British-Irish Parliamentary Assembly

Tionól Parlaiminteach na Breataine agus na hÉireann

Committee C (Economic Affairs)

Report on

The Small and Medium Enterprise (SME) Sector

May 2012

Doc No 188

1. Introduction

1.1. Background to the enquiry

Following an informal meeting of Committee C at the 43rd Plenary in Brighton in October 2011, the newly formed Committee took the decision to continue work on a report into SMEs which the previous Committee had begun. There was unanimous agreement by members present that, in the current economic climate, SMEs are facing great difficulties, in particular with regards to accessing finance and that this is very much a subject that should continue to be reported on and highlighted by the Committee.

The Committee began its enquiries into this report on SMEs on 30th January 2012 at a meeting in London. At this meeting the Committee discussed the approach it wished to take in producing a report on this subject and it was agreed that the Committee would apply new terms of reference from the work of the previous committee in order that a report could be presented by the 44th Plenary and also to reflect the current core issues effecting the SME sector. At this meeting the Committee took its first evidence from Roger Pollen, Federation of Small Businesses Northern Ireland.

On 12 March 2012, the Committee met in Dublin. On this occasion the revised terms of reference for the SME inquiry were agreed, reflecting the interests of the membership which had changed substantially since the inquiry was first launched. The Committee met with a number of guests to take evidence on aspects of this topic, with a focus on access to finance for SMEs: Mark Fielding, Irish Small and Medium Enterprises Association (ISME), Patricia Callan, Small Firms Association (SFA), John Trethowan and Catherine Collins, Credit Review Office (SFA), and officials from the Department of Enterprise, Jobs and Innovation and Enterprise Ireland.

The Committee met in London again on 23 April 2012 to conclude it's evidence-gathering on SMEs. Discussions were held with Graeme Fisher, Federation of Small Businesses (FSB), Adam Marshall, British Chambers of Commerce (BCC), Emma Wild, Confederation of British Industry (CBI), Irene Graham and David Dooks, British Bankers' Association (BBA), Matt Bland, Association of British Credit Unions Limited (ABCUL), and officials from the Department of Business, Innovation and Skills.

1.2. The Terms of Reference

Terms of Reference for an inquiry into the
Small and Medium Enterprise (SME) sector.

Committee C wishes to examine the access to finance, financial support mechanisms and incentives available to those in the Small and Medium Enterprise (SME) sector.

The Committee may wish to seek the views of all BIPA administrations on support for, and the potential of, the SME sector, with a particular interest in the following points:

Support for the SME sector

- The role of government in identifying potential SME opportunities and growth areas;

- Access to finance and sources of funding for SMEs;

- Government incentives for the establishment of and the continuing business of established SMEs ;

and

- The role and impact of public procurement policy in SMEs.

Potential of the SME sector

- The importance of the SME sector in the wider economy with regards to economic recovery, employment and growth.

2. IMPORTANCE OF THE SME SECTOR

2.1. In Ireland, there are almost 200,000 small businesses employing between them over 655,000 people. In the UK, these figures stand at 4.5 million small businesses employing an estimated 13.8 million people. By definition, a small business is one that employs fewer than 50 people and a medium business employs between 50 – 249 people. In Ireland, a large number of small businesses actually employ fewer than 10 people and may therefore be categorized also as micro-businesses. It is estimated that there are 23 million SMEs in the EU. This figure accounts for almost 99% of all business.

2.2. During its enquiry, the Committee heard evidence from the Irish Small Firms Association on the importance of small and medium enterprises to the Irish economy, arguing that they were a more sustainable way to grow the economy than relying on foreign direct investment. It is reported that during the economic crash as many jobs had been created in the SME sector as had been lost in other sectors.

In the UK, there has been a move to concentrate on support and development of medium scale businesses which are seen to have the potential to make a large impact on the economy. In 2011, 22% of revenue was generated by businesses in that category, which accounted for fewer than 1% of firms by number. Medium enterprises were often particularly strong in parts of the country hard hit by the recession. In the North East of England, for example, one in five jobs was with this type of company.

3. GOVERNMENT ENGAGEMENT WITH SMEs

3.1. The Irish Government, shortly after its establishment in early 2011, appointed a Minister for Small Business. Following on from this, the Advisory Group for Small Business was launched in June 2011, and its report published in November 2011.

