Opening Statement to the Joint Committee on Enterprise, Trade and Employment on Challenges Facing Small and Medium Enterprises

ISME thanks the Joint Committee for this opportunity to address the committee regarding the challenges facing small and medium enterprises.

OPENING ADDRESS

The first challenge for domestic SMEs ISME identifies is the fact that Irish industrial policy is structured around large businesses, and more specifically foreign owned large businesses. While this has been a great success in terms of GDP growth and the amount of corporation tax the State earns, it has come at the expense of a far less productive domestic sector.

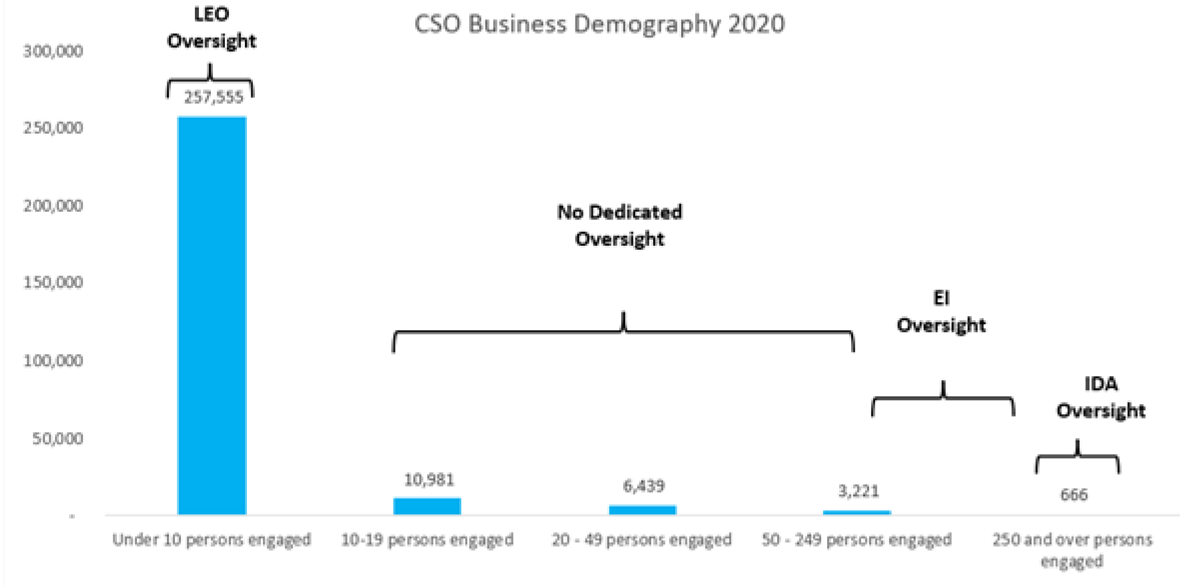
This results in our industrial and taxation policies, our research and development policy, and our policies to remunerate, motivate and retain staff being optimised for big business.

We have excellent agencies in the form of the IDA and Enterprise Ireland overseeing industrial development, but the former is focussed on FDI, and the latter on exporters and high-performance start-ups, despite the fact that both represent a mere 1% of Ireland's 279,000 active enterprises (in 2020).[1]

While the Department of Enterprise white paper has allocated responsibility for the "small enterprise" (10-49 employees) sector to the LEO network, we have reservations as to whether the LEOs have the capacity and capability to adequately look after this sector. See Figure 1 below.

[1] https://www.cso.ie/en/releasesandpublications/ep/p-bd/businessdemography2020/keyfindings/

Figure 1



The second challenge flows from the first, and it is the fact that the success of the FDI sector means it is expanding at a far faster rate than the domestic sector. The CSO's 2021 Annual National Accounts[2] show a GDP of €426bn compared to a GNI* of €231bn, a divergence of 46%. In simple terms, this means the output of the FDI sector is almost approaching that of the remainder of the Irish economy.

In one respect this is good, generating high employment, high wages and high corporation tax returns. On the other hand, it risks regulatory capture and pricing or crowding domestic enterprise out of our own economy. We have seen recent examples of this with the *energy network rebalancing mechanisms for large energy users* which meant they paid less for electricity than consumers did; and the Special Assignee Relief Program (SARP) which works well for big business while the Key Employee Engagement Program (KEEP) for small businesses which does not work at all.

