business angels and private investors, venture capital, private equity and government equity.
  - Business angels and private investors are particularly important to firms aged less than five years old.

<sup>62</sup> European Commission (2011) European Economy Occasional Papers: Economic Adjustment Programme for Ireland - Autumn 2011 Review.

<sup>63</sup> European Commission (2011) European Economy Occasional Papers: Economic Adjustment Programme for Ireland - Autumn 2011 Review.

<sup>64</sup> Gradations of creditworthiness are indicated by rating symbols, with each symbol representing a group in which the credit characteristics are broadly the same. There are nine symbols (Aaa, Aa, A, Baa, Ba, B, Caa, Ca, and C) used to designate least credit risk to that denoting greatest credit risk. Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa.

- Government financial supports and equity are particularly important for firms aged less than ten years.
- Off-balance sheet financing which includes lease financing, hire purchase and factoring.
  - Lease financing represents a small proportion of financing of firms.
  - Hire purchase or leasing which represent secured financing based on the existence of a tangible asset, for example a piece of machinery<sup>65</sup>.
  - Factoring which is a financial transaction whereby a business sells its accounts receivable (i.e. debtor invoices) at a discount to receive the money before the invoice payment due date. The factor provider usually charges the seller a service charge, which is interest based, depending on how long the factor provider must wait to receive payment from the debtor via the seller who generally acts as a collection agent thus maintaining the customer relationship.
- The Mazars SME Lending Demand Study, November 2011 shows that 6 per cent of micro enterprises, 11 per cent of small enterprises and 19 per cent of medium enterprises sought non-bank finance over the six months to October 2011. Of those applications where a decision had been reached, 55 per cent of enterprises were successful in obtaining non-bank finance and 7 per cent were partially successful<sup>66</sup>.
- CSO and Central Bank data show an increasing percentage of enterprises seeking equity investment and an increased reliance on equity investment. The Non-Financial Corporation sector continued to use shares and other equity as its main source of funding in Q3 2011, at 54 per cent<sup>67</sup>. However, there are concerns that potential equity investors are also facing capital constraints as a result of the economic crises.
- The CSO Access to Finance Survey, May 2011 shows an increase in the percentage of enterprises seeking equity finance between 2007 and 2010 from 3.3 per cent to 4.3 per cent<sup>68</sup>. This growth was fuelled by increased interest from small enterprises with 10-49 employees. However, the overall success rate in attracting equity investment decreased marginally from 66.1 per cent in 2007 to 65.4 per cent in 2010. While the success rate of small enterprises increased from 62.2 per cent to 63.6, the success rate of medium and large enterprises decreased from 81.8 per cent to 75 per cent over this period.
- Central Bank data highlights growth in equity funding levels<sup>69</sup>. From Q3 2004 onwards, funding through loans tended to be proportionately higher than equity funding. This trend was reversed in Q1 2010. The increased reliance on equity funding relative to loans continued in Q4 2010, with a 3.2 per cent increase in the volume of equity funding and a corresponding 3.6 per cent decrease in loans. The growth in equity financing is welcome given the challenges facing the banks.
- Despite growing interest and success in raising funds, the equity investment environment also faces significant challenges arising from the economic and financial crises. From an enterprise perspective, these macro conditions distil into very real micro impacts. Volatility in the funding markets increases the risk and therefore the return demanded by

---

<sup>65</sup> European Commission (2009) Cyclicity of SME finance: Literature survey, data analysis and econometric analysis.

<sup>66</sup> Mazars (2011) SME Lending Demand Study, November 2011.

<sup>67</sup> Central Bank (2012) Quarterly Bulletin Q2, April 2012

<sup>68</sup> CSO (2011) Access to Finance Survey.

