ISME
IRISH SMALL AND MEDIUM ENTERPRISES ASSOCIATION

SEANAD PUBLIC CONSULTATION COMMITTEE
SMALL AND MEDIUM SIZED BUSINESS IN IRELAND

ISME compliments Seanad Éireann for its Public Consultation on SMEs in Ireland. We have been asked by the Seanad to comment upon:

- Access to finance
- Recruitment of suitably qualified staff and ongoing training/skills development challenges (including mentoring)
- Retaining staff
- Building strong routes to market
- Broadband and Poor Connectivity (including transport)
- Cost of doing business in Ireland (i.e. rates etc.)
- Macro-economic and political challenges and volatility
- Start up support for entrepreneurs – low risk tolerance/culture – planning permission issues etc.
- Challenges in selling on, or transferring a business to family members
- Poor integration and communication perception of State agencies
- Other relevant challenges to be identified

Because ISME is a broad-based, multi-sector trade association, achieving consensus among our membership on prioritising the issues above would be impossible. Geography, enterprise size, enterprise maturity, and business sector all impact the issues above. What SMEs DO broadly agree upon is firstly, that substantial macro-economic threats exist to our society and economy, and secondly, that the policy responses from the State to these macro-economic threats are inappropriately focussed on the foreign multi-national corporation (MNC) sector.

The Macro-Economic and Political Challenges and Volatility

This we consider the most important issue at present, therefore we mention it first.

There is a remarkable degree of consensus across most economic commentators that we are not prepared for the challenges ahead. The NTMA is advising us that Ireland is highly dependent on a small number of US companies. The NCC also warns about this excessive sectoral concentration, reminding us that just 10 companies pay 39% of our corporation tax. The Central Bank's Quarterly Bulletin for Q3 2018 explicitly identifies domestic overheating, high Government debt, Brexit, changes to the international tax regime and US trade tariffs as material threats to Ireland. The ESRI's spring and summer Quarterly Economic Commentaries have voiced concern about global trade, Brexit, and the sustainability of Ireland's corporate tax base. The Irish Fiscal Advisory Council's Fiscal Assessment Report for June 2018 reiterates the Government debt warnings of others, tells us that negative shocks are inevitable, and says '*the Government needs a credible plan for the medium term*.' The OECD warns us that productivity in our domestic businesses is static or declining, and that national productivity figures are inflated by foreign multinationals. UK and US bond yield curves are at, or close to, inversion. McKinsey's estimate of US companies' off-shore reserves comes to some \$1trn. That represents a serious temptation for the US administration for a tax amnesty.

We could give more examples. The point however is this: such a consensus of downside macroeconomic warnings did not exist a decade ago, before the Great Recession. While we cannot reliably *predict when* the next down-turn will occur, we can confidently *predict that it will* occur, in the short to medium term. Yet Ireland's industrial policy is almost exclusively invested in foreign MNCs; the sector most threatened by the macroeconomic situation. Even Ibec, in its Pre-Budget Submission 2019 accepts the need to focus on SMEs.

The last major strategic analyses of the indigenous enterprise sector were Telesis (1982) & Culliton (1992). We consider it vital to employ a major consultancy to carry out a 21st Century review of industrial policy, with terms of reference to develop an Irish version of the German Mittlestand Action Program appropriate to indigenous SMEs. We need to pivot industrial policy towards indigenous enterprise as a matter of urgency.

Access to Credit

Access to credit remains a significant issue for most SMEs. The Central Bank has estimated the premium (small firm financing premium, SFFP) paid by SMEs to be at least 1% in research published in December 2016.[1] ISME members suggest the premium is significantly greater than this. The EU Commission SBA Factsheet for Ireland 2017[2] below notes that the cost of borrowing for our SMEs is significantly more than it is among peer economies.

