Speech by John Moran

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ISME Annual Lunch

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Introduction

Ladies and Gentlemen, it gives me great pleasure to address you today on the hallowed turf of Croke Park. I would especially like to thank ISME for this opportunity to address you today and pass on apologies from the Minister for his inability to be here today.

As a Limerick man I have to confess that my visits here have been few and far between in recent years. A lot of people have been asking me what I'll be doing in September. The answer quite simply is I don't know but I do hope that I'll be returning here in my capacity as a supporter on the first Sunday in September – perhaps a case of wishful thinking! Although as I look out at the assembled guests I'm sure a lot of your businesses began as a dream which, through your hard work and perseverance, has become a reality.

Medium Term Economic Strategy

One of the criticisms I've heard is that economic policy has become fragmented and disjointed since Ireland successfully exited the EU-IMF Programme. This is simply not true. The Medium Term Economic Strategy 2014-2020, published last December, sets out the framework for how we will build and sustain a competitive economy that can pay its own way, serve our society, and that can survive and thrive in a reformed eurozone and an increasingly globalised international economy. It provides an overall framework for social and economic policies that are being and will continue to be developed and implemented by the Government.

The MTES has a number of key objectives:

- to set out a path for economic growth to full employment;
- to provide an overarching whole-of-Government strategy to which other sectoral and horizontal policies and strategies are aligned;
- to identify new strategic priorities that will make the biggest impact to increase the economy's potential growth;
- to maintain the discipline and reform momentum achieved under the EU/IMF programme;
- to set out the fiscal parameters and targets required under both the EU Stability and Growth Pact and the Fiscal Compact; and
- to ensure that the mistakes of the past are not repeated.

The Strategy, which sets out broad policy orientations and specific actions to achieve the overall strategy has three pillars:

- Ensuring Debt Sustainability,
- Financing Growth, and
- Supporting Employment and Living Standards,

Obviously the strategy deals with the whole of the economy but for me personally though I was particularly pleased at how the Government and the broader system confirmed the need to elevate the importance of SMEs given their contribution to employment – half of Ireland's workforce. This has been a core part of the philosophy of what we in the Department of Finance under the Minister's direction have been pushing in recent years.

Many of you will be familiar with how my own background has helped me to understand what is important in this area. Firstly, having my own small business but also growing up in the home of an entrepreneur with his own business and the pleasure and pain associated with that, which certainly reached the kitchen table.

Many of the most public successes of Department of Finance activity have been in the macro space in recent years. But in a parallel space and with a parallel work programme, we have been working on a wide range of measures supportive to SMEs to which I'll come back later.

Recent Developments in the Irish Economy and Public Finances

Before I speak about Irish SMEs, I would like to first return to look at the first pillar of the MTES – economic and fiscal macro stability and sustainable public finances. Having had to undergo considerable reform over recent years, requiring a great deal of sacrifice from the people of Ireland, we are now beginning to see the fruits of our labour. Last year saw a number of key milestones achieved as the Irish economy continues down the path to recovery.

- **Defict -** Ireland again reduced last year's underlying general government deficit this time to 7.2 per cent – once again coming in below the EDP ceiling for the year, which was 7.5 per cent;
- **Borrowing Costs -** Our delivery of reduced deficits has meant that, having peaked at over 14 per cent in mid-2011, our borrowing costs for 10-year

bonds continue to fall and have now fallen to below 2.7 per cent. This is key - we've seen the importance of these lower levels in terms of the knock on lower funding costs for investment and enterprise.

- **Debt ratio -** Our debt-to-GDP ratio peaked at 124 per cent at the end of last year. For this year and beyond we believe the debt ratio is now on a firm downward path and must remain on such a path. Of course, this number was particularly high as we had built up significant cash reserves in order to smooth our re-entry to capital markets following our successful exit from the EU-IMF programme. While still very high, we are looking at a net debt ratio of about 98 per cent of GDP at the end of last year, a figure which is now not dissimilar to EU norms;
- **Household Debt -** Equally, household debt sustainability continued its steady rate of improvement during Q4 2013. Debt as a proportion of disposable income declined by 3.5 percentage points to 192 per cent. The decline largely reflected the reduction in household debt, as well as, to a lesser extent, a slight increase in disposable income. Overall, household debt has fallen by €30 billion or 18.3 per cent since its peak at end-2008 and is now back to 2006 levels but still at elevated levels we would like to see reduce further.
- **Employment -** The rate of employment growth in Ireland was up 2.3 per cent in annual terms in the first quarter this year – the 6th successive quarter of employment growth. I noted with particular satisfaction that this growth was driven entirely by full-time employment.
- **Unemployment -** In line with these developments, the unemployment rate continued to moderate in 2013 and has now fallen to 12 per cent since peaking at over 15 per cent in early 2012, again approaching EU norms although that is no great satisfaction given their still very high levels.