<sup>69</sup> Central Bank (2011) Quarterly Bulletin Q3, July 2011.

equity investors. This has implications across equity markets, including the venture capital market. Irish venture capital firms together with international venture capital firms have invested €1.5 billion each in Irish SMEs since the year 2000. Expenditure on R&D by venture capital backed companies in 2009 was €148 million. This represents 28 per cent of total Irish indigenous Business Expenditure on Research and Development (BERD) and represents 49 per cent of all SME's share of total spend on BERD. However, there are concerns that potential venture capital investors are also facing capital constraints which will constrain their ability to invest. It is also notable that the Irish Stock Exchange has suffered considerable losses in recent years - in particular, given its concentration in bank shares. With the decline in share price and the subsequent State ownership, this has impacted on the index. There have also been a number of high profile de-listings. This makes the current environment very challenging for the Irish Stock Exchange, but there remain significant Irish companies listed.

### 3.4 Development Agency Supports

The Mazars SME Lending Demand Study, November 2011 highlights that government financial support was the most popular form of non-bank finance<sup>70</sup>. There are a wide range of supports available to both new and existing businesses from state agencies both here in Ireland and within the EU.

- Enterprise Ireland disbursed financial supports to industry in 2010 amounting to €356.9 million. This included €44.5 million in share capital investment, €15.6 million in seed and venture capital funds, €77.7 million in R&D, training and other capability building support, €17.4 million in capital and employment support for capacity expansion, and €65.2 million in third level research<sup>71</sup>.
- In addition, Enterprise Ireland provided funding of €37.4 million to third party agencies on behalf of the Department of Jobs, Enterprise and Innovation, and administered grant support schemes on behalf of the Department of Jobs, Enterprise and Innovation and the Department of Agriculture, Fisheries and Food to the value of €99.1 million<sup>72</sup>.
- The Enterprise Stabilisation Fund was established by Government in 2009 to help viable, high growth potential enterprises survive the global downturn and Enterprise Ireland was mandated to administer it. During 2010, Enterprise Ireland continued to make interventions through this fund and, to date, have approved financial support of €84.5 million to 227 companies across all sectors.

---

<sup>70</sup> A number of government bodies and agencies provide funding and other supports to businesses, particularly small businesses including the City and County Enterprise Boards (CEBs), Enterprise Ireland, Bord Iascaigh Mhara (BIM), Fáilte Ireland, and Údarás na Gaeltachta.

<sup>71</sup> Financial payments to companies by Enterprise Ireland in 2009 amounted to €156 million. This included €74 million in share capital investment, €62.8 million in R&D, training and other capability building support, and €19.2 million in capital and employment support for capacity expansion.

<sup>72</sup> This included funding to the Employment Subsidy Scheme (€80.0m), Dairy, Beef & Sheep meat Funds (€19.1m), County Enterprise Boards (€31.8m), Business Innovation Centres (€2.2m) and the Crafts Council of Ireland (€3.4m)

Enterprise Ireland also endeavours to support the broader funding environment.

- Innovation Fund Ireland was launched in September 2010 and is a component of the National Recovery Plan 2011-2014. Through this initiative, the Government made available €125 million for Enterprise Ireland to invest in international venture capital funds that establish a presence in Ireland and that invest, at a minimum, an equivalent amount in Irish companies or companies with a significant presence in Ireland. A further €125 million has been made available by the National Pension Reserve Fund for this initiative<sup>73</sup>. The first call for expressions of interest in Innovation Fund Ireland closed on the 26th November 2010, with 32 expressions of interest received<sup>74</sup>. The second call for Innovation Fund Ireland will be made in 2012, worth approximately €60 million, to invest in Irish based innovative companies. The Innovation Fund Ireland has been created to increase the availability of risk capital for early stage and high-growth companies.
- Enterprise Ireland also partners with Irish seed and venture capital funds and, in 2010, significant progress was made in increasing the funding available to new businesses in Ireland. Four new funds were set up by Enterprise Ireland in association with Bank of Ireland, Allied Irish Bank, University of Limerick Foundation and the National University of Ireland Galway Foundation to provide critical seed funding for high potential start-up companies. These funds have a total of €124 million available for investment. Since 2007, 11 seed and venture capital funds have been established with investment funds under management of €645 million. In 2009 venture capital backed companies' generated exports of €539 million<sup>75</sup>.
- The Halo Business Angel Network and the regional business angel programmes based in the Business Innovation Centres (jointly supported by Enterprise Ireland and InterTradelreland) develop and foster the growth of business angel activity in Ireland. Private business angel investors are matched with pre-screened investment opportunities in start-up enterprises. During 2010, investments of €5.26 million were made by business angel investors in 25 client companies.