In the report, the Advisory Group acknowledged the severe impact that the challenging economic environment has had, and continues to have, on small businesses in Ireland. There were 8,000 fewer small businesses and 105,000 fewer people employed by small businesses in 2009 than there were in 2007.

The Department recently published an Action Plan for Jobs, which had a strong focus on SMEs. The report claims to deliver on a number of recommendations of Advisory Group on Small Business.

The objective is to secure 100,000 net new jobs by 2016 and have 2 million people at work by 2020. The Plan also contains a number of initiatives to help SMEs access public contracts, such as: looking at opportunities within the supply chain for capital investment; considering innovative methods of procurement – for example, not defaulting to buying standard products in bulk; and implementing a Small Business Innovation Research scheme (as has been done in the UK). The Department was interested in the model that had been adopted for the London Olympics, with Tier 2 and 3 contractors coming in further down the chain from the principal contractors. The introduction of such supply chains could begin with the proposed water metering roll-out and also the Irish Presidency of the EU in 2013.

There are 270+ actions across the whole of Government contained within the report. In order to ensure monitoring and implementation of the plan it is to be noted is that there is a “whole of Government approach”, with all 15 Ministers having commitments in the Plan. Also a ‘Central Monitoring Committee’ has been established, with dedicated resources and it has already identified key deliverables for Q1 of 2012 (approx. 80) and these will be published in Q2 of 2012.

Enterprise Ireland also explained its role in supporting small business start-ups. It focuses on 'high potential' start-ups, which have a 15-20% failure rate, much less than the average. He said they supported the idea of corporate tax exemptions for start-ups and stressed the point that having a competitive economy was the key to success in business.

3.2. The UK Department of Business, Innovation and Skills met with the committee to give an update on its research on the SME sector and gave an overview of current Government schemes to improve access to finance for SMEs.

Increasing the flow of credit to SMEs was a commitment made in the UK Coalition Agreement. The Government's priorities were to ensure the availability of debt finance and equity finance (both in terms of volume and diversity) to small businesses; to ensure affordability—reasonable terms and conditions for loans; to repair relationships with banks and their customers which may be affecting confidence (the BBA commitments on guidance for decision-making, the appeals process and the web portals were important here); and to ensure that businesses were equipped to secure the finance they needed to start and grow.

Key issues affecting SME finance on the demand and supply sides were summarised. Some of these were long-standing issues, such as equity aversion and lack of finance and investment readiness among SMEs, highly concentrated banking markets and banks seeking to reduce exposure to certain sectors. Others were particular to current circumstances: low business confidence in the economy, over-reliance on bank finance, and problems with the affordability and availability of bank lending.

Government schemes aiming to address some of these issues were outlined. These included government support for access to bank finance via the Enterprise Finance Guarantee (through which it was estimated that every £1 of government funding has facilitated £20 of bank lending); publicly-backed venture capital funds; support for exporters run by UK Export Finance; and schemes under the Regional Growth Fund (such as the Business Angel co-investment fund and the Community Development Finance Association wholesale finance scheme). These were in addition to Treasury-led credit-easing initiatives, the National Loan Guarantee Scheme and the Business Finance Partnership.

The role of the Small Business Economic Forum, which was set up in October 2010, is to bring together businesses and financial institutions to provide Ministers with advice on strategic issues and particular initiatives. At the quarterly meetings of the Forum, business organisations had been able to influence the design of policies including the small business taxation review, BBA's commitments, credit easing, finance readiness and regulation.

A Department official explained the work of the Breedon Review to the Committee. The review, "Boosting Finance Options for Business", was conducted by an industry-led taskforce and reported in March 2012. It examined the long-term structural issues faced by businesses seeking finance, and the options for non-traditional bank finance.

UK-based businesses had a similar proportion of bank to non-bank lending as elsewhere in Europe, but other countries tended to have a wider range of banks from which to choose. In comparison to the USA, UK businesses had few options for non-bank lending. The review concluded that there was no clear evidence that banks were not meeting SMEs' current needs for lending. However, between now and the end of 2016, owing to stricter prudential reserving requirements, it was estimated that the banks would be unable to supply between £84bn and £191bn of the finance need to support the growth in the UK economy, of which £25bn to £59bn related to smaller businesses.

