Small and Medium Enterprises

(SMEs)

Primarily relating to Ireland

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Small and Medium-Sized Enterprise Sector
with particular reference to Ireland

There are three types of SME –

1) Micro-enterprises have fewer than 10 employees

2) Small enterprise have between 10 and 49 employees

3) Medium-sized enterprises have between 50 and 249 employees

and the definition of an enterprise is ‘any entity engaged in an economic activity, irrespective of its legal form’.

SME Sector in EU

In the EU there are some 20m SMEs representing 99% of businesses and they provide two out of three of the private sector jobs. They are seen by the European Commission as a key driver for economic growth, wealth, employment and social integration and have a key role in innovation and R&D. It is interesting to note that nine out of ten SMEs in Europe are actually micro enterprises with less than 10 employees. The Small Business Act for Europe (SBA) embodies the EU’s commitment to SMEs and entrepreneurship which aims to promote successful entrepreneurship and improve the business environment for SMEs through networks and business support measures. Member States have committed to implementing the SBA alongside the EC in an effort to make the EU a better place to do business. The Commission helps Member States to develop policies aimed at promoting entrepreneurship, assisting SMEs at all stages of development and helping them access global markets.

85% of net new jobs in the EU have been created by SMEs. This clearly shows that SMEs punch above their weight in terms of total employment. This is clear evidence that SMEs are the force behind job creation in Europe.

As SMEs are by far the largest employers, and retention of key employees is paramount, it is essential that all – Government, Employer, Employee and Trade Unions – work together to ensure stability in the workforce. To this end employees must have an interest in the Company and what better way than employee share ownership in this highly important and progressive sector.

Importance of the SME Sector to Irish Economy

The SME segment is regarded as an important contributor to sustainable economic and employment recovery in Ireland and comprise a substantial proportion of the enterprise economy with over 99% of businesses falling within this sector and almost 70% of people employed by them. They are a largely indigenous and employment intensive sector and as such are responsive to domestic policy and dependent on domestic demand which is crucial for private sector employment.

The latest available figures show that 50% of turnover and 46% of gross value added (GVA) in the business economy relate to SMEs. The sectorial breakdown shows that almost half (47%) of active enterprises were in Services. This was followed by 23% in Distribution and 20% in Construction. The remaining were either in Industry with 7% or Financial and Insurance activities with 3%. The sector that made the largest contribution to turnover at 47% was Distribution, followed by Services 27% and Industry 21%.

SMEs make an enormous contribution to Ireland. The Government has recognised them as among the key drivers of the nation’s economy and they have been referred to as the ‘spine’ of the Irish economy. They are located in all sectors of the economy – Primary Industries, Industry, Construction, Wholesale/Retail Trade, Transport, Leisure, Health, Education and Software.

It is of no surprise that indigenous Irish business is playing an important role in the current economic recovery. Figures recently released show that one-quarter of the net increase in jobs in Ireland in 2014 came from foreign-owned firms while the rest of the net jobs created in the economy occurred in Irish-owned businesses. Unemployment at year end 2014 stood at 10.4% down from a crisis peak of 15.1%.

While domestic firms are proving quite successful in growing output and employment, it is a role that needs fostering. While we certainly need multinational investment we do need to wean ourselves off our dependence on the multinational sector which benefits from low tax rates for foreign firms. 700 US companies employ 130,000 people here in Ireland. We must put greater reliance on innovation by domestic business and developing skills and expertise.

What better way than a strong-performing SME sector that hopefully will continue to form the backbone of our economy and ensure its reliance.

Employment within the SME Sector

With some 70% employed in the sector it is crucial that we continue to support and recognise the vital contribution that the sector makes to the economy and ensure the creation of increasing employment.

It has just been announced that 1,500 new jobs have been promised over the next three years by more than 100 early stage, mostly technology focused companies. These fledgling businesses are all part of a 2014 High Potential Start-Up programme run by Enterprise Ireland. Funded by the Department of Jobs, Innovation and Enterprise, the programme supports new exported-oriented companies, based on technological innovation, likely to achieve annual sales of €1m and employ 10 within three years. It is, of course, possible not all will grow as planned or even survive but right now the firms are committed to creating 1,500 jobs over the next three years. The companies accepted on the programme span a range of sectors, from software and services, to engineering and medical devices. More than half are based in Dublin and the remainder spread across the country.

When making the announcement our Minister for Jobs, Innovation and Enterprise said 'that the firms concerned would be key to the Government's plans to create a powerful engine of Irish enterprise to fuel growth across the country'. What chances another Apple or Microsoft!!