Other sources of funds include County and City Enterprise Boards (CEB's). These provide a range of financial supports designed to assist with the establishment and or growth of small scale businesses employing up to ten people. Supports available include feasibility/innovation grants, priming grants, business expansion grants, refundable aid, and equity investment options. The Action Plan for Jobs 2012 has committed to establishing a new "one-stop-shop" micro enterprise support structure through the dissolution of the existing CEB offices and the creation of a new Micro Enterprise and Small Business Unit in Enterprise Ireland that will work with Local Authorities to establish a new network of Local Enterprise Offices (LEOs) in each Local Authority. The new LEOs will combine the enterprise support service of the previous CEBs and the business support work of the Business Support Units in the local authorities. A key role will be providing mentoring for micro-business.

---

<sup>73</sup> Enterprise Ireland (2011) Annual Report and Accounts 2010.

<sup>74</sup> Dáil Éireann (2011) Written Answers, Tuesday 29th March 2011 - Minister Bruton.

<sup>75</sup> IVCA (2010) The Economic Impact of Venture Capital in Ireland - 2009.

### 3.5 European Supports

- European Investment Fund (EIF) measures are co-funded by the European Regional Development Fund (ERDF). The EIF can offer loans, equity, guarantees to financial intermediaries targeting SMEs and technical assistance to microfinance providers through different EU initiatives / mandates including CIP Microcredit Guarantee Window; European Progress Microfinance Facility; JEREMIE; and technical assistance under the JASMINE initiative<sup>76</sup>. Commercial banks have indicated that the heavy reporting requirements required to access these funds, limit their commercial attractiveness.
- European Investment Bank (EIB) measures are not co-funded by the ERDF and are therefore more attractive to banks, as the related reporting requirements are less than the EIF. Measures from the EIB would also seem to be more attractive to business as the EIB is not-for-profit and therefore provides a source of capital at lower cost than the market. The EIB offers five main services to clients - loans, technical assistance, guarantees, venture capital and microfinance<sup>77</sup>.

## 4. Current Policy Context

A range of initiatives have been developed to support the flow of credit to enterprises since 2008. In addition to initiatives to support the banking sector (discussed in section 3.2.5), a range of initiatives has been developed to encourage lending:

### 4.1 Build Better Business Banking Relationships

**Code of Conduct for Business Lending to SMEs:** A revised ‘Code of Conduct for Business Lending to Small and Medium Enterprises’ was launched in January 2012. The code aims to facilitate access to credit, promote fairness and transparency, and ensure that banks will assist borrowers in meeting their obligations, or otherwise deal with an arrears situation in an orderly and appropriate manner. Under the code, banks are required to offer their business customers annual review meetings, to inform customers of the basis for decisions made, inform them of their right to appeal and to have written procedures for the proper handling of complaints. Where a customer gets into difficulty, the banks will give the customer reasonable time and seek to agree an approach to resolve problems and to provide appropriate advice. Based on the Mazars SME Lending Demand Study, November 2011, 57 per cent of SMEs were aware of the original Code of Conduct which was introduced in 2009.

**Credit Review Office:** The Credit Review Office was established in April 2010 to conduct independent and impartial reviews of the bank’s decision for SMEs, sole traders and small and medium-sized farm enterprises that have had their application for credit refused or reduced or have had credit facilities withdrawn, and feel that the bank’s decision is unjustified. The review process covers decisions to refuse, reduce or withdraw credit facilities (including applications for restructured credit facilities) from €1,000 up to €500,000, as of August 2011. While the Office has no statutory or regulatory powers, if the application is deemed

<sup>76</sup> [http://www.eif.org/EIF\\_for/microfinance/index.htm](http://www.eif.org/EIF_for/microfinance/index.htm)

<sup>77</sup> <http://www.eib.org/products/index.htm>

creditworthy in its opinion, the bank is asked to comply, or to explain their decision not to lend within five working days of being informed. The Credit Review Office's review process has resulted in reversals in lending decisions. Applications from borrowers to the office up to March 2012 have been relatively low, with 153 formal applications. However, through its helpline it has taken 1,357 calls to date and had 12,906 web visitors since its inception<sup>78</sup>. A radio and press advertising campaign in 2011 to promote awareness of this office was welcome.