The taskforce inquired into a number of aspects of the issue of non-bank finance: awareness and demand, access to capital markets, supply chain finance, business finance partnership, regulation, and credit information—meaning the concentration of credit data within the major banks, which acted as a barrier to new entrants to the market. In its conclusions the taskforce emphasised that all parties—business, industry and government—would have to work together to address structural and behavioural barriers. The review's recommendations to address awareness and demand included introducing a Business Finance Advice scheme which would 'kitemark' accountancy firms to show they are competent to give advice to businesses on finance options, creating a single brand for government support programmes, and consolidating responsibility for delivery of government Access to Finance programmes in one agency. Breedon also recommended that Government use its power as the biggest purchaser in the UK to encourage its own suppliers to adopt good practices to support their suppliers. A study had been commissioned to assess the impact of international regulatory measures on SMEs' access to finance.

The view of the British Chambers of Commerce is that the Small Business Economic Forum had started promisingly, but was now marginal. Under the previous Government there was a more effective mechanism for engagement between small businesses and financial institutions, as individual cases could be brought to it; in its present form, they were of the view that the Forum was more of a talking shop. The Federation of Small Businesses argued that it would be preferable for small businesses to have a permanent presence in government through a separate agency or administration (such as the US Small Business Administration).

3.3. There is a need for continuity and stability in Government initiatives targeted at SMEs. Information on support schemes is not always communicated adequately by Government departments to businesses. This is in marked contrast to practice in some other countries, for example in the USA where the Loan Guarantee Programme is still in operation having been established under legislation passed in 1953. Germany and South Korea offered other good examples of long-term business support schemes. It is probable that small businesses might be persuaded to try a new funding scheme once. However, if they felt it had not been worth their while, for example if there was a disproportionate amount of paperwork, they might not try it again. If they had certainty that those schemes would be there in the long term, they would have time to work out how best to make use of them.

4. ACCESS TO BANK FINANCE

4.1. The Committee heard from ISME that small businesses in Ireland were currently experiencing a 50% refusal rate for loans. It was argued that this was primarily because it was not as profitable for banks to lend to small businesses, and that it increased their exposure. The banks were reporting that there was little demand for finance, but Mr Fielding argued that while this may have been the case 18 months ago, demand had been rising since then.

Many of the businesses being refused loans were well-established: 85% had been in business for more than five years, and 40% for more than ten years. Loans were being refused in circumstances which in previous years had not been deemed problematic – for example, stocking loans over the Christmas period that had on previous occasions always been promptly repaid, loans against confirmed customer orders, or for businesses wishing to take advantage of deals. Some businesses were also finding their overdrafts reduced.

It was reported that ISME members have applied for loans in recent times and been unsuccessful. An example of this would be where a business owner might apply for a loan of €50,000 and the bank would approve a loan for €20,000. This amount, therefore, may be inadequate for the applicant in terms of the purpose of the loan. Regardless of whether such a loan offer is drawn down, the bank records it as a positive result as they have approved an application and made an offer even if it is significantly less than the amount applied for. This leads to warped statistics about what is actually happening when it comes to lending to small business.

In the UK, there are well-documented difficulties currently for small businesses seeking finance. The UK Federation of Small Businesses reported that around 40% of businesses applying for loans were being turned down, in contrast to around 10% a few years ago. Businesses said that they did not always receive useful feedback from banks on their loan applications. Most businesses that were successful in obtaining loans were being offered reasonable conditions, although a minority—around 15%—were being offered interest rates of 11% or more above base rate.

A major problem for small businesses seems to be the “slow no”, with banks taking a long time to make decisions and making repeated requests for information.

In response to the question as to how common it was for banks to seek to switch businesses from an overdraft facility to a term loan, the British Bankers’ Association said that there had in the past been cases where overdrafts had been used inappropriately, and some rebalancing was now taking place. Any business that felt what it was being offered was not right could appeal, they said, and businesses should be encouraged to be challenging. However, banks would naturally always need to assess carefully factors such as ability to repay, risk levels and the state of the market when making credit decisions.