- **Domestic demand -** While GDP is particularly important in my day job as a driver of debt and deficit ratios, on the ground for many SMEs, domestic demand is even more important. A measure of that, GNP -- which strips out the effect of multi-national activity, in particular in the pharma-chem and software sector – was a particular bright light last year and increased by 3.4 per, supported by a return to full-year investment growth. Investment increased by 4.2 per cent in the year, as confidence continues to return to businesses domestically.

In short, the Irish crisis has been a problem of **"debt"**, at each of the sovereign, bank and personal levels. The shorthand solution can probably be described as "**confidence",** that of foreign investors in Ireland, that of Irish businesses in their economic future, and that of Irish households that next year will be better or at least no worse off than this year.

We are now seeing increases in forward looking indicators which illustrate the enhanced confidence in our economy. Data from the Purchasing Manager's Indices in construction, manufacturing and services are at their highest levels in years, which augurs well for future growth. For example, the most recent Construction PMI indicates the sharpest rate of expansion in 10 years.

Going forward, my Department recently published updated macroeconomic forecasts out to 2018 as part of Ireland's Stability Programme Update 2014. We are projecting GDP growth of 2.1 per cent in 2014 – revised up modestly from Budget time -- with the pace of growth expected to accelerate in the coming years. On the domestic front, consumer spending is expected to rebound this year with growth of 2 per cent forecast for the year as a whole, while a continuation of the positive momentum in investment spending is expected, with growth of 15.4 per cent projected for the year.

Looking past 2014, the pace of growth is expected to accelerate in the coming years, with GDP growth of 2.7 per cent forecast for 2015. Employment growth averaging 2 per cent per annum is projected over the forecast horizon, with an expected reduction in the unemployment rate to 8 per cent by 2018.

However, it should be noted that, following the recent European elections, the political landscape seems to have shifted which may lead to some policy changes and carries some risk for us at European level. In my view, it is imperative that Europe continues to build on the themes identified by Ireland's Presidency of the EU, namely stability, jobs and growth.

Of course, the future will never turn out exactly as we forecast. The Department assesses risks, downside and upside, to the economic outlook in all our budgetary forecasts. Our most recent publication of these was in the Stability Programme Update (SPU) issued just last month. The key risks to the outlook we highlighted include:

- uncertain growth prospects for our main trading partners which can significantly influence an open economy such as Ireland;
- the persistence of pharma cliff patent issues on our GDP numbers (my Department published a technical paper assessing this issue last year);
- persistent low inflation which may impact our budgetary ratios; and
- rather low levels of investment in recent years point to upside potential if investment returns to more normalised levels. In that respect it is

critical that we continue to be one of the most attractive locations for drawing foreign capital for investment.

Funding SMEs

I wish to turn now to the second pillar of the MTES and the important issue of funding SMEs. Government policy in this area is to ensure that viable businesses can access finance from a range of bank and increasingly non-bank sources. As regards bank lending, I expect to see the upward trajectory in this area continue as the economy grows. Having completed a process of deleveraging, both AIB and Bank of Ireland are now concentrating on growing their balance sheets and coming under investor pressure to do so to build profitability. In this context, both banks recognise the need to increase business lending going forward, including lending to the SME sector.

Although the lending targets were a useful policy intervention, the focus has now shifted towards the collation and examination, on a monthly basis, of more granular data on the funding of the activities of SMEs from both AIB and Bank of Ireland, the wider banking sector and increasingly the non-bank funding sector to better identify any blockages for any particular sector. The most recent Red C demand survey, the results of which will be published on Tuesday, show that the trading performance of SMEs continue to improve and the provision of bank loans to businesses is an integral part of this improvement.

I would like to remind attendees that the Credit Review Office continues to deal with appeals from those small businesses that have had their requests for credit refused by the two main banks, and John Trethowan and his team are overturning 55% of refusals, albeit on a low base. In Budget 2014 the Minister raised the threshold for appeals to €3m having previously increased the number of reviewers with a view to ensuring that the CRO can deal with a wide range of appeals in a timely and competent manner. I cannot overemphasise the value of unfair terms or outright refusals going to the CRO for review as it provides a necessary objective insight for us of the reality on the ground. It is very unhelpful for us and the stakeholder group discussion if the sample size is too small.

When we published the MTES, as a signpost of things to come, we included the following sentence: *"The on-going discussions with KfW (Germany) allied to the EU's emphasis on the need to increase co-operation between the EIB and National Development Banks provides a new supportive framework in which to consider establishing a new strategic investment institution."* Like other sentences in the MTES, it is not without meaning.

