

Access to finance for growth for SMEs on the island of Ireland

December 2013

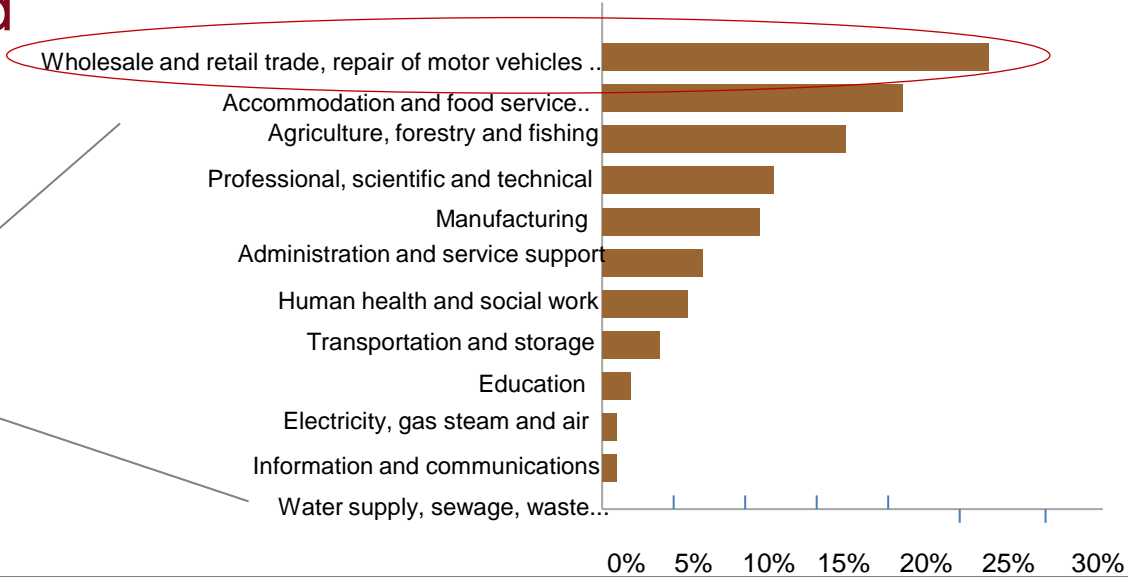
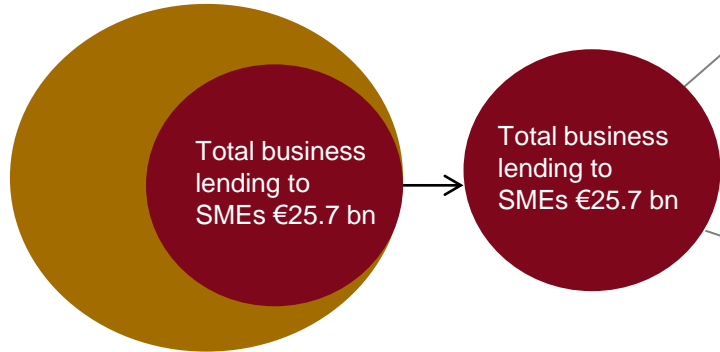
Introduction

- ❑ This report seeks to widen the debate from an important but narrow focus on the supply of and demand for bank finance to a broader, more comprehensive discussion on the availability and use of appropriate financial instruments to support and drive growing SMEs.
- ❑ This is the first all-island study of wider financial ecosystem that supports the needs of growth-focused SMEs
- ❑ The study uniquely presents a complete picture of the supply of finance to SMEs across the island of Ireland, in particular the supply of bank finance in Northern Ireland.

For the first time the report presents a clear picture of bank lending on the island