## 4.2 Increase Lending

**Lending Targets:** As part of the recapitalisation process, from 1<sup>st</sup> April 2010, Allied Irish Bank and Bank of Ireland agreed to sanction €3 billion each for new and restructured lending for two years (totalling €12 billion). Both banks have exceeded their €3 billion lending target for the first year (€8.036 billion in total), and both have indicated that they have achieved their 2011 targets<sup>79</sup>. In 2012, the Minister for Finance increased the lending targets to €3.5 billion for new and restructured sanctions for each bank and €4 billion each in 2013.

**Non-Traditional Bank Lending:** In announcing the lending targets in March 2010, the Minister for Finance placed a requirement on the banks to:

- Commit resources to work with Enterprise Ireland and the Irish Banking Federation (IBF) to develop sectoral expertise in the modern growth sectors of the Irish economy.
- Explore with Enterprise Ireland and the IBF how best to develop the range of banking services that Irish SMEs trading internationally will need.
- Develop expertise and bring forward new credit products in areas where cash flow, rather than property or assets, is the basis for business lending.

Enterprise Ireland is supporting banks as they develop knowledge around new economy sectors. Additional support is provided through workshops and Enterprise Ireland also engages on individual cases. This is to address the knowledge gap that has traditionally led banks to not lend to business for research and development and market development purposes.

In line with the Programme for Government, new initiatives are also being progressed:

**Temporary Partial Credit Guarantee Scheme:** Forfás, Enterprise Ireland and others have worked with the Department of Jobs Enterprise and Innovation on a temporary partial credit guarantee scheme. The scheme has been designed and will be rolled out in mid-2012 to support new lending to SMEs. It will be reviewed at the end of year one. When assessed, potential may exist to extend the partial credit guarantee scheme by including an add-in of a commercial export specific credit guarantee facility. For every €100 million extra in loans guaranteed under this demand-led scheme, over 1,200 small businesses will benefit.

**Micro-finance Fund:** A micro finance fund will be launched in 2012, generating up to €100 million in extra lending for micro-businesses over ten years. It is currently being developed to

---

<sup>78</sup> Credit Review Office (2012) Seventh Quarterly Report from John Trethowan, Credit Reviewer.

<sup>79</sup> Dáil Written answers Thursday, 2 February 2012, Minister Noonan.

provide loans to sustainable micro-businesses. It will be targeted at newly established or growing micro-businesses across all industry sectors, employing not more than 10 people. It will provide loans of up to €25,000 for commercially viable proposals that do not meet the conventional risk criteria applied by commercial banks.

**Prompt Payment:** To improve cash flow, from July 2011, the Government has extended the 15 day prompt payment rule beyond central Government Departments to include the Health Service Executive, the local authorities, state agencies, and all other public sector bodies, (with the exception of the commercial semi-state bodies).

**Regional Meetings:** As set out in the Action Plan for Jobs 2012, a series of regional meetings will provide a platform for an open exchange of views and genuine engagement between key stakeholders. The meetings will explore the findings of the Mazars SME Lending Demand Study, November 2011 by the Department of Finance and will discuss any further suggestions for actions that might be taken to improve access to credit for SMEs.

**Small Business Finance Website:** The Small Business Finance website is an online portal to assist small businesses to find the information they need about getting access to finance at [www.smallbusinessfinance.ie](http://www.smallbusinessfinance.ie). It is a joint initiative between the Irish Banking Federation (IBF) and Chambers Ireland which was launched in February 2012.