4.2. There were a number of differences in opinions from witnesses about SME experiences and bank decisions when the committee was taking evidence for this report. From ISME, the Committee heard that not all instances of loans not being granted were being recorded officially by banks as refusals. Typical responses to inquiries included being told that the bank was not lending at that time, or not lending in a particular sector. Banks also argued that small businesses were not presenting their cases adequately, but they said that this had not been a particular problem in the past. There is a need to insist on “honest and reliable” reporting by banks, including distinguishing between loans and overdrafts, and new lending as opposed to continuations of existing agreements. There was a difference between what the banks were reporting centrally, and what was being said to applicants in local branches. The success rate of loan applications had been distorted by the recent inclusion of the agricultural sector within SME lending statistics. Their inclusion has been a departure from the norm and, as farmers are being granted loans applied for which were accompanied by letters of guarantee of government grants due, their inclusion in SME statistics has created the appearance of increased lending.

The Irish Small Firms Association said access to finance was an area of “market failure”. The venture capital market was not developed, and the lending market had contracted with the number of Irish banks falling from eight to three. The lack of competition was increasing the costs of lending. The pendulum had swung from easy lending during the economic boom, to far too much information being demanded of businesses by banks in order to secure finance in the present climate. The banks stated that even the companies which were trading well were losing them money. There was no longer a crisis situation with banks simply not making any decisions, but the system was still not moving rapidly enough. Banks were no longer forcing loan restructuring on businesses to the extent they were previously. However, not every business has been able to access the overdraft facility they routinely needed to manage cash flow.

Commenting on the mismatch of information between banks and small businesses about the amount of lending that is taking place the representative from the Credit Review Office in Dublin suggested that each party in the debate could be both right and wrong. With consumer confidence and therefore demand low, many businesses did not have plans to expand and therefore did not need as much credit as they did during the economic boom. Reports from businesses that "the banks aren't lending" might be a response to "the casual decline to the casual request"; businesses needed to be encouraged to make formal applications. The CRO had implemented a common application form for finance, and would like in future to encourage businesses to adopt a standardised cash flow as well.

The UK Federation of Small Businesses explained that margins on small loans were very tight for banks, and one large bank had told FSB that even if one out of every hundred small start-up companies on their books failed, that would allegedly wipe out the margin. Administration costs of credit-easing schemes would further reduce these margins, and as a consequence only one major bank was providing very small loans under the initiative. Many businesses were instead financing through credit cards, mortgages or friends and family. It seems that many firms understandably also did want to see signs of economic recovery before investing in their own businesses. Small businesses and banks gave different impressions to the CBI, too, about whether the problem in access to finance lay in supply or demand.

The British Chambers of Commerce reported that there was indeed some evidence of discouraged demand for finance. He also argued that the Office of National Statistics figures on the state of the economy painted a picture which was not recognised by many businesses. The Quarterly Economic Survey gave grounds for "guarded optimism", but the media reporting of ONS figures—which often seized on incomplete or unrevised data—undermined business confidence by suggesting a much gloomier outlook. In this context, BCC was appreciative of the independent surveys of businesses that had been commissioned by the banks, through the SME Finance Monitor.

The British Bankers' Association provided the committee with the following statistics on SME lending:

- 51% of all SMEs had not used external finance in the past five years; 46% are currently using external finance.
- In 2011, 4% of all SMEs applied for loan facilities; of these, 63% were approved, although the approval rates were significantly higher for larger businesses, low risk businesses, and those applying for renewals rather than making first-time applications.
- In 2011, 9% of all SMEs applied for overdraft facilities, of which 79% were approved, with the same variations as above.
- Over the year prior to the survey, 12% of SMEs had considered applying for finance but had not done so. The most significant factor inhibiting applications was SMEs assuming they would be declined finance, or inferring this from informal discussions with their bank.

The BBA expressed concern about reports of SMEs being scared to approach banks, and argued that pessimistic media reports were causing a lack of confidence, even where a business' own experience had hitherto been positive. It was acknowledged that an interaction that a bank might regard as a normal part of the business relationship might be interpreted by an SME as an informal refusal. Businesses were also very concerned about the future of the Euro.