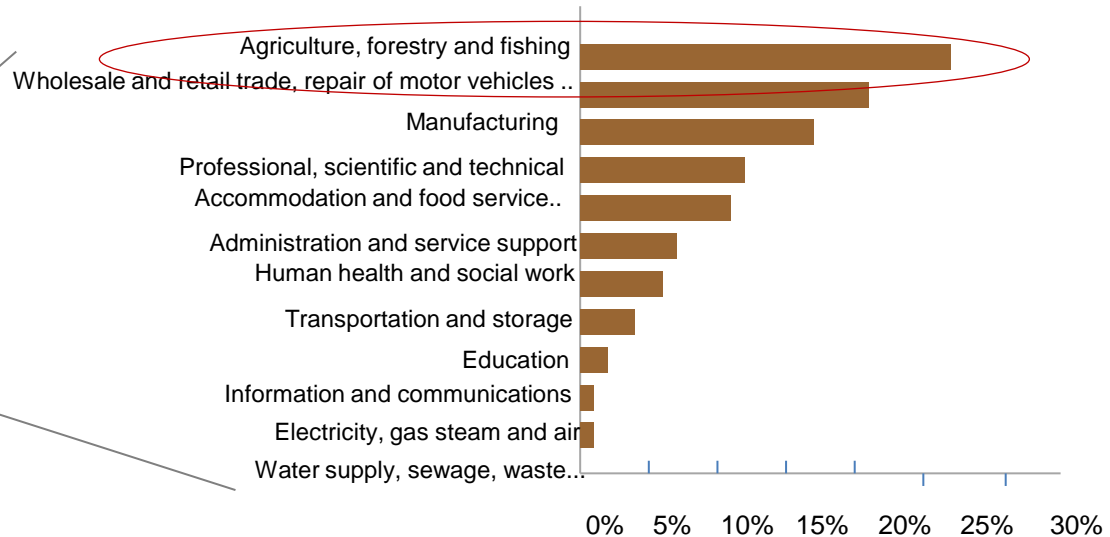
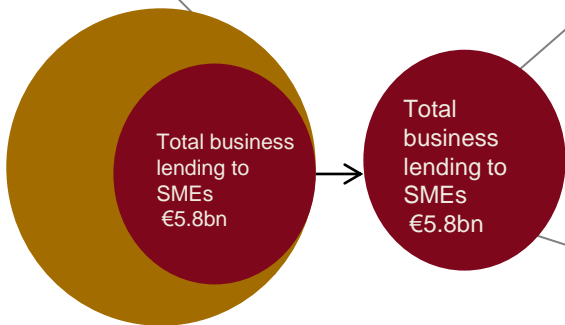
Ireland

Credit to Irish SMEs:
€58.2bn



Northern Ireland

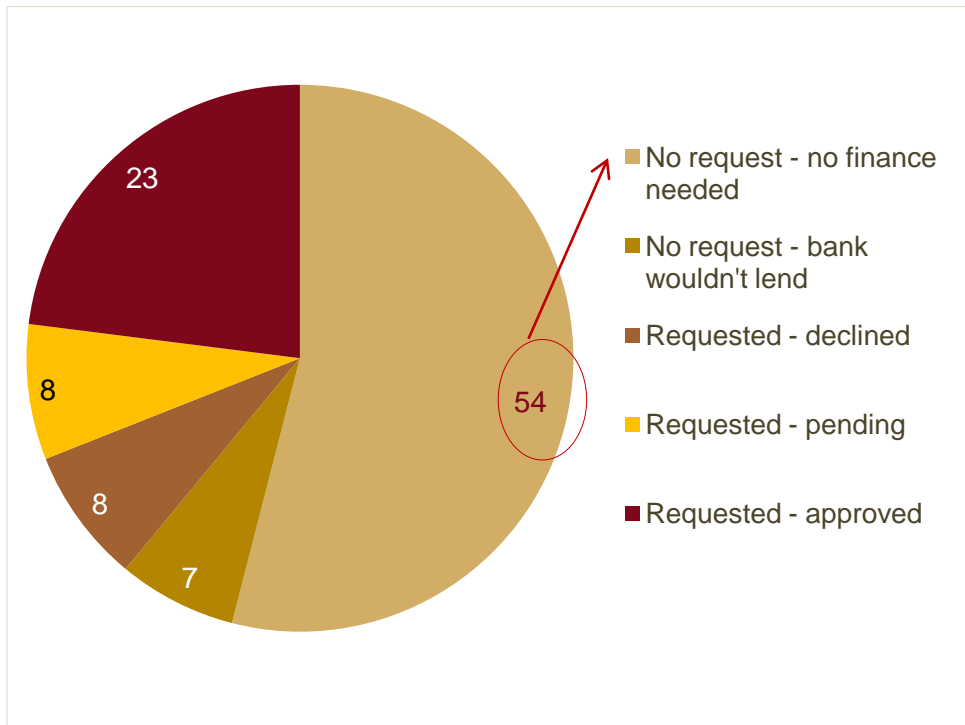
Credit to NI
SMEs:
€14.8bn



Key findings

1. Demand for finance is at least as important as supply of finance

SME finance demand profile- Ireland



Source: Irish Department of Finance, 2012

- Demand for credit is currently at its lowest level since 2010 as measured by applications for credit by SMEs.
- A concern remains that, when the economic recovery gains momentum, it could be inhibited by supply side deficit.