## 5. Policy Issues Arising

Given the complexity surrounding the market for funding and the policy solutions being advanced, a wide range of measures are required to support an improved lending environment. As noted earlier, a recovery can be creditless because credit is not available or because it is not needed. While international evidence suggests that the absence of credit growth in weak economic recoveries generally arises from problems with the availability of credit, it seems clear that credit demand is also an issue in Ireland. For example, the Credit Review Office indicates that a legacy of previous debt is a major constraint on new lending in Ireland<sup>80</sup>. Actions to support a return to credit growth will be required through the banking sector and the broader enterprise sector.

This section sets out actions to support a return to funding growth under four headings. An earlier draft of this paper fed in to the Action Plan for Jobs 2012. It is welcome that the Plan<sup>81</sup> sets out agreed and time bound actions to address many of the issues raised in this paper. A full list of measures relating to access to finance from the Action Plan for Jobs 2012 is contained in Appendix I. Policy actions recommended and actions agreed under the Action Plan are set out below.

---

<sup>80</sup> Credit Review Office (2011) Fourth Quarterly Report from John Trethowan, Credit Reviewer.

<sup>81</sup> Department of Jobs Enterprise and Innovation (2012) Action Plan for Jobs 2012.

## 5.1 Banking Sector

- Considerable uncertainty remains over the impact of the banking crisis on banks' ability to raise funds and support lending. There is a need to ensure that the efficacy of measures put in place to improve credit flows through recapitalisation, deleveraging and restructuring of the banks can be assessed and action taken if required.
- There is a need for a cultural shift in Irish bank lending to align with the strategic economic growth targets of the economy. In this regard, a move towards a banking system with an in-depth understanding of innovative sectors (e.g. software, telecoms, digital content, medtech and life-sciences) and a pro-active overseas banking network are required in the medium term. More immediately, there needs to be a focus on supporting internationally trading businesses in terms of both the provision of credit and the bank facilities/products. In particular, concerns have been raised about the availability of products such as international invoice discounting, performance bonds and specialised leasing, amongst others. For example, banks can be reluctant to provide leases for specialist equipment where there is no obvious resale market in Ireland or to provide international invoice discounting to exporters in markets the banks are not familiar with.
- The collapse of the domestic banks and the withdrawal of many foreign banks (e.g. Bank of Scotland Ireland, Halifax, and Bank of America's MBNA) raise concerns over the levels of competition in the banking sector. Three banks dominate lending in the SME market, with 78 per cent of those applying for credit in the Mazars SME Lending Study, November 2011 seeking credit from the pillar banks. In addition, the costs of funds for Irish banks are increasing which is being passed on to customers when their facilities are being reviewed. Efforts to encourage existing foreign banks to retain lending operations in Ireland and to attract new entrants in the medium term, while challenging, are important. Potential may also exist for Enterprise Ireland and the Irish banks to work with clients to establish business banking relationships with banks in export markets.
- While data on the supply of credit has improved significantly since 2010, further improvements would be welcome, in particular, classification of the supply of credit by the principle purpose of the credit e.g. in a situation where farmers take out loans for property development, the credit supplied would be captured under the agriculture sector and not construction.

Building on this report, the Action Plan for Jobs 2012 commits to monitoring the lending targets for the pillar banks, with a particular focus on new lending; and conducting a follow-up survey on demand for credit from SMEs. These measures will be implemented and monitored over the next twelve months.

## 5.2 Building Business Banking Relationships

Efforts have been made to strengthen business relationships between banks and enterprise by putting in place a code of conduct for business lending to SMEs, establishing and developing the Credit Review Office and training bank staff. Further efforts are required to:

- Encourage businesses to talk to their banks and to apply formally for credit. It has been argued that negative publicity has led many businesses to believe that their banks are 'closed for business'. The Mazars SME Lending Study showed that 7 per cent of businesses that did not apply for credit gave the reason that they thought banks were not lending.



- Following the crises, the banks are increasingly returning to becoming prudent cash flow lenders rather than focusing on collateral. Efforts are required to support businesses in improving their cash flow planning.
- Train bank staff to support lending to viable, cash flow based businesses.
- Potential exists to enhance the code of conduct to SMEs by the Central Bank.