If each of our SMEs were to take on one extra employee it would make a crucial difference to our employment numbers.

Representation of the Sector

Both the Irish Small and Medium Enterprises Association (ISME) and the Small Firms Association (SFA) function for these businesses.

ISME – www.isme.ie – an independent organisation represents small and medium enterprises and has in excess of 8,750 members and is funded by members. It supports SME owner-managers by lobbying, providing advice and information. It provides opportunities for its members by networking through events and training.

SFA – www.sfa.ie – is the national organisation exclusively representing the needs of small enterprises (i.e. those employing less than 50 employees) and is funded through subscription fees from its 8,000 member companies. Lobbying with Government and decision makers is part of its mission to ensure that the economic environment is conducive to small business establishment and development.

Grant Aid for the Sector

There are a variety of State funded sources among which are:-

1) Heavily funded training programs

2) Assignment of a Mentor – 5/10 sessions with a relevant expert to provide feedback and guidance. Each session is valued at €175.00

3) Feasibility Study Funding – Up to €20,000 is provided to assist a company to evaluate the technical, market and financial viability of its new business or product idea

4) Priming Grant – It is a business start-up grant available to within the first 18 months of start-up. Typical funding is less than €80,000 (in exceptional circumstances it can be up to €150,000) and supports early stage capital, consultancy, marketing and employment costs.

5) Business Expansion Grants are available to companies once they are at least 18 months in business with amounts ranging from €80,000 to €150,000.

6) International Grant is designed to assist companies undertake market research and develop a new export market or for the introduction of a new product/service into an existing export market. The maximum grant value is €35,000.

7) Competitive Feasibility Fund for Female Entrepreneurs has as its objective progressing new growth-orientated business propositions to become a High Growth Potential Start-Up (HPSU). It is dedicated to Female entrepreneurs and offers up to €25,000. This fund is released periodically and applicants compete for the available funding on the basis of their business plan and proposal.

8) Innovation Vouchers to the value of €5,000 are available to assist a company to explore a business opportunity or problem with a registered knowledge provide (higher research institutes and public research bodies).

Funding Availability to Sector

SMEs as with other sectors are experiencing credit constraints due to banks suffering losses and the need to shrink balance sheets and of course the situation is not helped with bank competition decreasing. However it is hoped that the Government's new Strategic Banking Corporation of Ireland (SBCI), launched last October, will provide a shot in the arm for small businesses and provide a further boost for improving availability of finance for SMEs.

It has the task of creating a more competitive finance market for small business owners. It will initially make available specially tailored loans totalling €800m, at low rates (up to 2% cheaper than current market rates), to SMEs, while the legislation used to establish it allows for up to €5bn to be made available over the next five years. The SBCI is jointly financed by the German promotional bank KfW, the EIB and the Ireland Strategic Investment Fund (ISIF). A fund rather than a bank its first products are due by end of March. While the loans are lower-cost, they will be for periods of 2 to 10 years for working capital and capital investment. Two banks – AIB and Bank of Ireland – will act as intermediaries and there are plans to channel funds through non-bank lenders too.

It is estimated that a typical five-year €400,000 business loan is likely to cost an SME €15,000 - €20,000 less than the current market cost over the lifetime of the loan.

While farmers are included in the programme, under the SBCI eligibility criteria the loans cannot be used for purchase of land, commercial real estate or livestock. This sector is expected to tap into funds because of the improving economy which, while still incomplete, will further cement recovery.

It is hoped that SBCI funds will provide greater choice for small businesses looking for finance more especially when they don't have significant assets and that a more commercially sensible look at the SME in terms of trading history, its management team and its customer base will operate.

In another aid to the sector the European Investment Bank is to provide €12m for the roll out of broadband in rural towns and villages. It will be the EIBs first investment of its kind through its Innovin initiative which is a joint programme with the European Commission. It supports innovation and technology schemes and a pilot scheme for four areas will be completed in March 2015.

The National Pension Reserve Fund (NPRF) has recently announced details of three new funds that it expects will provide credit to SMEs, taking a lead role in the development of the three funds and will be a cornerstone investor in each, to the tune of around €500m, alongside additional investment from third-party investors. While the funds are likely to be more applicable to established firms, they could provide a good source of cash to help companies grow or aid them in keeping their heads above water.

The funding is split into three distinct funds, each with a different function and investment partner.

SME Equity Fund will focus on investing in healthy businesses seeking to grow.