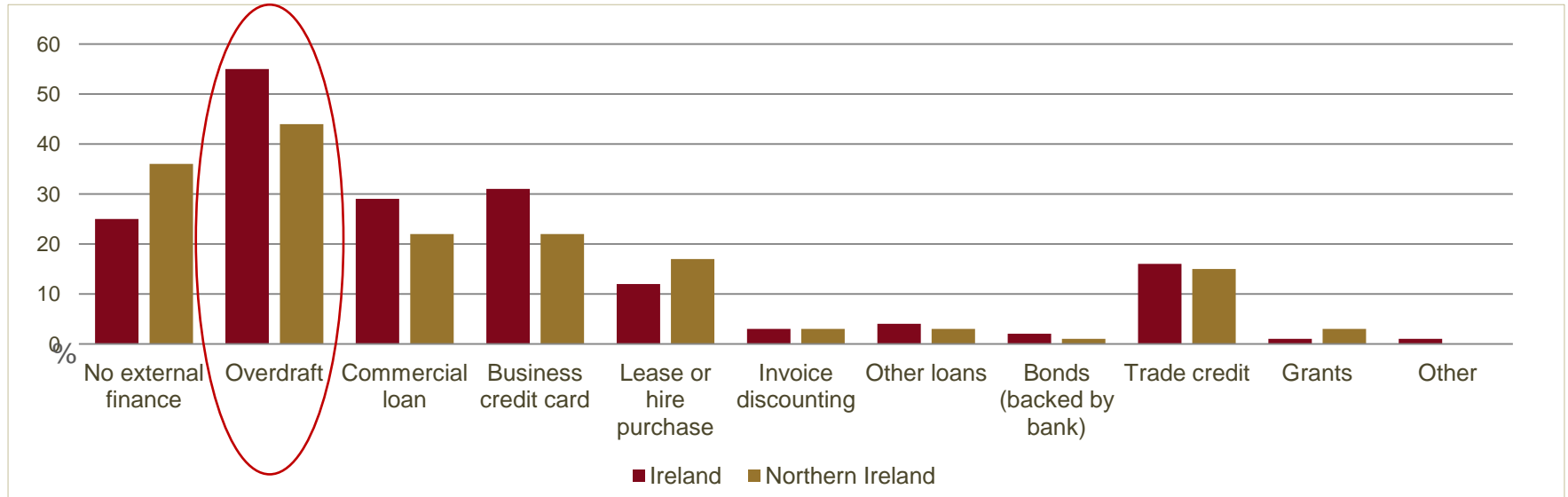
2. Businesses are disproportionately reliant on bank funding

Source of Funding	Ireland €m/£m	Northern Ireland €m/£m	Total €m/£m	Total %
Bank Finance	25,697/ 20,972	5,815/ 4,745	31,512/ 25,717	93.4
Seed & VC	1,385/ 1,130	249/ 203	1,634/ 1,333	4.8
Angel & Private (visible and invisible)	184/ 150	62/ 50	246/ 200	0.7
Public Finance	312/ 254	27/ 22	339/ 276	1.0
Total €m	27,578	6,153	33,731	100
Total %	81.8	18.2	100	-

Bank funding is by far the most significant source of funding amongst both Irish and Northern Irish SMEs at 93% of total SME finance (31st December 2012).

3. There is a lack of diversity in the financing landscape for SMEs

Types of finance in place



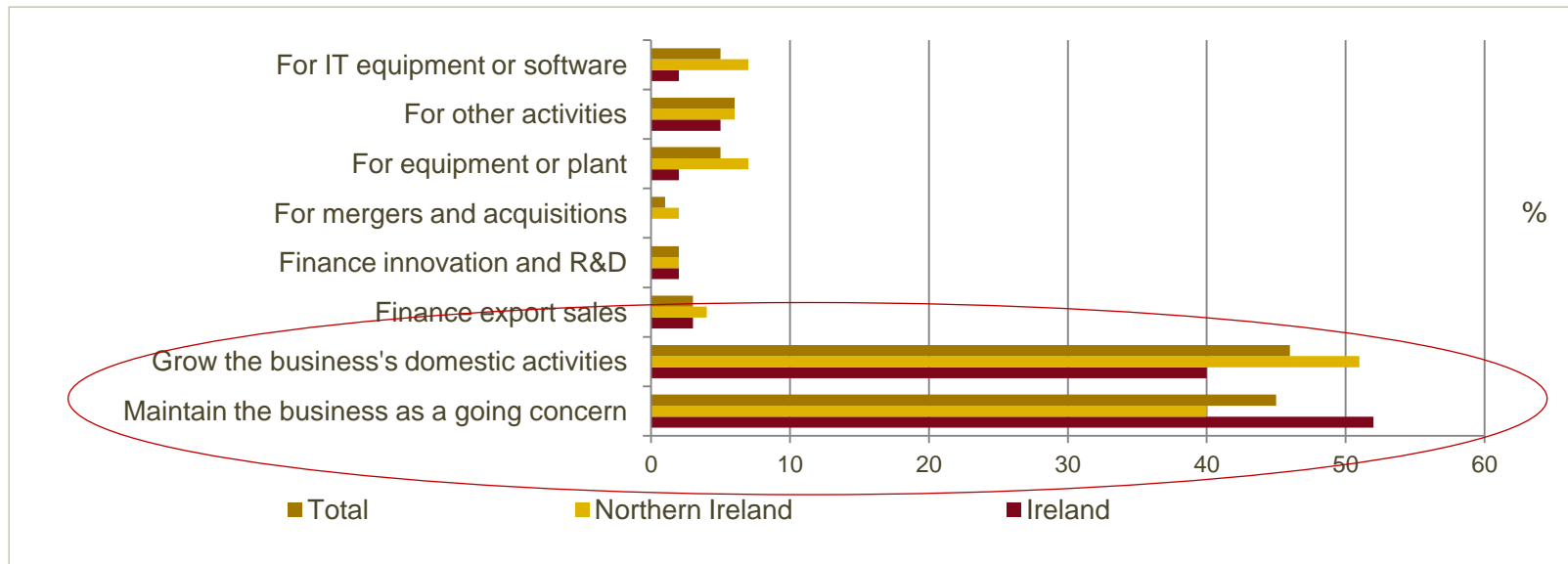
❑ SMEs in Ireland have a higher proportion of external finance in place than their Northern Ireland counterparts

