

Economic Assessment of SME Sector in Ireland

This paper sets out the size and structure of the small and medium-sized enterprise sector in Ireland taking into account its contribution to the economy in terms of employment, Gross Value Added and Turnover. It also outlines the main challenges facing the sector today in the form of low credit supply and weak domestic demand. Substantial data and commentary for this paper were taken from both Business in Ireland 2009 and SMEs in Ireland: Stylised facts from the real economy and the credit market produced by the CSO and the Central Bank respectively, and as such can be used for further reference. The key points to note from this paper are set out below.

- SMEs make up the substantial proportion of the enterprise economy, with over 99% of businesses in this sector and almost 70% of people employed by them. Despite this SMEs make up only 52% of both turnover and gross value added in the economy.
- Despite Ireland's reputation as one of the world's most globalised economies, 64 percent of private sector workers are employed by indigenous non-exporting firms, with 56 per cent working for indigenous, non-exporting SMEs. These numbers highlight the importance of domestic demand for sustaining and generating employment, and suggest that an export orientated growth policy may not have as large an impact on number of people employed as might be expected.
- Large firms pay substantially more than SME's; in the manufacturing sector it can be up to 25-30% more. In establishing the importance of the SME sector to Ireland, the above outlined issues point to the need to understand the extent to which SMEs economic weight as evidenced through their large employment numbers and majority ownership of GVA and Turnover are as a result of large exporting companies.
- The dependence of SME's on domestic demand given their largely non-exporting structure is significant in light of high savings rates, poor consumer sentiment and retail sales index figures all pointing towards a flagging domestic economy.³
- Lending to non-financial, non-property related SMEs by Irish resident credit institutions declined by €217 million (0.8 per cent), over the quarter to March 31st, and €1.7 billion over the year ending Q1 2012 (6.3 per cent). This follows an annual decline of 6.2 per cent in 2011.
- Both the Retail Sales Index and the Consumer Sentiment Index are at historically low levels resting at 90 and 61 which are half their 2005 levels.

³ As of late August CSO figures show domestic demand has risen 1.5% though retail sales continue to fall.

Introduction

SMEs form by far the majority of the business community in Ireland. As a largely indigenous, employment-intensive sector that relies primarily on domestic demand, SMEs are particularly responsive to changes in domestic policy. In view of the high proportion of people employed by SMEs in Ireland they are especially relevant to addressing the country's unemployment concerns.

SMEs have fared particularly badly when viewed against larger enterprises i.e. those above 250 employees, as a result of the poor economic climate over the last few years. Since larger companies and multinationals have access to funding from international sources, domestic financial sector difficulties which have resulted in tighter lending policies have greater implications for SMEs.

They also are more dependent on demand in the domestic economy which is continuing to experience the historic lows in consumer sentiment, retail sales and, the corollary, high savings rates maintained by consumers.

Role of SMEs in the Irish Economy

Business Demography

The data presented in this section is based on the Business Demography statistics taken from the CSO Central Business Register. The Business Register is a register of all enterprises that are active in the State and is based on enterprises that are registered with the Revenue Commissioners.

In 2009, there were over 199,000 active enterprises in the business economy with over 1.3 million persons engaged. Table 1 below represents the number of people employed and people engaged in each of the 5 areas Industry, Construction, Distribution, Services and Financial & Insurance Activities. These represent the business economy according to the NACE Rev. 2 classifications of economic activity which leave out Agriculture, Forestry & Fishing, Public Administration & Defence, Education and Health.

Table 1: Total Number of Enterprises by Sector

	Industry	Construction	Distribution	Services	Financial & Insurance Activities	Total Enterprise Economy
Active Enterprises	14,273	44,970	44,143	90,799	5,056	199,241
Persons employed	216,527	124,774	340,012	527,377	93,392	1,302,082
Employees	211,243	96,350	317,601	471,337	92,632	1,189,163

Source: Business in Ireland 2009

Using the Business Demography data, it is possible to break down the number of active enterprises and the number of persons engaged into employment size classes. The majority of enterprises in the business economy at 90.4% were micro enterprises with less than 10 persons engaged. A further 8.0% were other small enterprises with between 10 and 49 persons engaged. Medium-sized enterprises with between 50 and 250 and large enterprises with greater than 250 persons engaged made up 1.3% and .2% respectively. In total SMEs

accounted for 99.7% of the enterprise economy in Ireland. Persons engaged include employees as well as proprietors and family members.