4.3. The Credit Review Office was established by the Irish Department of Finance under Section 210 of the NAMA Act (National Assets Management Agency) as one of the responses to a dysfunctional banking system since the economic crash in 2008. The CRO has three core staff members, supplemented by a panel of expert advisers. Its remit is to review decisions of the two 'pillar' banks on lending, but also have contacts with a third bank, which between them cover up to 75% of the SME / Farm market in Ireland. The lending reviews are on amounts of up to €500,000 to businesses employing up to 250 employees (although most of the applications for review were made by 'micro-businesses', employing fewer than ten people). These decisions could be refusals of credit, or changes of conditions to existing agreements. As well as acting as a credit ombudsman, the CRO operates as a consultancy service, attempting to produce deals which are acceptable to both the lender and the borrower. Take-up of the service is not as high as the CRO would like. Many businesses' applications suffered from having buy-to-let properties as assets. In good economic circumstances, businesses had been encouraged to invest reserves into these properties, which had plunged in value and had outstanding mortgages which dragged the business down. The CRO tried to disaggregate these properties from the health of the business when it reviewed decisions. Conversely, at present there were excellent deals to be had on commercial property, but the banks did not entertain the idea of financing these.

4.4. The UK banking industry, through the British Bankers' Association and its 'Better Business Finance Taskforce', has made a number of commitments to businesses. These were originally agreed with six major banks, since when the Co-operative Bank and the Northern Irish banks had also signed up. A monthly round table was held with business organisations to discuss progress against these commitments, and a similar round table specifically for Northern Ireland had recently been launched. One of the commitments was to fund and publish a regular independent survey to provide an authoritative information base on business finance demand and lending supply. Accordingly, the BBA had begun funding a quarterly survey of 5,000 SMEs, conducted by BDRC Continental, known as the SME Finance Monitor. This has now collected a year's worth of data relating to businesses intentions and experiences of accessing finance. The annual report of the survey would also include a regional perspective on the figures.

There has been progress made towards fulfilling some of the other commitments. A common set of lending principles had been agreed and a team set up to review the effectiveness of banks' appeals processes. The right of an applicant to appeal against a decision was described in refusal letters. Already, 500 out of an eventual total of 1,000 new business mentors have been recruited, and a mentoring portal has been established to facilitate access to 11,000 mentors across the country. The SME Finance Monitor showed that a very large number of businesses did not seek accountancy advice before applying for a loan, and many had no internal sources of expertise. Mentors could help support businesses through the process of approaching banks for finance.

A website (betterbusinessfinance.co.uk) gave businesses an opportunity to compare what was on offer from different banks, and alongside individual banks actively promoting their products; The BBA was also seeking to use social media to spread awareness of what is available and also working with credit reference agencies to understand better how personal credit ratings could adversely affect business applications.

The BBA also sought to reassure to the Committee about the consistency of data reporting by banks, for example in ensuring that continuing and new lending are categorised appropriately. It said it was "very confident" that the lending situation was being monitored and reported as accurately as possible, both in its own and in Bank of England statistics.

5. REASONS FOR DIFFICULTIES IN ACCESSING BANK FINANCE

5.1. The British Chambers of Commerce assured the Committee it no desire to "bash the banks", recognising that they were caught between the need to service business customers on one hand, with the need to submit to greater regulation and repair their balance sheets on the other. However, there was a need to build relationships, trust and transparency between banks and businesses, and more choice was needed in the lending market.

5.2. ISME questioned the ability of frontline bank staff to understand the information that businesses presented to them, and therefore to assess risk appropriately. There was a tendency for banks to make lending decisions on the basis of businesses' physical assets. Further loss of expertise in the banking sector was likely, with the announcement that Allied Irish Bank would be shedding 2,500 jobs. The Irish SFA said that the assessors in bank branches needed the skills and knowledge for "traditional" business banking, which involved understanding the potential of a business. Banks were attempting to reform the service they offered to businesses, for example by placing business specialists in branches, but this would take some time to have an impact.

The Irish Credit Review Office argued that the "art of banking"—meaning the autonomy for decision-making at the front-line—had to some extent been lost, and the bar was being set too high by credit analysts. Some of the applications which had been rejected and subsequently sent to the CRO showed poor understanding from bank staff—even on occasion wrongly classifying the industry concerned, which resulted in an immediate rejection. The CRO had asked Allied Irish Bank and the Bank of Ireland to translate their lending targets to the frontline, to encourage staff to lend whenever possible.