SME Turnaround Fund will invest in underperforming businesses which are at or close to the point of insolvency but have potential for financial and operational restructuring.

SME Credit Fund will lend to larger SMEs and will also acquire and finance loans close to maturity where existing lenders are not willing to provide new lines of credit.

Enterprise Ireland (EI) is responsible for the funding, development and international growth of innovative start-up companies in Ireland. EI partners with entrepreneurs and investors to help companies grow, innovate and win global sales. It has developed a €10m fund for international start-ups to attract entrepreneurs to relocate to Ireland. The fund will invest equity in ambitious, innovative start-ups, led by strong teams and focused on international markets.

Venture Capital is a further option for firms seeking investment to take the next step and can often be the best source of funding and access to a network of people that will assist early stage firms build their businesses.

It is interesting to note that over €400m was raised in 2014, against €285m in 2013, by SMEs and some 13% was raised mostly in Silicon Valley by five Irish firms. However the Irish venture capital community continues to be the main source of funding for innovative SMEs through direct investment.

Recent released figures suggest that since the onset of the financial downturn in 2008, more than 1,000 SMEs have raised €2.1bn via venture capital funds.

Assisting the SME Sector

In an effort to assist family owned SMEs – up to 75% of all SMEs are family owned – Allied Irish Bank, PwC and William Fry Solicitors have joined forces with Dublin City University's recently established Centre for Family Business. This partnership, which will run for three years, will allow the centre to continue its vital work in supporting the longevity of Irish family businesses which contribute to about 50 per cent per cent of Ireland's GDP and employment.

While family firms aspire to continuity across generations, longevity and survival present particular difficulties in the family business sector. It is estimated that just 30 per cent of family firms pass into the second generation. Of these, only 12 per cent make it to the third and subsequent generations.

It is acknowledged that family businesses account for the greatest number of start-ups each year and so are the engines of our economy. The centre plays an important role in helping family businesses to grow and in supporting them through the unique challenges that working in a family business can bring.

Yet another interesting development is the new MSc in Innovation, Entrepreneurship and Design two-year, part-time course, which starts in September next at the UCD Michael Smurfit Graduate Business School. The course aims to give graduates in the field of broad science, technology, engineering and mathematics (Stem) both practical and theoretical expertise in innovation, entrepreneurship and new venture creation. This will enhance their technical skills and expertise in creating new business start-ups and helping existing ones to grow new lines of business.

This new course for Stem graduates is unique in the way it brings innovation, entrepreneurship and design together with extensive practical experience involving the creation of actual new ventures.

The Irish Food Board has come up with an interesting initiative for food and drink manufacturers, both large and small, that would see them operate in the most sustainable manner thereby demonstrating their sustainable credentials. It operates on a national scale, uniting government, the private sector and food producers.

It is hoped that the programme will enhance the reputation of those companies as a source of sustainably produced food and drink resulting in competitive edge and selling opportunities for their products together with greater efficiency. Greater efficiency means reduced costs. A second benefit is its potential to deliver a point of differentiation to potential customers.

Perhaps programmes modelled on this scheme could also be implemented across other SME sectors to promote sustainability and prove competitive advantage to the participants, help create employment and environmental benefits to nations.

Plato, a confidential support network which originated in Belgium in 1988 has been up and running in Ireland since the mid 1990s.

Participation is open to SMEs in any sector who have been in business for more than two years and employ two or more staff. Participants are put in groups of 10 or 12 with meetings facilitated by senior managers from large multinationals. Groups get a formal training programme, meeting once a month for three hours, over a period of 12 or 18 months. The group decide on the training required and facilitators source the expert tuition. Following the formal training element of each meeting, a group discussion takes place and the informal peer-to-peer teaching begins.

Having input from multinationals helps introduce small businesses to the kinds of structured systems and processes that large companies excel in and, of course, it assists SMEs enter the supply chain of large companies. The real value is the peer-to-peer learning and as it is a confidential forum participants can really open up to one another in an invaluable way.

In yet another aid to SMEs the European Investment Bank is to provide €12m for the roll out of broadband in rural towns and villages. It will be the EIBs first investment of its kind through its Innovin initiative which is a joint programme with the European Commission. It supports innovation and technology schemes and a pilot scheme for four areas will be completed in March.

A major commitment by the Government to support SMEs throughout the country was the launch in April 2014 of 32 Local Enterprise Offices (LEOs). Enterprise Ireland, through its Centre of Excellence, provides back-up support, training and guidance to the 31 LEOs to ensure a professional and consistent level of support is provided to all SMEs. A major initiative undertaken by the LEOs with Enterprise Ireland support was Ireland’s Best Young Entrepreneur Competition which attracted over 1,000 entries. The core of the strategy is starting and growing world-class businesses and preparing and helping entrepreneurs all over the country.