Table 2: Number of Active Enterprises and Persons Engaged by Size Class 2009

Class Size	<u>Total Business Economy</u>			
	Active enterprises	Percentage of Active Enterprises by Class Size	Persons Engaged	Percentage of Persons Engaged by Class Size
Micro <10	180,199	90.4%	350,533	26.9%
Small 10-49	15,990	8.0%	305,296	23.4%
Medium 50-249	2,571	1.3%	245,123	18.8%
Large >250	481	0.2%	401,130	30.8%
Total	199,241	100.0%	1,302,082	100.0%
SME	198,760	99.76%	900,952	69.19%

Source: Business in Ireland 2009

Business Operations Data

The following data is taken from the main structural business surveys which cover the enterprise economy in Ireland.⁴ Though the Industrial Survey which covers NACE sectors B, C, D and E is missing data on micro businesses with 2 or less people it still represents adequate coverage of the sector.

Data relates to NACE rev 2 categories B to N, less 642 (excluding activities of holding companies), and excludes NACE rev 2 categories A (agriculture, fishing & forestry) and categories O to U (which includes public admin, education, health & social work, arts, entertainment & recreation, and a number of other smaller activities). The Financial & Insurance Activities sector (NACE Sector K) was not included in this analysis due to the unavailability of persons engaged data on the relevant survey forms.

The following financial variables of turnover and gross value added are analysed in terms of the employment size classes using the business survey data. Turnover comprises the totals invoiced by the enterprise during the reference period and Gross Value Added is the gross income from operating activities after adjusting for operating subsidies and indirect taxes.

Large enterprises were dominant in terms of both turnover and gross value added. Large enterprises accounted for 48.1% of turnover and 48.9% of gross value added. In contrast to the employment data seen above, micro enterprises were not as significant in terms of turnover and gross value added. Micro enterprises accounted for just 11.4% of turnover and 14.7% of gross value added while other small enterprises accounted for 19.0% of turnover and 15.8% of gross value added. Overall, SMEs contributed 52% both to turnover and gross value added which is much lower than their percentage of persons engaged contribution of 69%.

⁴ Census of Industrial Production (CIP), Building & Construction Inquiry (BCI), Annual Services Inquiry (ASI)

Table 3: Turnover and Gross Value Added Broken Down by Sector and Size Class 2009

Class Size	<u>Total Business Economy</u>			
	Turnover €m	Percentage of Turnover by Class Size	Gross Value Added €m	Percentage of Gross Value Added by Class Size
Micro <10	35,756	11.4%	12,406	14.7%
Small 10- 49	59,570	19.0%	13,325	15.8%
Medium 50-249	67,533	21.5%	17,323	20.6%
Large >250	151,130	48.1%	41,207	48.9%
Total	313,989	100.0%	84,261	100.0%
SME	162,859	51.87%	43,054	51.10%

Source: Business in Ireland 2009

An important point to note from the above outlined statistics is that while SMEs are responsible for the majority of employment in the economy it is large firms who generate a disproportionate amount of turnover and gross value added. This perhaps reflects the concept of large companies creating demand for large numbers of indirect jobs in the economy which are supplied by SME's.

Also of interest, is a breakdown of companies, by their size, ownership nationality and export orientation. Data taken from the Census of Industrial Production (2009) and Annual Services Inquiry (2008) (Note: omitting the construction sector) is displayed in the tables 4, 5, and 6 below. This data does not include sole traders and firms with fewer than three employees in the manufacturing sector, and so under represents micro enterprise's contribution in the economy.