However, this fixation on FDI means we undervalue our domestic enterprise sector. The FDI sector makes a huge contribution to Ireland, but in Net National Product terms, the domestic sector contributes 3.75 times more to the Irish economy[3] (see Figure 2). This is principally down to employee remuneration. While employees of FDI operations typically earn a substantial income premium over those in domestic businesses, there are fewer of them, and

[2] https://www.cso.ie/en/releasesandpublications/ep/p-ana/annualnationalaccounts2021/gniandde-globalisedresults/
[3] https://www.esri.ie/news/success-of-the-economy-now-depends-very-heavily-on-the-progress-of-domestic-business

they a geographically concentrated in the urban conurbations. SME employers on the other hand are everywhere.

Figure 2

TABLE 1 NNP AT BASIC PRICES, BEFORE ADJUSTING FOR THE STATISTICAL DISCREPANCY, € MILLION

Foreign MNEs	2013	2014	2015	2016	2017	2018
1. Compensation of employees	18,056	18,848	20,201	21,089	22,373	23,308
2. Gross operating surplus/mixed income	52,654	59,552	117,723	118,073	131,425	145,830
3. Consumption of fixed capital	14,710	16,135	42,730	49,244	57,244	62,279
4. (2-3) Net operating surplus	37,944	43,417	74,993	68,829	74,181	83,551
5. (1+2) Gross value added	70,710	78,400	137,924	139,162	153,798	169,138
6. (5-3) Net value added	56,000	62,265	95,194	89,918	96,554	106,859
7. Corporate taxes	3,329	3,427	5,202	5,615	6,258	7,936
8. Factor flows - profit repatriations (allocation of primary income flows)	34,615	39,990	69,791	63,214	67,923	75,615
9. (6-8) Contribution to NNP	21,385	22,275	25,403	26,704	28,63	31,244

Domestic	2013	2014	2015	2016	2017	2018
1. Compensation of employees	52,591	54,250	57,588	61,579	65,778	69,986
2. Gross operating surplus/mixed income	41,267	45,924	48,977	53,266	57,671	63,958
3. Consumption of fixed capital	11,829	12,548	13,603	14,512	15,832	16,989
4. (2-3) Net operating surplus	29,438	33,376	35,374	38,754	41,839	46,969
5. (1+2) Gross value added	93,858	100,174	106,565	114,845	123,449	133,944
6. (5-3) Net value added	82,029	87,626	92,962	100,333	107,617	116,955
7. Corporate taxes	955	1,206	1,689	1,758	1,959	2,485
8. Factor flows - profit repatriations (allocation of primary income flows)	0	0	0	0	0	0
9. (6-8) Contribution to NNP	82,029	87,626	92,962	100,333	107,61	116,955

Total	2013	2014	2015	2016	2017	2018
1. Compensation of employees	70,647	73,098	77,789	82,668	88,151	93,294
2. Gross operating surplus/mixed income	93,921	105,476	166,700	171,339	189,096	209,788
3. Consumption of fixed capital	26,539	28,683	56,333	63,756	73,076	79,268
4. (2-3) Net operating surplus	67,382	76,793	110,367	107,583	116,020	130,520
5. (1+2) Gross value added	164,568	178,574	244,489	254,007	277,247	303,082
6. (5-3) Net value added	138,029	149,891	188,156	190,251	204,171	223,814
7. Corporate taxes	4,284	4,633	6,891	7,373	8,217	10,421
8. Factor flows - profit outflows	34,615	39,990	69,791	63,214	67,923	75,615
9. (6-8) Contribution to NNP	103,414	109,901	118,365	127,037	136,248	148,199
10. Residual factor outflows excluding profit repatriations and redomiciled PLCs	1,022	-1,888	-3,176	-6,456	-1,327	280
11. (9-10) NNP adjusted for redomiciled PLCs	102,392	111,789	121,541	133,493	137,575	147,919
12. Redomiciled PLCs	6,492	6,852	4,662	5,781	4,458	5,002
13. (11+12) NNP	108,884	118,641	126,203	139,274	142,033	152,921
NNP adjusted for redomiciled PLCs	102,392	111,789	121,541	133,493	137,575	147,919
Foreign MNEs % of GVA	43	44	56	55	55	56
Foreign MNEs % of NNP adjusted	21	20	21	20	21	21