The Confederation of British Industry commented that medium-sized enterprises often struggled to source funding to grow their businesses; while start-up funding could still be found, venture capital to take a business to the next stage was harder to come by. This is what led to many companies coming under foreign ownership.

Small businesses need raised levels of confidence and ambition, and a scaling up of capability to manage a higher turnover (in areas such as recruitment, innovation and overseas expansion). CBI reported that there was a capability gap in SMEs; many did not have fully qualified Finance Directors, and consequently there was a need for them to be more open to external advice. One option for achieving this was the Business Growth Fund, an initiative by the banks to provide both equity and expertise, so, for example, placing an experienced hand on the board with a minority stake in the company. Business support services provided directly by government had generally been scaled back, but these had often been viewed with scepticism by companies anyway. Graeme Fisher of the FSB argued that there was insufficient expertise within the banks at regional level, which impeded the development of exports.

5.3. ISME wants the availability of funding to be increased, stating that the amount of new finance coming forward was lower than that promised by the conditions of bank bailout packages. Furthermore, the finance that was coming forward was not all 'new and additional', as promised (€3bn of new and additional finance had been promised but this figure was subsequently revised downwards to €1.6bn). ISME also recommended that the Irish Government bring forward a micro-finance scheme, and investigate the funds available for small businesses across Europe, for example through the European Investment Bank.

According to the SFA, the Irish Government had promised to put a Government-backed loan guarantee scheme in place by the second quarter of the new financial year. The SFA argued that it was crucial that this generate additional lending, not just provide greater security for banks and higher costs for businesses on loans that would have happened regardless.

The UK FSB's view was that the credit-easing packages that had been announced by the UK Government would for the most part only help businesses that were successful in getting a loan in the first place. They would not be a "silver bullet", therefore, but might possibly encourage some businesses to come back into the market for finance. The BCC argued that credit easing had been "over-sold", as it would not help with new finance, just better terms for loans that would have been granted anyway. The consensus view was also that quantitative easing had helped – and, indeed, rescued – the banks, but had had little impact on the wider economy, including lending to small businesses.

Government consultation is also underway on proposals to simplify the tax regime in 2013, which by the FSB's estimate would help some three million small businesses by allowing them to move to cash accounting. However, the £77,000 turnover threshold means that tax simplification is "a very niche issue". BCC are concerned in general that there has been little in the Budget to help medium-sized businesses. Whereas corporation tax changes would help the largest, and tax simplification the smallest, those in the middle would be hit by increased business rates and a cut in capital allowances.

The BBA also expressed "absolute confidence" that the 1% reduction in interest rates under the National Loan Guarantee Scheme would be passed on to businesses (rather than increase banks' lending margin), as this was mandatory under the scheme. The scheme would also aid banks which were finding it expensive to finance from the wholesale market because of intense regulation.

6. ALTERNATIVES TO BANK FINANCE

6.1. Although the long-term solutions might lie in reform of the banking sector, FSB argued that in the shorter term promotion of non-banking routes to finance (peer to peer lending, crowd funding and SME bond markets) would make more impact. Greater innovation, choice and competition were needed. The FSB had published a paper on alternative finance in which it had investigated options from the USA and Germany, where such mechanisms were more developed. The Confederation of British Industry had observed that many small companies were actively seeking to reduce their dependence on bank loans. This was vital, as the Breedon Review had highlighted the fact that in three years' time demand for finance would have increased, but supply of credit from banks would not. Many non-bank financing options required SMEs to give up a share of equity, however, and the British Chambers of Commerce noted that a lot of SMEs found that idea problematic. They argued that SMEs needed to be educated about equity funding, and have more access to models such as mezzanine finance, not least because the banks should not be expected to shoulder all the risk of growing smaller businesses.

When new routes to finance were made available, all the panellists agreed that it was vital to ensure that SMEs understood them and how to access them. BCC argued that at present there were some good products being made available for SMEs, but also there was a failure of marketing and communication on the Government's part. UK Export Finance was an example of a good scheme that was not being advertised clearly, and the difficulties in communicating were only exacerbated by having it sold through the banks. Through regional networks of medium-sized enterprises, the CBI was aiming to address lack of awareness of the different types of finance such as those highlighted by the Breedon Review. It was also promoting a kitemark scheme that would help businesses identify accountants who would be able to advise them on finance options beyond traditional banking.