Table 4 identifies the Services and Manufacturing share of employment by national and non-national owned SMEs as well as their export status. Note that the table now breaks down by employment in the non-construction, non financial private sector. SMEs are shown to account for 72 per cent of employment in the private sector, while they account for 82 per cent of the people employed in the indigenous economy. Of note is the fact that, despite Ireland's reputation as one of the world's most globalised economies, 64 per cent of private sector workers are employed by indigenous non-exporting firms, with 56 per cent working for indigenous, non exporting SMEs. These statistics highlight the importance of domestic demand for sustaining and generating employment, and suggest that an export orientated growth policy may not have as direct impact on number of people employed as might be expected.

Table 4: Services and Manufacturing, Share of Employment by Ownership, Export Status and Size

Class Size	Irish Non-Exporter	Irish Exporter	Foreign Non-Exporter	Foreign Exporter	Total
Micro<10	23.4%	0.6%	0.4%	0.1%	24.5%
Small 10-49	20.3%	3.1%	1.0%	0.7%	25.2%
Medium 49-250	12.7%	4.1%	2.3%	2.9%	21.9%
Large >250	7.5%	6.6%	7.4%	6.9%	28.4%
Total	63.9%	14.3%	11.1%	10.7%	100.0%
SME	56.4%	7.8%	3.7%	3.7%	71.6%

Source: Irish SMEs: Stylised facts from the real economy and credit market

Table 5 below outlines the share of Gross Value Added by class size, export status and nationality. It's clear that in terms of this measure of output, neither SMEs nor indigenous non-exporters are as important as they are for employment. Multinational exporters, accounting for 11 per cent of employment, make up 38 per cent of GVA. Indigenous non-exporters, on the other hand, while accounting for 64 per cent of employment, appear much less important in GVA, with 33 per cent of the total. The SME total of 52 per cent of GVA is also significantly lower than their 72 per cent share in employment.

Table 5: Services and Manufacturing, Share of Gross Value added by Ownership, Export Status and Size

Class Size	Irish Non-Exporter	Irish Exporter	Foreign Non-Exporter	Foreign Exporter	Total
Micro <10	11.2%	0.8%	1.0%	0.3%	13.3%
Small 10-49	10.6%	2.7%	4.0%	1.0%	18.3%
Medium 50-249	6.3%	4.0%	2.7%	7.4%	20.5%
Large >250	4.7%	9.0%	5.2%	29.0%	48.0%
Total	32.9%	16.5%	12.9%	37.7%	100.0%
SME	28.1%	7.5%	7.7%	8.7%	52.1%

Source: Irish SMEs: Stylised facts from the real economy and credit market

Table 6 below sets out the sources of aggregate investment. Similar to GVA, SMEs are shown to account for 52 per cent of total investment in the private sector. The non-exporting sector in Ireland accounts for 59.9 per cent of aggregate investment. This suggests that flat domestic demand is likely to be having a large impact on aggregate investment, regardless of the performance of the exporting sector.

Table 6: Services and Manufacturing, Share of Investment, by Ownership and Export Status and Size

	Irish Non-Exporter	Irish Exporter	Foreign Non-Exporter	Foreign Exporter	Total
Micro <10	10.9%	0.1%	0.7%	0.0%	11.7%
Small 10-49	9.2%	2.4%	11.0%	0.6%	23.2%
Medium 50-249	8.4%	3.5%	2.4%	3.2%	17.4%
Large >250	10.7%	18.0%	6.6%	12.3%	47.6%
Total	39.2%	24.1%	20.6%	16.2%	100.0%
SME	28.5%	6.0%	14.1%	3.8%	52.3%

Source: *Irish SMEs: Stylised facts from the real economy and credit market*

Table 7 displays information on average wage of firms of different class size and nationality. It shows that firms that are larger tend to pay more, with foreign firms paying more than Irish firms. This information could be viewed as a proxy for the value of generating a job in a large company versus a small or medium sized enterprise. Combined with the knowledge that large firms have much higher GVA with lower amounts of persons engaged, it seems likely that a given amount of jobs in a large firm are worth much more to the economy as a whole than the same amount in SMEs on average.