Only last week, the Taoiseach announced the establishment of this institution, the Strategic Banking Corporation Ireland. The Government will be prioritising the passage of the enabling legislation through the Houses of the Oireachtas with a view to completion by the summer recess. In the initial phase of its existence the objective of the SBCI will be to improve the availability of credit to the SME sector. To achieve this, the SBCI will operate as a higher tier lender, providing funds to on-lending institutions. On-lending institutions will include Irish commercial banks but importantly can also include foreign banks, specialist funds and other finance houses engaged in lending activities. I need hardly tell this audience that credit is the lifeblood of all SMEs but it's not just cost which is still important. Other terms can be more important. Lenders will now be able to fund loans of greater duration or more flexible cashflows with enhanced terms facilitated by the SBCI and its European funding partners. I would also like to see this act as a catalyst for greater competition in the SME lending sector from institutions without their own domestic deposit base.

That said, we can only support credit applications with a good supporting business case. One of the observations I have had through the last couple of years is the lack of investment by many parts of Irish society in good management skills and technology. Developing better management skills to set up and then grow enterprises has to remain a priority. In Budget 2014, the Minister announced a programme to assist business owners to improve their business case when seeking to raise finance for their firm. These programmes, run by Management works, consist of 2 full day workshops followed by one-to-one mentoring sessions and are aimed at senior managers of SMEs from all sectors who want to better understand their finances with a view to the better presentation of this information to potential funders.

Structural Changes

Coming to the third pillar of the MTES, I suspect we surprised many people in the choice of priorities for structural reforms by not selecting multinational companies' and FDI up front and instead targeting a broader range of enterprises, including indigenous SMEs. We listed Innovation, Entrepreneurship and Building New Markets as the first three areas of focus. Underpinning all of the MTES are references to growing indigenous companies and improving the competitive environment in which they operate. You'll also see the key reforms of Local Government so as to have full and proper alignment of responsibilities for economic development focused at a local level, especially around the LEOs.

It is vital that SMEs are fully aware of the suite of developmental business supports, totalling approximately €2bn, which is available from State bodies and agencies. In spite of the work done by relevant Government Departments and agencies, all parties accept that a challenge remains around SMEs' awareness and understanding of Government supports. We would welcome continuing support from ISME for this task. The most recent SME credit demand survey found that there was a low level of awareness of certain initiatives. It is against this background that my Department, in conjunction with a number of other State bodies, has designed an online guide which helps small businesses to navigate through the range of Government supports available to them. The Minister launched the “Supporting SMEs” guide in the Limerick Local Enterprise Office last week and within 3 days it had already seen 5,000 hits. The guide allows a business to access a list of potential supports for their company and relevant contact information after answering a short number of questions. The guide is available on the new Local Enterprise Office website as well my own Department’s website. It’s great to see that ISME also have a link to it on their own website.

I admit that some of the measures are not having the scale of impact we would like them to have, but before we can seriously work out how to fix them for greater impact (to which I assure you we remain committed) we need to at least make sure that people know about them and try them out to give fully constructive feedback through our stakeholder fora.

Another key issue facing many start-ups today is the lack of equity available from family and friends, given the structural negative equity issues around the property sector and less accumulated wealth in households than in many other key countries. We are in the midst of a public consultation exercise on the

Department's website inviting interested parties to make submissions regarding the under-utilisation of equity/quasi equity finance in the SME sector and practical suggestions as to how this situation can be improved. I would also urge attendees who have views in this area to please submit them for consideration. In tandem with this a further public consultation exercise in advance of this year's Budget is also ongoing regarding the EIIS scheme, another important policy tool to assist SMEs.

Of course, no sectors were hit harder in the recession than the retail and construction sectors. These sectors must now play a key role in supporting our recovery. The recently published Construction Sector Strategy will help rebuild that and provide a supply of homes for our people.

In relation to retail, we are concerned that in spite of solid employment growth in the wider economy, the retail sector is still shedding jobs. To gain an understanding of the underlying issues and how they might be resolved, the Department of Jobs, Enterprise and Innovation has convened a Retail Consultation Forum with representatives from both industry and the public sector.

SME Policy Achievements

Your Chief Executive Mark Fielding said the following in January 2011: "What is urgently required is the introduction of policies to provide the confidence for businesses to start investing and creating employment. The current reality is that business owners see an administration that has no plan to address business concerns, with companies consequently in survival as opposed to expansion mode". I hope, Mark, you have seen we've been listening and continue to listen.

Lest people think I've made this up and that all we've been doing at the Department these past three years is a Troika Programme and annual budgets, let me remind you of the following.

