Ibec submission to the Seanad Public Consultation Committee on Small and Medium Sized Business in Ireland

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By e-mail: seanadpublicconsult@oireachtas.ie

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I am pleased to communicate the views of Ibec and its members on the issues surrounding the growth of Small and Medium Sized Business (SMEs) in Ireland. Ibec represents the interests of Irish business including indigenous and multinational enterprises and SMEs, spanning all sectors of the Irish economy.

Ibec and its sector associations work with government and policy makers at a national and international level to shape business conditions and drive economic growth. A key part of this, which we have focused on in much of our work in recent years is reform of the environment to encourage small business and entrepreneurship. Although there have been some tax, regulatory and structural reforms aimed at small business and start-ups in recent years these have not gone far enough, in our view, to bridge the gap to having an indigenous sector on par with elsewhere in Europe.

Overview

Some notable successes aside, there is a strong argument that we have not done enough over the past 60 years to fulfil the promise of the First Programme for Economic Expansion to 'foster in every way' the development of Irish indigenous business. If we are to follow through on the economic promise of the last six decades, then it is evident we must go further than industrialisation by invitation and develop our indigenous enterprise base.

We have made some real progress in recent years. In order to survive the downturn firms have invested in new product, engaged in capital deepening and become leaner. The impact of this and better price competitiveness in the Irish economy can be seen in the fact that Irish exports over the eight years to 2017 were between five and six times more responsive to growth in global demand than they had been between 2001 and 2008. As a result, for the first time in 2015 agency figures showed Irish owned exporters accounting for a greater share of agency supported employment than foreign MNEs.

While Ireland does not produce enough start-ups, equally worryingly is not enough small companies make it big. Finance, access to export markets and the ease and cost of doing business all remain significant hurdles. We need a business environment that supports entrepreneurship and rewards innovation and risk taking. Enterprise policy must focus on helping companies scale up. An appropriate definition for a scale-up is as important for start-ups so that both groupings are given appropriate attention by policymakers.

We must go further, however. All available evidence shows that Irish indigenous firms are well below 'best in class' when it comes to management, innovation and exporting — three of the main drivers of business growth and productivity. Improving management practices, helping firms innovate or export earlier will increase the productivity and growth of Irish indigenous firms. We also have low start-up rates compared to the majority of our European neighbours – the second lowest in the EU15 and one-quarter that of the UK. We must do more to help people starting out on the journey of building a business.

To change this, we need to address what is within our control. Irish firms face a number of ongoing challenges to their growth. These include high legacy debts and costs, a small domestic market, a lack of diversified funding options, barriers to innovation and challenges accessing and competing for the right skills to help them grow. Below we set out some of the key policy levers which we believe can help Irish business to grow.

Business priorities to support SMEs

Recommendation 1: Improve investment supports for indigenous firms

Why?

Ireland's broader investment tax environment for indigenous business is an outlier in its lack of attractiveness by international norms. We have the third highest capital gains tax rate in the OECD, a stamp duty regime on shares which is the highest in the world (twice that of the second highest) and an R&D tax credit which is far too complicated and onerous for smaller firms to engage with.

In addition, feedback from our members and users of the EIIS, the state premier investment incentive for indigenous business, has shown that changes to the EIIS to make it compliant with state aid rules has increased the complexity of the scheme to the extent that firms and users of the scheme are finding it very difficult to operate the scheme (resulting in incomplete applications). The drop-off in applications in Q1 of 2018 (down by 47% year-on-year) is a clear indicator of the material impact this is having on confidence in the scheme and consequently in investment in Irish business.

This perverse treatment of investment by indigenous business cannot be allowed to continue if we are serious about growing internationally competitive companies.

Government should:

- Send a signal of intent to serial entrepreneurs by radically improving the CGT entrepreneurs' relief by introducing a 12.5% rate with no lifetime cap on gains.
- Renew confidence in the EII scheme by improving processing times, matching the UK's €2 million annual limit on investment (currently €150,000 in Ireland) and ending the uncertainty caused by the current system of split relief (based on employment levels or R&D expenditure) with full relief given in the investment year.
- Reduce the level of stamp duty on equity to UK levels (0.5%) over a period of three years in order to increase liquidity, make raising capital easier for Irish firms and reduce the cost of raising capital significantly.
- SMEs may be over-reliant on bank funding - partly an institutional issue but exacerbated by national tax systems – demonstrated by it being easy to start a business in Ireland but difficult to scale one. Government must do more to promote alternative investment sources.
- Improve information flow on all funding sources (e.g. VC, grants, tax, banks, angel etc) allowing start-ups to pick suitable strategy best suited to their ambitions and management style. Schemes and portals may exist but they are not well branded, marketed and suffer from lack of awareness. Monitoring of draw-down of national or EU funds & schemes targeted at start-ups and SMEs should occur and corrective action taken if poor take-up is identified.

Recommendation 2: Protecting the indigenous sector from Brexit

Why?