Table 7: Average wages in €000s in Manufacturing and Services by nationality

	Manufacturing		Services	
	Irish	Foreign	Irish	Foreign
Micro	35	42	30	65
Small	36	51	32	62
Medium	41	52	31	56
Large	48	63	36	41
SME	37	48	31	61

Note relatively large wage in Micro/Small foreign firms could be a result of small sample size allowing some high-end foreign producers to push up the wage average. Also, the average wage for SME is a simple average. The relatively high number of employees in micro firms with lower wages would pull down the average even further if weighted.

Source: *Irish SMEs: Stylised facts from the real economy and credit market*

Challenges facing the industry

Access to Credit

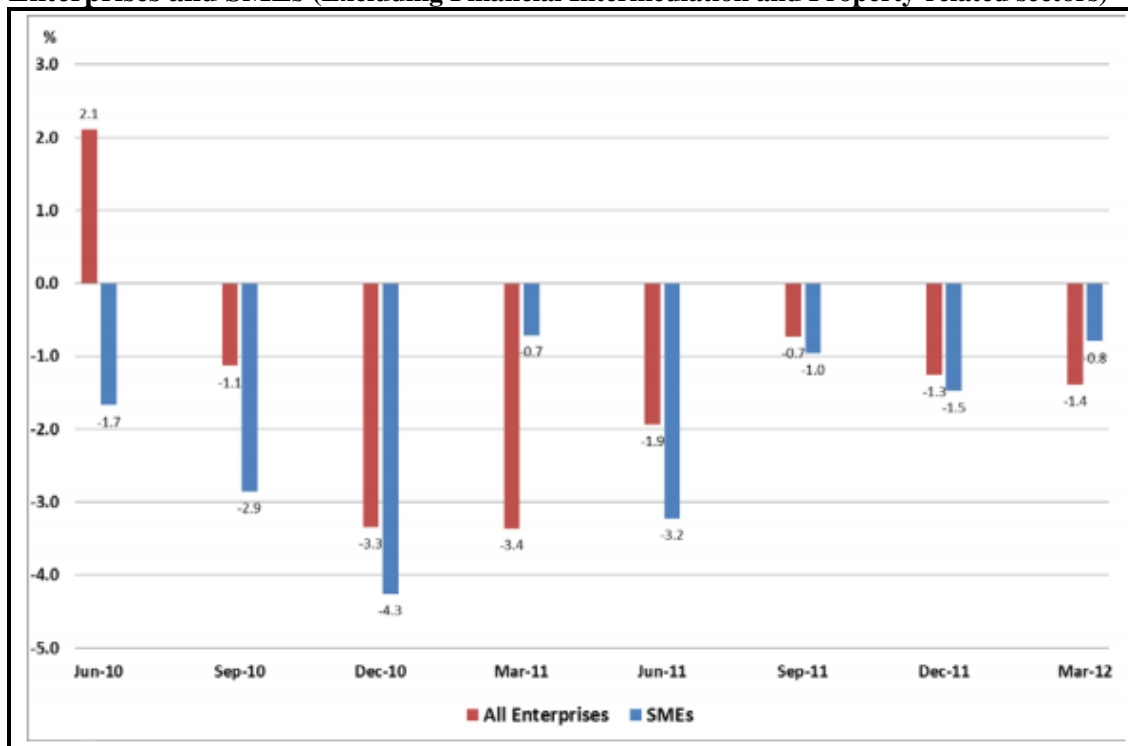
Research conducted by the Central bank has shed light on the difficulties SME's face in accessing credit. They have found evidence that as a consequence of economic conditions, many foreign banks are exiting the Irish lending market leaving a smaller pool of lenders supplying credit to meet demand (especially so for SMEs), with less competition between those lenders.

The Central Bank's research shows that while there has been a small fall in SMEs demanding credit there has been a large rise in rejection rates independent of the productivity or growth rate of the firm. They also indicate the likelihood that banks' lending decisions are likely to

display credit rationing implying that viable businesses aren't receiving funds they would have in years gone by or they are receiving them at higher interest rates.