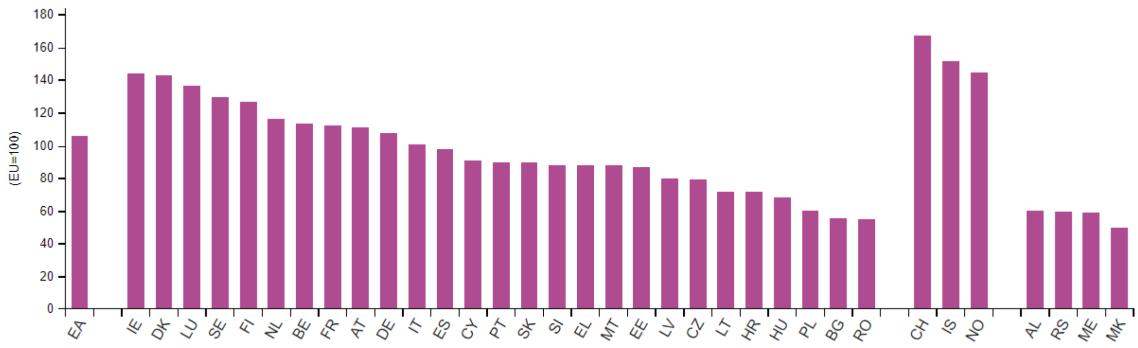
Source: CSO Institutional Sector Accounts, Non-Financial and author's calculations.

The State also excludes SME employers from the Labour Employer Economic Forum (LEEF); despite the fact that they make up the vast majority of employers in the State, and account for the majority of employees.

The third challenge is that of our domestic costs and competitiveness. In 2022, Ireland had the dubious privilege of overtaking Denmark as the most expensive EU country for consumer prices.[4] (See figure 3) Denmark has a land border with the largest economy in Europe, a luxury Ireland lacks.

Figure 3

Price level index for final household consumption expenditure (HFCE), 2021



The failure to control consumer costs is driving payroll expectations which many domestic employers simply cannot meet.

Our VAT rates are also high by EU standards, even at the currently reduced rate of 9%. We believe not only in the retention of the 9% VAT rate, but in its extension to all the services sector. The 23% rate should revert to its historical 21% level.
(List of VAT rates applied in EU member countries last updated March 2022)

Member State	**Standard rate**	**Reduced rate**
Austria	20	10 / 13
Belgium	21	6 / 12
Bulgaria	20	9
Cyprus	19	5 / 9
Czechia	21	10 / 15
Germany	19	7
Denmark	25	-
Estonia	20	9
Greece	24	6 / 13
Spain	21	10
Finland	24	10 / 14
France	20	5.5 / 10

[4] https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Comparative_price_levels_of_consumer_goods_and_services

Croatia	25	5 / 13
Hungary	27	5 / 18
Ireland	23	9 / 13.5
Italy	22	5 / 10
Lithuania	21	5 / 9
Luxembourg	17	8
Latvia	21	12 / 5
Malta	18	5 / 7
Netherlands	21	9
Poland	23	5 / 8
Portugal	23	6 / 13
Romania	19	5 / 9
Sweden	25	6 / 12
Slovenia	22	5 / 9.5
Slovakia	20	10

Some services businesses such as early years childcare represented here today must pay these exorbitant rates of VAT while being incapable of recovery of VAT paid.

Despite a significant amount of legislative activity over the last four years, insurance costs remain high. Reforms to date have made a minimal impact on motor insurance, and there are signs that motor premiums may be rising again. EL or PL insurance costs have not declined, and excessive premium cost remains an issue, as does non-availability of cover (or a single, take-it-or-leave-it quotation from one underwriter) in certain sectors. We need to see action on perjury by the judiciary, and we need rapid progress on defamation act reform, PIAB/PIRB reform, duty of care reform, and legal costs.

Regarding the report of the Review of Administration of Civil Justice[5] completed by Mr Justice Peter Kelly, we endorse the minority report by John Shaw, Liam Gleeson, Oonagh Buckley, and Kevin Fidgeon, which recommended the setting of fixed maximum costs charges and rates. We look forward to the publication of the Indecon study into legal costs later this year.

We are happy to take any questions from the Committee.

[5] Review of the Administration of Civil Justice