The British Bankers' Association said there was a need to expand alternative sources of finance to SMEs. The banks had committed to signposting alternative sources of finance for customers whose applications for loans were declined. A website (businessfinance4u.co.uk) would launch later this month to help them find out what is available. The Business Growth Fund had been established to provide equity finance from banks for high-growth businesses. A growth in asset finance required an education process for both businesses and banks.

Although all the banks had strong programmes to support start-ups, the BBA argued that it was not always appropriate for banks to be the lender for these enterprises. Banks should signpost to sources such as angel finance or community development finance which might be more suitable, and the individuals behind the business need to show ownership as well.

6.2. Pilot schemes in Ireland which would have allowed Credit Unions to lend to small businesses have been closed down by the regulator. However, the SFA believes that it should not be necessary to look to Credit Unions for finance; the banks have sufficient funds, but were not making them available.

There are currently nearly 840,000 adult members of Credit Unions in England, Scotland and Wales; they held over £700m in deposits and more than £570m is on loan. The umbrella organisation is the Association of British Credit Unions Limited, but credit unions in Northern Ireland do not come under this group.

Full current account facilities were provided by 25 credit unions in partnership with the Co-operative Bank. The Committee noted that, despite some recent growth, credit unions were a much less widespread feature of the financial landscape in the UK than in Ireland. ABCUL suggested some reasons for this: a banking system dominated by a small number of large banks, and many of the services provided by credit unions being available through other channels. Active discussions are underway about the potential to make credit union services available through Post Offices in the UK.

New legislation which came into force on 8 January 2012 enabled credit unions for the first time to provide loan finance and other services to local businesses, community groups and social enterprises. ABCUL commented that this was one of a number of reforms that might provide an avenue to greater sustainability by increasing profitability and enhancing deposits.

The Legislative Reform Order would restrict the level of funding to SMEs to a minority area of their business (up to 10% of a credit union's loans), and credit unions would still be bound by their statutory objects. Although the scale of this lending was at present small, ABCUL noted that in countries where credit union movements were more fully developed, the sector often played a significant role in providing finance to SMEs. In the USA, for example, the Government was supporting legislation that would enable credit unions to more than double their cap on business lending. At December 2011, the total lending to businesses by US credit unions stood at $40bn or around 4% of assets.

7. SMEs AND PUBLIC PROCUREMENT

7.1. The Irish SFA would like the state sector to publish details of businesses with which it had contracts, in terms of how many are going to domestic businesses rather than overseas, and the size of the firms involved. There should be international benchmarking for who wins contracts, and the state should also assess the impact of procurement practices on quality of service. Reducing lot sizes, and requirements such as insurance, could make public procurement through SMEs more attainable.

7.2. Variable interpretation of EU procurement rules are a possible reason for difficulties experienced by SMEs. International procurement policies could make it difficult for SMEs to compete for public contracts. While all EU countries worked to the same public procurement processes, there were differences in how the rules were implemented and terms defined between Ireland, the UK and, for example, France and Germany. Some Irish SMEs had been successful in obtaining public contracts elsewhere in Europe, but not at home. Anecdotally, small businesses reported that it was easier to secure public contracts in Northern Ireland than in Ireland.

7.3. The UK Federation of Small Businesses and the British Chambers of Commerce agreed that central government had made considerable progress in encouraging the involvement of SMEs in public procurement. The Cabinet Office portal had stimulated SME involvement in supply chains, and the London Olympics procurement portal, 'Compete4', was praised as an excellent example of encouraging SMEs to bid for public contracts; some 46% of Games contracts went to small firms. However, procurement was very devolved in the UK, and the British Chambers of Commerce described the practice of local government and executive agencies as "a disaster". Pre-qualification and other bureaucratic processes, and hurdles such as turnover thresholds that had been abolished at central government level were reappearing in local or devolved procurement processes. The FSB felt that over-cautious attitudes to risk in local authorities and other local public agencies were hampering SMEs' prospects.