Figure 1 below shows changes in credit advanced to all enterprises in the economy and SMEs. Lending to non-financial, non-property related SMEs by Irish resident credit institutions declined by €217 million (0.8 per cent), over the quarter to March 31st, and €1.7 billion over the year ending Q1 2012 (6.3 per cent). This follows an annual decline of 6.2 per cent in 2011. Figure one below shows declining overall lending to all enterprises in the economy with lending to SME's losing a greater amount of credit each in many quarters than all enterprises taken together.

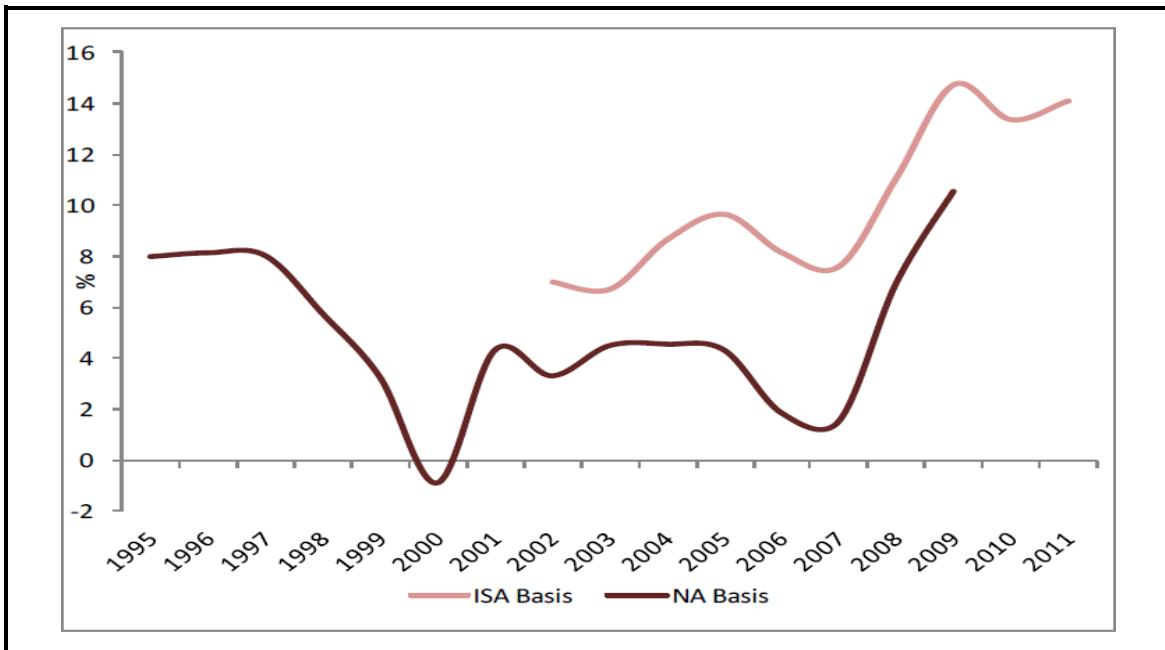
Figure 1: Quarterly Rates of Change in Credit Advanced to All Private-Sector Enterprises and SMEs (Excluding Financial Intermediation and Property-related sectors)⁵



⁵ http://www.centralbank.ie/polstats/stats/cmab/Documents/2012q1_ie_trends_in_business_credit_and_deposits.pdf

Flagging Domestic Demand

Figure 2: Savings rate in Ireland 1995-2011



Source: The savings rate during the recession-ESRI Paper6

The data from the National Accounts and the Institutional Sector Accounts displayed in Figure 2 above, tell the same story; the level of the savings rate during the period 1998-2007 was low relative to those estimated for earlier periods and were associated with significant increases in the level of real household consumption, with the National Accounts Data averaging 6.3 per cent from 1997-2007. The negative savings rate in 2000 was associated with a volume increase in consumption of 10.5 per cent between 1999 and 2000. In 2008 and 2009 the savings rate increased to 6.9 per cent and 10.5 per cent respectively from a level of 1.5 per cent in 2007 and these increases were associated with a decline in real household spending. This reservoir of savings contributes to the poor domestic climate faced by the SME sector but is worthy of hope if fundamentals of the economy increasing consumer sentiment. In this environment consumers may be encouraged to draw down savings which will support SME's going into the future.