In the context of Brexit, companies will need support to diversify, innovate and re-align their business models. The education system will need support to provide the capacity for up-skilling. Supporting our domestic industries will mitigate the worst impacts of Brexit domestically. While progress has been made on issues surrounding trade questions at the European level there is significant uncertainty surrounding the outcome. In this context, there must be a stronger delivery on Brexit preparation and mitigation domestically. Yes, there are still major uncertainties which make it difficult to plan ahead for Government but the time for preparation is now. Ibec members will be making key decisions in advance of March 2019 and the Government can play a greater role in supporting them.

This does not just extend to the agrifood-sector but also to the wider domestic economy with tourism, forestry, traditional manufacturing, retail and energy, transport, utilities and telecoms all impacted either directly through loss of trade or otherwise through disruption of their supply chain. It is worth remembering that the need for diversification not only applies to exporting companies but also to those importing. 36% of Irish consumer goods are imported from the UK along with 23% of material goods which go into the production of finished goods here. Increases in tariff or non-tariff barriers, regulatory divergence or transport delays will impose significant costs on all areas of the Irish economy past the initial export shock. Companies will clearly need to diversify not just their export markets but also their sourcing strategy in response to these issues.

Government should:

Outline a Brexit strategy on assistance for firms to prepare for Brexit, not just limited to exporting companies

Strand 1:	Strand 2:
Put in place a multi-annual framework for funding Brexit mitigation beginning in Budget 2019. The resources required will be in the region of 5% of the value of current annual indigenous export sales to the UK	Continue work to put in place a broader temporary state aid framework to help Governments provide short-term assistance to companies
Measures under strand 1	**Measures under strand 2**
Introduce direct supports for companies looking to re-tool and re-invest in plant and machinery to produce product lines for new markets. This should take the form of pre-approved accelerated capital allowance scheme for projects which are deemed necessary under a clear Brexit related contingency plan. Provision must be in line with those already available for energy efficient equipment, with allowances available to be claimed at an accelerated rate of 100% in year 1	Introduce an enterprise stabilisation fund with assistance from EU colleagues. This would enable short-term financing similar to the supports that were introduced in 2009 that helped firms through the financial crisis and an increase in 'de minimus' levels of state aid
Allow companies claim VAT as an input credit at the same time as declaring their liability in order to minimise Cashflow needs. This VAT deferral licence regime already exists in the Netherlands. A review of Section 56 of the VAT regime (particularly the rules on group registrations) could provide a better solution in the long run.	Work to improve the terms and conditions under the current Brexit Loan Scheme which has interest rates of 4% and loan terms of only 3 years maximum
Introduce additional marketing and innovation supports for companies looking to reformulate, re-package or innovate their product lines for new markets	Review double tax agreements with high growth developing countries with a view to reducing withholding tax (particularly on royalty/licensing fees) facing companies trading with those markets
Introduce trade support measures, including further export trade financing and export credit guarantees to support the continued development of international export markets. This must also include supply-chain supports to companies in the non-tradeable sector.	

Recommendation 3: Unlock SME Growth Potential Through Innovation

Why?

We must look at boosting Ireland's capacity for innovation and exploitation of spill-overs. SMEs may experience greater challenges than larger companies to dedicate and develop internal resources needed to engage successfully with universities and to capitalise on their research outputs. These enterprises will require additional state support to build the absorptive capacity and to participate in any research collaboration.

The OECD have highlighted that the productivity gap between indigenous SMEs and larger multinational organisation is widening. Too many SMEs miss opportunities to fully realise the potential of research activity in higher education institutions, and too few have the knowledge and skills to develop, value and exploit the situation

The R&D tax credit has been a successful model in encouraging Irish companies to invest in R&D and create value in the economy. In line with international research an Ibec study showed that for every €1 given in tax credit to participating firms they spend in the region of an additional €2.40 on R&D over and above what they would otherwise have spent. Studies in the UK suggest this additional spend could rise as far as €3.60 in the long-run and that it is higher for smaller firms.

Government should:

- Introduce a simplified pro-forma R&D tax credit scheme for SMEs which allows smaller firms to overcome funding constraints on their innovative activity. An Ibec survey in 2013 found that among SMEs in R&D intensive sectors 31% of the firms saw the administrative burden involved as being the number one reason they had for not claiming the R&D tax credit. The UKs Research and development tax relief for SMEs gives a good example of how to overcome this. It is an excellent example of simple language tax guidance for SMEs. The tax treatment is more generous (particularly if you have outsourced your R&D), but the key advantage for small operators is that you file the claim with your tax return and a short form outlining how you qualify – and that is it. There is no additional record keeping requirements and you receive 'advanced assurance' for the first three times you claim it. These two in particular help smaller firms deal with the uncertainty and the administrative burden.
- Ireland has the second lowest density of industrial robots in the EU15[1], despite them being strongly linked with increased productivity. In order to encourage investment in high-value manufacturing accelerated capital allowances for a number of areas of advanced manufacturing (including Computerised/computer aided machinery and robotic machines) should be introduced. France, for example, operated a similar scheme for robotics and 3-D printing (for SMEs) allowing for provision over a two-year basis.
- Introduce funding for a targeted, paid internship programme for PhD students, aimed at installing innovation expertise directly into the SME operation to identify new product and process development opportunities, highlighting development and commercial opportunities to increase innovation within the business. A critical feature of the programme will be that the internship provides supporting link to higher education consultancy services, business and legal schools, research programmes, spin-out companies and state-backed innovation supports.
- Building on the successful Trade Mission in Ireland and Meet the Buyer Events, provide seed funding to foster linkages between indigenous and multinational firms on projects of common interest and co-selling opportunities which have the potential to enhance the productivity and innovation potential of both firms. This should not be limited to firms in the exporting sectors.