- A road tour of six locations outside Dublin where the Minister for Small Business and myself held a number of regional roadshows to really hear what was happening with businesses on the ground;
- The establishment of a new SME State Bodies Group, to pull together in one room with a common purpose, representatives from Government Departments and Agencies, to meet on a monthly basis with a view to ensuring that the commitments contained in the "Access to Finance" chapter of the Action Plan for Jobs are carried through. Quite quickly on, we realized we didn't have all the right actors in the room, and since both the ISIF and D/Education have joined the Group;
- The re-establishment of the SME Funding Consultation Committee, on which ISME are represented, to bring Government and private stakeholders together to hold the state agency group to task and come up with the best ideas to resolve the difficulties facing SMEs seeking funding. It is through that dialogue that the problem of equity became so obvious;
- The credit guarantee scheme is soon to be widened in scope after an external review;

- Microenterprise Ireland to provide unsecured business loans of €2,000 to €25,000 for commercially viable proposals that have been declined bank credit;
- AIB is also collaborating with the European Investment Bank to finance small and medium-sized projects promoted by SMEs and Midcaps;
- A €700 million seed capital aimed to get aspiring companies up and running;
- The Ireland Strategic Investment Fund to make €6.8 billion of resources available for supporting SME funding and for investment on a commercial basis to support economic activity and employment in Ireland;
- The ISIF commitments to funds totalling close to €1bn in three new long-term funds which will provide equity, credit and restructuring / recovery investment for Irish small SMEs;
- Work with the European Investment Bank to see if we can find a better solution for trade finance for European SMEs in Ireland;
- The ground-breaking establishment of the Strategic Banking Corporation Ireland, on which I touched earlier;
- The Local Enterprise Offices as a First Stop Shop for anyone seeking information and support on starting or growing a business in Ireland;
- The SME online-tool launched by the Minister last week as a portal by which SMEs can establish what element(s) of the €2bn of State supports they may be eligible;

- 2013, the year of The Gathering, was the best year for inbound tourism since 2008. The reduced VAT rate and reduction of the air travel tax to 0% last month to provide a major boost for the tourism sector and generate even more direct air services into Ireland in the years ahead;
- The 10 Point Tax Reform Plan announced in Budget 2013 to assist small businesses in a number of ways including Reducing the costs associated with the administrative burden of tax compliance;

- The Budget 2014 Capital Gains Tax Relief for re-investment to encourage re-investment of the proceeds of a previous asset disposal into new productive trading or a new company keeping capital focussed on business and the creation and maintenance of employment; and
- Our participation in formation and operation of the Activating Dublin forum which pushed the online trading pilot – a combined private and public sector effort. Our chairing of the review for Activating Dublin of how to make Dublin the best place in Europe to start and grow a tech business, out of which we now have the establishment of the recently advertised post of a Commissioner for Start-ups to lead this effort.

Conclusion

Before I conclude, I wish to briefly discuss two challenges for the future which I fear are not yet getting enough attention and where ISME may especially help.

Firstly, in relation to online trading, it is clear that the trend towards online spending is ever increasing and it is estimated that only 23% of small Irish businesses are engaged in any meaningful way in e-Commerce sales. For businesses employing less than ten people this percentage could be even lower. It is now believed that of online purchases made in Ireland 70% of these are done in overseas markets.

There is now an urgency to ensure that businesses recognise that this is happening and that they are encouraged and supported to correctly respond to this digital reality. In order to support this goal, the National Digital Strategy aims to get a further 2,000 businesses trading online by the end of 2015. I would urge ISME to involve itself in this initiative to ensure its members don't get left behind in this area.

From our Activating Dublin pilot, we've seen that within 2 months:

- 55% of partaking companies increased Sales or Leads over the course of the pilot;
- 70% claimed to have potential to create jobs;
- 30% are exporting for the first time or grew export sales; and
- 30% made significant capital investment to better equip themselves for the online opportunity.

Quite frankly, it's a question of not looking what can I get for the €2,500 government voucher and €2,500 matching funds but putting in the real investment to reap those rewards.

Secondly, I believe the areas of innovation and creativity are still being undervalued and perhaps misunderstood. Innovation is something which came up again and again last year as a particular challenge in the consultative process that informed the Medium Term Economic Strategy.

We identified this as a key priority in the MTES, noting that we lag behind world leaders and European leaders and more importantly that innovation is too concentrated in foreign-owned firms.

While significant steps have been made through increasing the capacity of Science Foundation Ireland and the R&D tax credit, innovation often does not involve step change but rather incremental improvements. We need to continue to create and encourage environments and thinking conducive to innovation and creative thinking and consolidate and build critical mass and international reputation in these areas.

We identified the need to enhance collaboration between creative and design firms on the one hand and other entreprises, academia and public sector bodies on the other.

I began my speech dreaming of a Limerick victory in September here in Croke Park. Is it too much to dream that 2015, which will be the National Year of Design could be the catalyst for the creation of a national programme or even centre for Future Thinking and Creative Sciences to stimulate collaborative efforts that will deliver innovative solutions.

With that thought I shall leave you and just again thank ISME for their invitation to speak to you here today and I wish you all every success with your businesses in the future.