[1] https://www.centralbank.ie/docs/default-source/publications/research-technical-papers/research-technical-paper-09rt16.pdf?sfvrsn=6

[2] https://ec.europa.eu/docsroom/documents/26562/attachments/15/translations/en/renditions/native

Guarantees, cross-guarantees, warranties, personal guarantees, and other requirements in support of the most basic of business finance are also onerous. Last year we revealed that the directors of a member company had been required to sign undated letters of resignation as collateral for a credit facility. This year, a member has advised us that one of the pillar banks has sold their overdraft to a fund.

SMEs are bridging the gap by financing capital expenditure from working capital. While this may sound prudent and thrifty, it results in a contraction of a business's balance sheet, an issue the Credit Review Office has seen fit to issue a guidance note to SMEs upon in their latest commentary.

Recruitment and Retention of Staff

The market is hardening, and recruitment of staff, particularly at the more skilled end, is becoming much more competitive. This is always an issue for SMEs, because they are rarely in a position to pay salaries that are competitive in comparison to the public sector, the semi-state sector, or foreign MNCs. The notion of a skills 'trickle-down' to the SME sector is not merely untrue, it is reversed. MNCs are able to hoover the best employees from domestic employers with higher remuneration. SMEs involved in professional services in particular are under pressure to retain skilled staff. This is especially so within the Greater Dublin Area; conversely it is somewhat easier to retain staff in the regions, where salary competition is lower, as are costs of living.

Some construction firms report difficulty recruiting for skills such as civil and structural engineering as they are not graduating in sufficient numbers locally. The expense and shortage of accommodation is leading to some SMEs either providing housing at below-market rents, or finding it impossible to attract talent to certain areas.

The cost of housing is also producing some strange discontinuities in the jobs market. The income limits imposed by local authorities for eligibility for social housing means that many potential employees (or promotion candidates) are discouraged by the possibility of exceeding local income limits. We see this as highly detrimental and socially undesirable.

Building Strong Routes to Market

The EU Commission SBA Factsheet for Ireland 2017 notes that our completion of single market directives, and our ease of market access for new and growing firms, lags that of our peers. In view of the potential difficulties of transiting Northern Ireland and Great Britain post Brexit, ISME believes we will have to invest more time and energy in establishing marketing, supply, and physical distribution channels beyond and around the UK in the future.

Broadband Connectivity (including transport)

We survey our members quarterly on the issues affecting them. In our most recent survey, Trends Q2 2018 28% of our members stated that inadequate broadband was a significant issue for their business. We are wholly dissatisfied with the progress of the National Broadband Plan. ISME was disappointed with the level of Government engagement with the broadband issue in the Project Ireland 2040 literature. It expressed the main objective (National Policy Objective 24) as follows:

> ***Support and facilitate delivery of the National Broadband Plan as a means of developing further opportunities for enterprise, employment, education, innovation, and skills development for those who live and work in rural areas.***

The budget for the project was described as 'confidential.' We should reflect seriously on why all but one of the tendering contractors have withdrawn from such a large state contract. We should also question whether a planning strategy which states that it is the '*Government's ambition to ensure that the opportunities presented by this digital transformation are available to every community in Ireland*' is compatible with one which states that planning density should be prioritised, where possible. It may well be, particularly when it comes to very low-density rural areas, that one size does not fit all. We should have the courage to express that clearly and openly to people. Other utilities, such as water, electricity and foul water, are not provided to all rural dwellers on a 'last mile' basis.

In summary, we no longer have confidence in the NBP to deliver. We have suggested, in our Pre-Budget Submission 2019, that the Government actively considers the re-purchase of the wholesale network into State hands, and its lease to retail operators.

In the context of Brexit, it is prudent to consider seaborne Continental EU access via Zeebrugge and Rotterdam. The introduction by Germany, France and Austria of statutory minimum wage laws (so-called *MiLog* and *Loi Macron*) applicable to transit workers is a flagrant breach of the single market rules, and is the subject of infringement investigations by Commissioner Bulc. It is quite absurd for the EU Commission to be enforcing the 'four freedoms' upon the UK during the Brexit negotiations while simultaneously permitting member states to introduce local laws in breach of the TFEU. The Government must, through the Commission, get these laws struck down, and quickly.