8. CONCLUSIONS

8.1. Small and medium sized businesses are of huge importance to the economies of Ireland and the UK, and a thriving SME sector will be an indispensable ingredient for economic recovery. We are encouraged to hear about the many initiatives which have been put in place by both Governments to engage with the sector, promote its growth and ease access to finance.

8.2. If SMEs are to have confidence in provision made for them by the banking system, it is vital that accurate, consistent information about bank lending is available. The SME Finance Monitor survey in the UK, and the analysis of the Credit Review Office in Ireland, are both invaluable in this regard. We support the CRO's efforts to publicise its service more widely. It is also important that SMEs be encouraged to make formal applications for finance and have access to the support they need to do so. This support includes access to skilled and knowledgeable staff in bank branches.

8.3. In the present economic circumstances, it is likely that there is some suppressed demand in the SME sector for bank credit. However, as the economies of our countries recover, demand will surely far outstrip supply, particularly as there will be no quick remedy for some of the identified current issues, such as a concentrated banking market. The UK's Breedon Review has highlighted an alarming prospective shortfall of bank lending over the next four years, a finding which has important repercussions for Ireland as well, given the importance of UK-based banks for the economy. Businesses will have to look beyond the banks, to non-traditional finance streams such as equity funding, angel finance or peer-to-peer investment. Both Governments also need to respond urgently, firmly and imaginatively to the implications of the Review.

8.4. This is new territory for most small businesses. They will need support to take advantage of non-bank finance options: expertise either in-house or readily available from trustworthy external sources, clear and timely information about what the options are and how to access them, and Government action if necessary to promote a diverse range of finance routes. We urge both Governments to prioritise these actions so that our small and medium sized enterprises can reduce their dependence on bank lending over the longer term.

8.5. Public procurement remains a difficult area for many small and medium-sized enterprises. We welcome the initiatives announced in the Irish Government's Action Plan for Jobs to address this, and we are encouraged to hear positive reports of recent developments at central Government level in the UK. We recommend that our Governments seek to learn from each other about successful models for stimulating greater SME success in public procurement, particularly at local levels and at lower tiers of the Government supply chain.

COMMITTEE MEETINGS AND ATTENDEES (LIST)

London, 30th January 2012

Attendees:
Jack Wall TD (Chair), John Robertson MP (Vice-Chair), Oliver Colvile MP, Senator John Crown, Paul Flynn MP, David McClarty MLA, Mattie McGrath TD, Senator Paschal Mooney, Ann Phelan TD, Mary Scanlon MSP, Arthur Spring TD.

Attended for part of the meeting:
Joe McHugh TD (Co-Chair of Assembly), Laurence Robertson MP (Co-Chair of Assembly.

Dublin, 12th March 2012

Attendees:
Jack Wall TD (Chair), John Robertson MP (Vice-Chair), Paul Flynn MP, David McClarty MLA, Mattie McGrath TD, Esther McVey MP, Senator Paschal Mooney, Ann Phelan TD

London, 23rd April 2012

Attendees:
Jack Wall TD (Chair), Paul Farrelly MP, Paul Flynn MP, Mattie McGrath TD, Esther McVey MP, Senator Paschal Mooney, Ann Phelan TD, Arthur Spring TD

WE WOULD LIKE TO THANK THE FOLLOWING FOR THEIR ASSISTANCE IN BRIEFING THE COMMITTEE MEMBERS ON THIS SUBJECT

Roger Pollen, Head of External Affairs, Federation of Small Businesses, Northern Ireland.

Mark Fielding, Chief Executive, Irish Small and Medium Enterprises Association.

Patricia Callan, Director, Small Firms Association.

John Trethowan (Credit Reviewer) and Catherine Collins (Deputy Credit Reviewer), Credit Review Office.

Officials from the Irish Department of Enterprise, Jobs and Innovation.

Neil Cooney from Enterprise Ireland.

Graeme Fisher, Head of Policy, UK Federation of Small Businesses.

Adam Marshall, Director of Policy, British Chambers of Commerce.

Emma Wild, Head of Knowledge Economy, Confederation of British Industry.

Irene Graham. Managing Director, Business Finance and Strategic Initiatives, and David Dooks, Director of Statistics, British Bankers’ Association.

Matt Bland, Policy and Communications Officer, Association of British Credit Unions Ltd

Officials from the UK Department of Business, Innovation and Skills.