Building on this report, the Action Plan for Jobs 2012 commits to working with the banking sector to focus on and understand the key sectors of growth in the economy; to help SMEs improve the quality of their loan application; to ensure businesses are notified of their right of appeal through the Credit Review Office if they have been refused credit; to ensure sufficient training and development procedures are in place to enable staff to make more informed lending decisions; and assess the Credit Review Office to ensure SMEs are getting the support on bank lending they require.

### 5.3 Increased Lending

Increasing lending is a critical challenge. Actions include:

- The timely implementation of announced initiatives such as the partial credit guarantee scheme, micro-finance fund and Enterprise Ireland's development capital scheme.
- Continued monitoring of the agreed lending targets and their effectiveness. While new lending is critical, it is also important that existing lending is maintained and restructured (e.g. continuation of overdrafts, restructuring of overdrafts into term loans, etc.).
- Investigate measures that may aid overleveraged businesses, which can demonstrate future viability through a recovery plan such as debt/equity swaps or restructuring.

Building on this report, the Action Plan for Jobs 2012 commits to rolling out the temporary partial credit guarantee scheme; rolling out the micro-finance fund to provide loans of up to €25,000, targeted at start-up, newly established, or growing micro enterprises across all industry sectors; and assessing the feasibility of introducing a new structured and non-judicial debt settlement and enforcement system to meet SME needs - 'Examinership Light'.

### 5.4 Equity

Encouraging equity investment represents a mechanism to some help over-indebted but viable businesses to rebalance their balance sheets. Data from the Central Bank indicates that reliance on equity funding increased over the fourth quarter of 2010, with its share growing by 3.2 per cent, in contrast to loan funding whose share declined by 3.6 per cent<sup>82</sup>. Further actions are required to:

- Seek approval for the extension of the Employment and Investment Incentive Scheme (EIS) beyond its current deadline of 31st December 2013 to ensure certainty for enterprise, investors and fund operators.

---

<sup>82</sup> Central Bank (2011) Quarterly Bulletin Q3, July 2011.

- Make legislative amendments to support venture capital investments in companies engaged in R&D and innovative activities. The Programme for Government commits to supporting the development of a more dynamic, venture capital industry in Ireland by seeking to attract top tier venture financing and investment companies to Ireland.
- Undertake further research to assess the use of equity, its realistic potential to rebalance business balance sheets and the policy options available.

The Action Plan for Jobs 2012 commits to designing and launching a new Enterprise Ireland development capital scheme to address a funding gap for mid-sized, high-growth, indigenous companies; launching a second call under the Innovation Fund; developing the mandate of the Strategic Investment Fund; establishing a working group to ascertain the need for the State to continue matching support for the development of the domestic venture capital sector; and promoting the Employment and Investment Incentive Scheme (EIS). It is important that the timelines for delivery of these recommendations are adhered to. Building on this report, Forfás, working with Enterprise Ireland, and the Department of Jobs, Enterprise and Innovation, and the Department of Finance have been requested to review the equity landscape in Ireland with a view to introducing measures to support equity investment.

## 6. Conclusions

Finance is vital for enterprise to survive and at present bank lending is a central element of the funding environment. Analysis of bank lending data and its conclusions is complex. There is no single comprehensive database comprising the supply of and demand for credit. Credit advanced to core<sup>83</sup> Irish private-sector enterprises experienced an annual decline of 7.2 per cent in the year to December 2011 with outstanding credit to private-sector enterprises reflecting June 2005 levels. While very limited data is available on non-bank funding sources, it is clear that non-bank sources are also adjusting to the financial and credit crises. Therefore a wide range of actions are required to improve access to finance (not just bank lending), as discussed in this paper, with the implementation of the finance measures in the Action Plan for Jobs 2012 a vital part of this process.

---

<sup>83</sup> Core sectors exclude property-related and financial sectors.