Innovation to support the Sector

One of the 10 principles developed by the EU in support of SMEs is innovation and this should come as no surprise. The importance of the innovative capacity of business has never been greater in order to remain competitive in today’s markets. While innovation has traditionally been seen as technology-led, it is now seen in a broader context and is as vital to the services sector as it is to the manufacturing sector and there now appears to be evidence of an eagerness in the newer sectors to embrace innovative approaches.

Workplace innovation is a vital means of unlocking talent and know how. Involving and engaging employees in the workplace means being open to change and partnership. It is about embracing change and turning it to the advantage of the company. As we know employee involvement has been shown to improve a wide range of organisational performance including communications, management/employee relations, workplace adaptability and organisational effectiveness.

Innovation has indeed assisted indigenous Irish companies who have to compete with the very best in the world on both domestic and export markets. It is a proven fact that they wouldn't survive if they weren't constantly innovating to remain competitive. The culture of innovation allows employees in production, delivery and every other department to feel free to come up with ideas to improve the business.

A recent study by Gartner Research suggests that traditional manufacturing-based companies are actually displaying more innovation and interest in change than is necessarily seen in banking and insurance or for that matter in the established technology providers like IBM or an HP. It is felt the reason is that manufacturers are realising that you can focus on lowering the cost of what you are doing by having machinery, processes, devices and sensors internet-enabled and linked. This would appear to suggest that knowledge worker jobs could vanish in the coming years.

It is reckoned that companies who interact directly with people and provide customer care as increasing value will be placed on human-to-human interactions, instead of automated call centres. SMEs would do well to take heed of the importance of interaction.

Innovation is alive and well in Ireland but we like other countries can never have enough of it. SMEs, as with other companies, need to keep innovating and there is an enormous need for innovators and entrepreneurs.

It was timely and well-judged that University College Dublin introduced the Innovation Academy which has become an internationally recognised exemplar of best-practise in innovation and entrepreneurship education. It is dedicated to supporting Ireland's innovative culture by fostering entrepreneurial talent in communities across the country.

Students at the Academy find themselves working with people from very different disciplines and levels of experience in an international approach designed to broaden minds.

Some Academy graduates start companies, some spin out companies from universities or corporations, some pursue new employment in a company while others will instigate change within existing organisations or at a societal level.

Innovation will continue to rejuvenate Ireland's economic and social landscape and it is crucial that innovation is fostered and supported in indigenous businesses.

Tax Efficient Share Schemes for SMEs

The knowledge that employees have a financial stake in their company can only incentivise and motivate people to approach their work thoughtfully and conscientiously and be innovative, leaving not only themselves, but customers, investors and the economy as a whole, better off.

Taxation is critical to making employee ownership viable and it is incumbent that Governments adopt a more proactive policy regarding employee ownership taxation by creating meaningful incentives in the tax regime to encourage increases in employee ownership. Such ownership has a role in driving innovation, attracting top talent and promoting growth in the enterprise. Employee ownership works because it so neatly aligns incentives and puts the workers at the heart of the business.

Irish ProShare Association (IPSA) sees employee financial involvement in SMEs, High Potential Start UP (HPSU) and Listed Companies as an essential tool to aid recovery and contribute to the success of our economy. IPSA has, and continues to, lobby for changes in taxation matters.

Skills shortages have been reported across a number of sectors, particularly in specialised high skill niche areas with ICT and engineering. This can be problematic for HPSUs who often require employees with a specific skill set. HPSUs find themselves in competition for this limited pool of talent with multinational counterparts. IPSA believes that effective tax efficient employee incentives can attract and retain skills across all firm types, but can also allow indigenous SMEs to offer employees more attractive ownership incentives, aligned with the potential for a future sale.

IPSA in a budget submission has sought that assimilating the Irish rules to reflect reforms in the UK would help to generate and sustain employment by giving businesses the flexibility over remuneration they require to attract and retain a talented workforce by boosting the productivity of their companies.

The UK in their Finance Act of 2000 introduced Enterprise Management Incentives (EMIs) which are advantaged share options designed to help small high risk companies recruit and retain employees who have the skills to help them grow and succeed. Where these businesses do not have the cash resources to provide competitive salaries and bonuses, the ability to offer tax efficient share-based remuneration has proven to be most successful in retaining those vital to the future of the Company.