Cost of doing Business, and National Competitiveness

Every single ISME survey shows cost and competitiveness as areas of concern. Consumer prices matter because they set an expectation among employees that their employer will meet them. ISME, as the sole independent representative of small business in Ireland, should be represented on the NCC.

The Cost of Labour in Ireland is high relative to peer economies, and is regulated to an inappropriately high degree. As of July 2018, we have the second highest national minimum wage[3] (NMW) in Europe. It is forecast to rise again in January 2019.

The costs of Commercial Property are very high for a small economy, in a country with a low-density population. While the Land and Conveyancing Law Reform Act 2009 banned upward only rents from 2010, many such leases are still in place. ISME believes that upward only rent reviews (UORR) should be outlawed in their entirety. We are in receipt of specific legal advices that no impediments exists to the banning of UORR clauses.

While the inputs to Energy Costs have been falling for several years, medium and large users have been hit with large increases in the PSO levy. The PSO levy is designed to support renewable generation plants primarily, but also certain peat and gas plants in order to increase the security of the energy supply through the promotion of renewable energy generation and the use of indigenous fuels. Some SMEs have seen a 277% increase in the cost of the PSO levy over the last four years, even as they have invested heavily in energy efficient technologies to reduce their energy consumption.

Our rates of CGT, taxation of share-based remuneration, standard rate VAT, and personal taxation for those above the average industrial wage are very high. Incentives to attract talent, such as SARP; and to innovate, such as the R&D tax credit regime; are weighted heavily towards large companies and the MNC sector, despite these occupying only a tiny part of Ireland's business demography.

Insurance costs have now become such a serious issue, they are business-threatening for some SMEs. We understand that the Personal Injuries Commission Report by Justice Nicholas Kearns benchmarking general damages awards will show damages in Ireland to be five times greater than those for the same injury in peer countries. There is no financial, constitutional, legal, or moral justification for this. It is a disgrace, and has been allowed to persist because it benefits vested interests.

The progress of the Cost of Insurance Working Group (CIWG) on the matter has been glacial. Most of its 'actions' are in fact processes, very few of which, upon completion, will result in lower insurance costs. The CIWG has shirked the issue of meaningful control of Book of Quantum award levels. It is ISME's informed opinion that there is no such legal or constitutional impediment to legislating for caps upon general damages; this is already the case under the Civil Liability Act 1961, and the Supreme Court has already capped damages for catastrophic injuries in Sinnott .v. Quinnsworth Limited [1984]. The emotive cases are already taken care of. All that is absent is the political will to tackle the cottage industry that is personal injuries litigation. We estimate the value of legal costs in this area alone to amount to some €350m annually.

Consistent with our policy on lowering insurance costs, we ask the Seanad to bear in mind our imperative for the introduction of a statutory offence of Perjury. Not alone would this assist in reducing insurance costs, it would facilitate the prosecution of white-collar crime.

Start up support for entrepreneurs – low risk tolerance/culture – planning permission issues

Start-up supports for business are generally good. However, as in the macro challenges above, there is no agency dedicated to the approximately 100,000 companies which do not 'fit' in the IDA, EI or LEO.

The Key Employee Engagement Program (KEEP) in the Finance Act 2018 was so badly structured as to be virtually unworkable for SMEs.

The planning (and objections) systems are a blight across our economy. In common with the cost of insurance issue, a constant factor is the long drawn-out nature of resolution, which absorbs significant legal cost.

While our insolvency/bankruptcy framework has radically improved in recent years, it under performs by comparison with our neighbours, according to the EU Commission SBA report (2017).

Lastly, our SME community quite consistently complains that IDA has money to lavish on MNCs, while SMEs are effectively ignored by other state agencies unless they have significant export potential.