## Appendix I: Action Plan for Jobs 2012 - Access to Finance Measures

|      |  |
|------|--|
| 1.33 | <p>Examine the feasibility of introducing a new structured and non-judicial debt settlement and enforcement system to meet SME needs - “Examinership Light”.</p> <p><b>(DJEI, Company Law Review Group)</b></p>  |
| 3.29 | <p>Design and launch a new Development Capital Scheme, aimed at addressing a funding gap for mid-sized, high-growth, indigenous companies with significant prospects for jobs and export growth. This Scheme will support companies which would not generally fall within the focus of seed or venture capital funds, by leveraging further institutional capital. €50 million of State investment is expected to leverage up to an extra €100 million in private sector funding.</p> <p><b>(Enterprise Ireland)</b></p> |
| 3.30 | <p>Roll-out the temporary targeted partial credit guarantee scheme, to complement existing initiatives to improve the credit environment and to address specific market failures.</p> <p><b>(DJEI)</b></p>   |
| 3.31 | <p>Launch a second call under Innovation Fund Ireland worth approximately €60million, to attract additional significant venture capital players to Ireland.</p> <p><b>(Enterprise Ireland)</b></p>   |
| 3.32 | <p>Develop the mandate of the new Strategic Investment Fund for targeted investment to enterprise via equity and debt funding.</p> <p><b>(D/Finance / NPRF / DJEI)</b></p>   |
| 3.33 | <p>Work with the banking sector both on one-to-one firm issues and to assist them in a cultural shift in lending practices towards sectors that are critical to economic growth. Develop better protocols with banks to enhance sectoral expertise within the banks and the range of lending products to meet exporter needs and tourism providers.</p> <p><b>(D/Finance / Credit Review Office / DJEI / Enterprise Ireland)</b></p>   |
| 3.34 | <p>Monitor closely the lending targets for pillar banks and ensure these targets are met, and develop a sharper focus on the “new money” element.</p> <p><b>(D/Finance / Credit Review Office / DJEI)</b></p>  |
| 3.35 | <p>Engage with stakeholders on the findings revealed in credit supply and demand surveys with a view to identifying and addressing blockages in the system.</p> <p><b>(D/Finance / Credit Review Office / DJEI)</b></p>  |

|      |  |
|------|--|
| 3.36 | <p>Conduct a follow-up survey on demand for credit from SMEs.</p> <p><b>(D/Finance)</b></p>  |
| 3.37 | <p>Work with banks and small business representative organisations to help SMEs improve the quality of loan application.</p> <p><b>(Central Bank/Credit Review Office)</b></p>   |
| 3.38 | <p>Arrange that banks formally notify clients who have been refused loans of the right to an internal review by the bank and an appeal to the Credit Review Office.</p> <p><b>(Central Bank)</b></p>   |
| 3.39 | <p>Work with the banks to ensure that sufficient training and development procedures are in place to enable staff to make more informed lending decisions, in addition to monitoring refusal rates, internal appeals and appeals.</p> <p><b>(D/Finance/ Credit Review Office / DJEI)</b></p> |
| 3.40 | <p>Assess the Credit Review Office to ensure SMEs are getting the support on bank lending they require.</p> <p><b>(D/Finance / Credit Review Office / DJEI)</b></p>  |
| 3.41 | <p>Review the equity investment landscape in Ireland with a view to introducing actionable steps (enterprise supports, tax, etc.) to support equity investment in productive firms.</p> <p><b>(Forfás / DJEI D/Finance / Enterprise Ireland)</b></p>   |
| 3.42 | <p>Establish a working group to ascertain the need for the State to continue its support, on the same terms as the private sector, for the development of the domestic venture capital sector.</p> <p><b>(DJEI, EI, NPRF)</b></p>  |
| 3.43 | <p>Promote the Employment and Investment Incentive Scheme for business expansion and ensure the objectives of the Scheme are being achieved and assess if any amendments are required.</p> <p><b>(D/Finance / DJEI)</b></p>  |
| 3.44 | <p>Make available to SMEs an Official Notice regarding the Government's current 15 day Prompt Payment Practice.</p> <p><b>(DJEI)</b></p>   |

## Appendix II: A Summary of Potential Funding Options<sup>84</sup>

Outside personal equity, Irish firms heavily rely upon bank funding options. Banks offer different types of lending products for business customers, the most common types of which are outlined below:

- **Overdraft:** An overdraft is an agreed limit on a current account which can be used to fund the timing gap between income and expenditure. Its purpose is to help a business meet its day-to-day cash flow demands. In any 12-month period, the balance on the account should fluctuate between credit and debit. In general, this credit facility is provided on an annual basis, i.e. approved annually and rolled over.
- **Business Loans:** A business loan is a credit facility, which is repaid by the business by way of regular repayments over an agreed term - typically between three and fifteen years depending on the purpose of the borrowing. Repayments usually include interest and part of the principal amount borrowed.
- **Leasing Agreement (Asset Finance):** is a credit facility where the lender purchases an asset and hires it out for a fixed period of time at an agreed rental rate. Generally, leasing agreements are for a period of 3 to 5 years and can be used to fund moveable plant and equipment. Under Leasing Agreements, ownership of the asset is not transferred at the end of the agreement. Leasing can have tax benefits.
- **Invoice Discounting:** Many businesses suffer from slow or late payment of invoices. Invoice discounting can help a business to overcome cash flow problems by giving immediate access to a pre-determined percentage of invoiced debt without affecting the relationship with customers. However, when sales are decreasing this reduces the level of finance that can be obtained.
- **EIB Loan Scheme:** The European Investment Bank (EIB) Loan Scheme provides competitively priced medium term funding to help fund business expansion projects for SMEs. It is available from some Irish Banks in partnership with the EIB.
- **Hire Purchase Agreement:** is a credit facility where the lender purchases an asset and hires it to the business for a fixed period of time at an agreed rental rate. Until the final payment is made, the asset is owned by the lender, but the borrower will have full use of the asset for the term of the hire purchase agreement.

External equity finance comprises of:

- **Business Angels** - these are private individual investors who invest capital in companies during the early stages of development. Business Angels usually seek active participation, contributing their business know-how or experience in company management. They also generally expect an equity stake in the business in which they invest.
- **Venture Capital** - is money invested in innovative enterprises in exchange for a stake in the business. The business can also draw on the expertise and advice of the venture capitalists.

---

<sup>84</sup> Credit Supply Clearing Group (2010) Your Business Your Bank.

- Business Expansion Scheme (BES)/Enterprise Investment Incentive Scheme (EIS) - allows individual investors to obtain income tax relief on investments in certain new businesses. There is no tax advantage for the company in receipt of the BES/EIS but securing this funding may enhance its ability to attract other external funding.
- Seed Capital Scheme - provides for a refund of income tax already paid by an individual when that individual sets up and takes employment in a new qualifying business. Tax years for which an individual may claim refunds can be selected from any or all of the six years prior to the year of investment, subject to a €100,000 limit in each year.

There are also a wide range of supports available to both new and existing businesses from State Agencies both here in Ireland and within the EU. These supports range from grants for R&D, Business Expansion, Business Stabilisation, Exporting, etc. to providing advice and expertise of business matters, e.g. accessing international markets, etc.

In addition, a number of other funding options are available for larger firms including:

- Commercial Paper - this is an unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. Maturities on commercial paper rarely range any longer than 270 days. The debt is usually issued at a discount, reflecting prevailing market interest rates.
- Medium Term Notes - this is a debt note that usually matures in 5-10 years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis.
- Mezzanine Fund Financing - A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. Mezzanine financing is debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full.
- Private Placement - The sale of securities to a relatively small number of select investors as a way of raising capital. Investors involved in private placements are usually large banks, mutual funds, insurance companies and pension funds.
- Public Debt - A public placement is where a security is offered to the whole market rather than to selected investors. It is usually listed on a stock exchange in relatively small denominations. The costs to the issuer are usually higher than for a private placement but there may be benefits in obtaining a wider range of investors in terms of public recognition and liquidity for the secondary trading of the security.

The publications of Forfás and the advisory groups to which it provides research support are available at [www.forfas.ie](http://www.forfas.ie)

To sign up for our email alerts contact us at [info@forfas.ie](mailto:info@forfas.ie) or through the website.

April 2012

## **Forfás**

Wilton Park House  
Wilton Place  
Dublin 2

Tel: +353 1 607 3000  
Fax: +353 1 607 3030

[www.forfas.ie](http://www.forfas.ie)