Recommendation 4: Help SMEs attract management and skills

Small firms and particularly start-ups also face problems attracting the necessary human capital and skills they need to grow. This is a particular problem due to the fact that staff in start-up companies typically will have low incomes, relative to the market, as the business builds. Management and skills are key components business growth in any economy. Research has shown internationally that improved management skills can improve sales growth, market share growth and particularly higher productivity.

A 2010 study of Irish firms for the IMI by researchers from the London School of Economics had some disconcerting results in this context. They found that manufacturing firms in Ireland has poor management practices lagging considerably behind their counterparts in the US and UK. They also found that Ireland had a long tail of poorly performing firms which was not seen in other countries covered by some very high scoring multinationals. Irish domestic firms in general were 20% behind multinationals in terms of management practices. Among 10,000 firms in manufacturing and retail across 21 countries Irish domestic firms and particularly SMEs suffered the when it came to management practices. Irish indigenous firms were second bottom among developed countries, barring Portugal and Greece.

Government should:

- Match the Swedish enterprise management incentive scheme for smaller firms. The Swedish Government received European Commission clearance to abolish tax on stock options at companies that are younger than 10 years, have fewer than 50 employees, and revenue and a balance sheet of below €8 million.
- Remove, the limit on grants to any individual in any year to "50 per cent of the annual emoluments", increase the €3 mn cap on options in use under the KEEP scheme
- Ensure better guidance for firms on share buybacks or redemptions, the definition of holding companies and excluded activities (ie Fintech) under KEEP. Make sure the scheme aligns favourably with the UKs EMI scheme
- Pilot an online system to match up mentors and entrepreneurs across the country in order to allow businesses access specific skills with the right expertise and advice regardless of geographic location. This should complement existing mentor programmes operated by Enterprise Ireland, the local enterprise office network and accelerators.

[1] http://bruegel.org/2017/12/the-growing-presence-of-robots-in-eu-industries/

Recommendation 5: 'Think small' first when it comes to regulation

Poorly designed policy, legislation and regulation add to the cost of doing business and are obstacles to growth and job creation. This is particularly an issue for SMEs, who in many cases are 'time poor'. Ireland requires a comprehensive approach involving government, the Oireachtas, regulators and stakeholders to effectively address the burden of regulations in Ireland, one that is fair and transparent.

Red-tape is not just an issue for SMEs, but the burden is often more acutely felt amongst smaller firms. This is due to resource constraints and the fact that much of the costs associated with compliance are fixed. Our regulatory system can be a labyrinth for SMEs. According to the National Competitiveness Council "there is a continuing and urgent need, therefore, to enhance the regulatory environment for SMEs, to enable them to trade successfully".[2]

Government should:

- Monitor stakeholder engagement, use of regulatory impact assessments and ex-post evaluations across the public policy system and publish statistics annually. These assessments should have a particular focus on SMEs.
- Ensure that any new employment regulations adopted are based on solid evidence and accompanied by both stakeholder consultation and regulatory impact assessments.
- Launch a red tape challenge regulatory reduction campaign and mandate government departments to undertake regulatory burden assessments on each business sector.
- Ensure the Legal Services Regulation Act is fully implemented and identify further mechanisms to reduce the legal costs on business, including identifying alternative dispute resolution measures and examining low cost appeals mechanisms other than the High Court for particular areas (e.g. public procurement).
- Develop a SME procurement statement informing companies of what they can expect when tendering for public contracts. Encourage more innovative products and solutions. Appoint a dedicated SME lead to each procurement category council and host category/sector specific meet-the-buyer events. All public bodies to have a "doing business with us" section on their websites.
- Local authorities should be given the powers to use the commercial rates system to direct investment in specific areas (e.g. start-ups) to assist entrepreneurship and to encourage productive investment and local authority premises should be examined for suitability to be used as much needed incubation space for start-ups.
- Start-ups and scale-ups should be a key pillar of the "think small first" approach and EU policies (e.g. single market, VAT reform etc) should support accordingly. Not all sectors are alike so some for some sectors priority issues may differ between them.
- Support policies fostering entrepreneurship amongst targeted societal groups: In terms of promoting entrepreneurship, dedicated actions may be required to encourage higher levels of entrepreneurship amongst specific demographics (e.g. women, seniors, migrants etc).

[2] National Competitiveness Council Bulletin 15-6 (October, 2015) p.2