Challenges in selling on, or transferring a business to family members

There is a 90% CAT relief in the transfer of business assets from one generation to another. However, this only applies where control of the business transfers at the same time. In many cases, it is not appropriate or possible to transfer 100% of the assets of a business at one time. This is particularly common where buildings are concerned; in many cases, as one generation of a business withdraws from the executive function, it will retain buildings as assets rented to that business. But subsequent transfer of those buildings will not qualify for CAT relief. This should be amended.

[3] https://ec.europa.eu/eurostat/statistics-explained/images/3/3a/Minimum_wages%2C_July_2008_and_July_2018_%28EUR_per_month_and_%25%29.png

Poor integration and communication perception of state agencies.

Regrettably we find, in dealing with Government Departments and agencies, there is too often a response that a particular matter is the preserve of a different Department. We acknowledge that, from a legislative point of view, this may be the case. But from a practical, day-to-day perspective, the outputs of several different Departments directly impact SMEs. Navigating these can be most challenging for SMEs, where the most precious commodity is rarely money, it is time.

In the same manner as most businesses have had to embrace lean/six sigma principles to survive, we feel that a similar approach is required in all areas of government and administration. For example, the Government was right to adopt a 'one-stop shop' approach to its communication effort with the www.gov.ie website. It follows that a great deal of what appears on Departmental websites should be properly curated and cleaned up, to ease access for the public and business.

Other relevant challenges: Brexit

While the UK Government's DExEU is publishing technical papers of relatively low orders of sophistication and depth, Irish SMEs are being asked to 'plan for the worst' while hoping for the best. The extent to which they can meaningfully plan beyond matters of customs and VAT impacts is debatable. ISME has taken an activist role in preparing its members for Brexit. However, we must point out that the ability of firms to work up detailed contingency plans for a currently unquantified and ill-defined Brexit is severely constrained, especially towards the small and micro enterprise end.

SMEs are already facing pressure due to sterling depreciation. This obviously benefits our members who are importing, but those exporting are suffering. Very few ISME members are hedging. We are advising exporters to source as much of their inbound supplies as possible in sterling. However, this can only help so much. Irish taxation policy is not accommodative of SMEs, particularly those which export. ISME believes we will need to more aggressively encourage exports beyond the UK if Brexit results in a departure from the Customs Union.

We believe that the Revenue should be willing to put forward imaginative solutions to the VAT-at-point-of-importation issue for imports from the UK. This will have a severe cash flow impact on SMEs, yet it could be mitigated in whole or in part by Government action.

However, while financially painful, VAT and Customs issues are predictable and therefore can be mitigated. Of much more impact will be the issue of non-tariff barriers:

- These can be technical measures, such as sanitary and phyto-sanitary measures for food, or non-technical 'Rules of Origin.' Brexit could mean the end of the mutual recognition of driving licences, vehicles, registration documents, and certificates of professional competence for drivers.
- Regarding Data Protection, the EU rules for transfer of personal data to a third country will apply to the UK. If the UK decides to diverge from the protections provided in the GDPR regulations, this will be highly impactful for the delivery of services, particularly financial and insurance services, in Ireland.
- A big area that will be impacted by Brexit is private international law. This could have a possible consequences in the areas of family law, adoption, custody, divorce, and access to children. If the UK totally withdraws itself from the EU, and ECJ jurisdiction, it will remove itself from the 'norm' of reciprocity. Under current rules, when a person is divorced in the UK, that divorcee is entitled to automatic recognition in Germany or Ireland.
- Company law could be similarly affected. UK companies may lose their limited liability status. This would have significant implications for shareholders if a third party were to sue.

In summary, whole areas of business will be affected by Brexit in non-economic ways, which are very difficult to predict. More than 40 years of custom, practice, and cross-border mutual recognition are threatened in ways we simply cannot quantify. It is no longer sufficient for Government agencies to ask SMEs to 'plan for the worst' when the regulatory environment post-Brexit is unknowable. This is an area where we need far more help than we have had to date.