Briefly options may be granted by independent trading companies, which do not employ more than 250 staff and whose gross assets do not exceed £30m, to employees who work at least 25 hours per week or 75% of their working time for that company and who do not control 30% of the share capital.

Options over shares with an unrestricted market value (UMV) at the date of grant up to £250,000 may be granted tax free and there will normally be no tax or social security for the employee to pay when the option is exercised. There may well be a liability to Capital Gains Tax.

As of 2012, in excess of 7,500 companies in the UK operated EMI schemes, 96% of which did not operate any other share scheme. These figures clearly demonstrate a unique commercial need for smaller high risk companies which is not catered for under alternative share schemes.

Of course some of our approved schemes, all with tax benefits, may well suit some in the sector, such as:-

A Restricted Stock Plan generally includes some performance criteria and the initial income tax is reduced because of restrictions imposed on disposal and/or risk of disposal. Briefly employees are awarded a future interest in shares, subject to certain restrictions and the shares are granted at a discount or zero cost. Restrictions lift after a period of time leaving the employees with full ownership of the shares. Periods of retention run from 1 to 5+ years with the maximum reduction on liability to income tax (60%) where the shares are held for in excess of 5 years.

Employee Share Ownership Trusts (ESOT) may very well be the answer for family owned businesses, and indeed those owner-controlled, who wish to realise their investment.

An ESOT is used as a mechanism whereby shares can be acquired by the Trustees of the trust and allocated to employees of the company over staged periods. The trust purchases shares in the employer company and the ESOT may borrow money to purchase the shares or receive them as a gift. Shares are allocated to participating employees over a period of up to 20 years and all employees must be eligible to participate on equal terms. As the shares can be held by the trust for periods up to 20 years the company can use the ESOT as a mechanism as an avenue whereby shares may be purchased at today's price and allocated to employees at a future date without having to pay the market price at that time.

All costs in relation to the establishment of an ESOT are tax deductible for the company as are all costs incurred in administering the scheme.

Economies are based on the skills and knowledge of workers and profits are based on their efforts and economic growth on their labour. The policy of Governments in recognising these benefits should facilitate the growth of employee ownership in an effective tax efficient manner.

Gainsharing

Gainsharing as a tool for employee involvement, innovation and motivation should be considered for companies in this sector and where applicable as an alternative to annual pay rises. With price inflation falling to near zero it does become harder for companies to pay annual pay increases and this, I believe, is where employee share ownership will support.

Gainsharing can best be defined as a means of rewarding employees for exceptional performance above a pre-determined target based on sharing financial gain. A single measurement may be chosen or alternatively separate targets in areas such as quality, productivity, cost and customer service may be identified. Introduction of such a scheme will encourage employees to continually improve performance and set targets and enable employees to identify how they can impact on improving the company performance resulting in a payback mechanism for them. A formula for sharing the gains, minimum payments and on-going review must be agreed prior to the implementation of the scheme. This will ensure that those who make the profits, the workers, get a share in the reward.

Naturally tax concessions will play a large part in the launch and on-going successful direction of the scheme.

China and SMEs

With the Chinese economy in its worse shape in two decades it is interesting to learn that this month (March) the Chinese Premier has encouraged the 7.5m university graduates to start their own business. The government has undertaken to support business start-ups for new industries.

It is hoped that the start-ups will revitalise the economy and to this end three of China's top angel investors have launched a new training and mentorship programme for start-up founders in China. One of the Chinese government's key economic targets this year is job creation with a goal of 10m new jobs. The hope is that Chinese entrepreneurs will focus on new frontiers including internet finance, medical services, education and also on traditional industries such as manufacturing, energy and agriculture.

Hong Kong has also been pushing for greater funding and more policy support for local start-ups.

Conclusion

SMEs in Ireland, and indeed across Europe, have had to navigate a difficult terrain in recent years and it is heartening to note they have met these challenges and prove to be the engine of jobs growth and development in our economies. They have clearly shown their flexibility, adaptability and endurance skills.

It is important that measures aimed at developing additional sources of finance, along with raising awareness of the supports that are out there among the SME sector, are acted upon and communicated clearly to ensure entrepreneurs are confident of support.

We must all actively support the growth of SMEs to ensure the continuation of job creation and ensure dynamism and confidence to generate ideas and innovations and at the same time we need to address the disincentives for entrepreneurs and their employees which exist in the tax system.

The opportunity for SMEs to succeed and grow underpins the future potential for increased employment, growth and prosperity with innovation, research and development the driving force.

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