The Retail Sales Index (RSI) and the Consumer sentiment Index (CSI) going back to 2005 are graphed in Figure 3 below. The Retail Sales Index is the official short-term indicator of changes in the level of consumer spending on retail goods. It measures the trend in the level of average weekly sales for each month, after allowances are made for calendar composition. The Consumer sentiment index records details on consumers' attitudes towards trends in the economy.

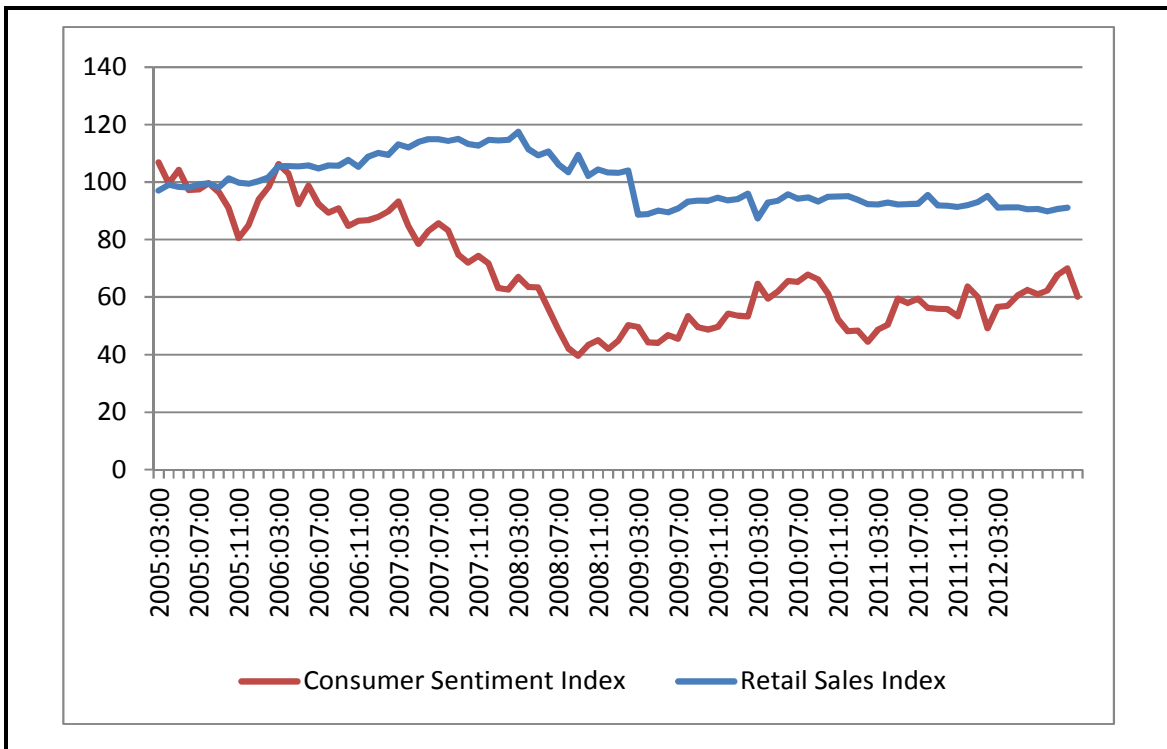
Both indexes have fallen substantially from 2005 onwards and remain low historically.

⁶ http://www.esri.ie/publications/latest_publications/view/index.xml?id=3563

These indexes reflect the poor performance of the domestic economy which, as demonstrated earlier in the paper, is highly relevant for SMEs in the economy. The CSI declined from 70.0 in August to 60.2 in September. This compares to a reading in September of last year of 53.3. It is now down 44% from the peak in January 2005. The 3-month moving average also weakened, to 66.0 from 66.7 in August.

For the RSI, August figures show the volume of retail sales (i.e. excluding price effects) increased by 0.4% in August 2012 when compared with July 2012 while there was an annual decrease of 0.6%. It is now down 33% from its peak in January 2008.

Figure 3: Retail Sales Index and Consumer Sentiment Index from 2005 to May 2012 and April 2012 respectively



Source: CSO Statbank