❑ There is a clear preference for bank finance apparent amongst Irish and Northern Irish SMEs and a specific focus on short term facilities such as overdrafts.

4.

Demand for bank finance is focused on short term working capital needs

Purpose of finance applied for (ITI BM Q4 2012)



□ SMEs who are “growing” request finance for development and investment purposes. ‘Stable’ SMEs request a mix of working capital and growth finance. ‘Struggling’ SMEs are more likely to request short term working capital and cash flow type of finance.

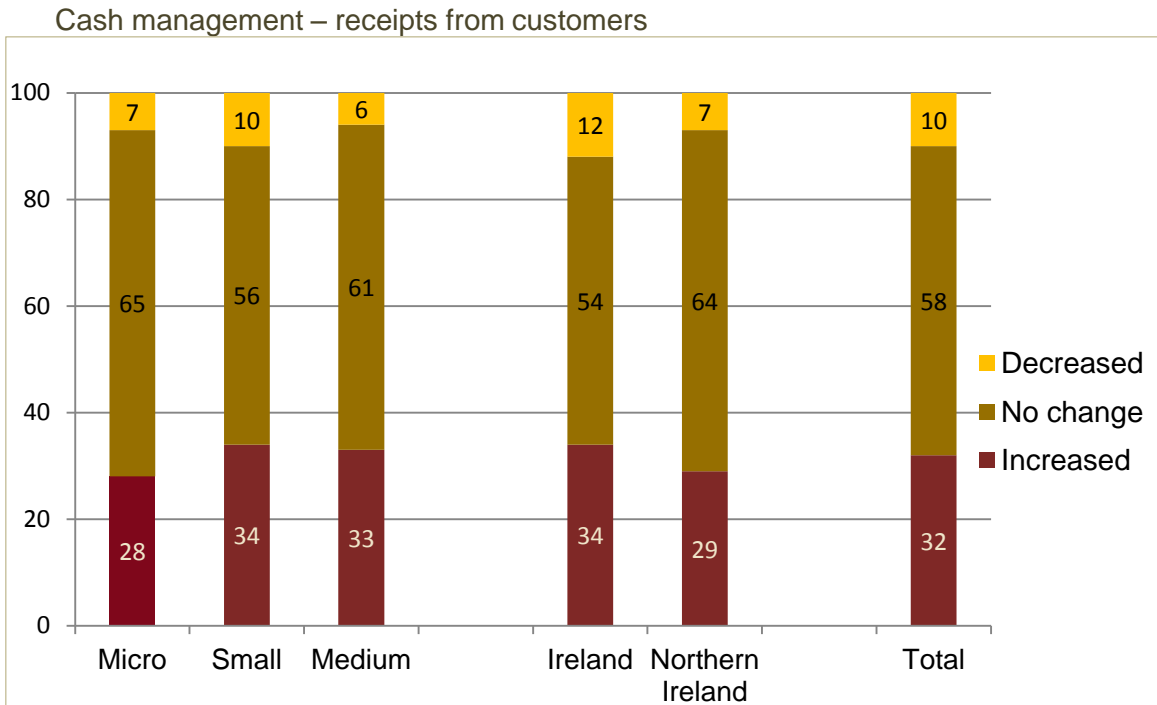
5. There is legacy of property debt and a lack of balance sheet “right sizing”

❑ **Property Debt Overhang:** SMEs with distressed property debt are three times more likely to request working capital finance than their counterparts pointing to the difficulty many SMEs are facing in servicing legacy property debt and the absence of restructuring programmes for such debt by most banks.



Banks remain primarily engaged in short term forbearance measures, a temporary and short term solution which, in the absence of strong economic growth may not address the need for long term restructuring of the balance sheets of many SMES.

6. Late payments and cash flow are key challenges for businesses

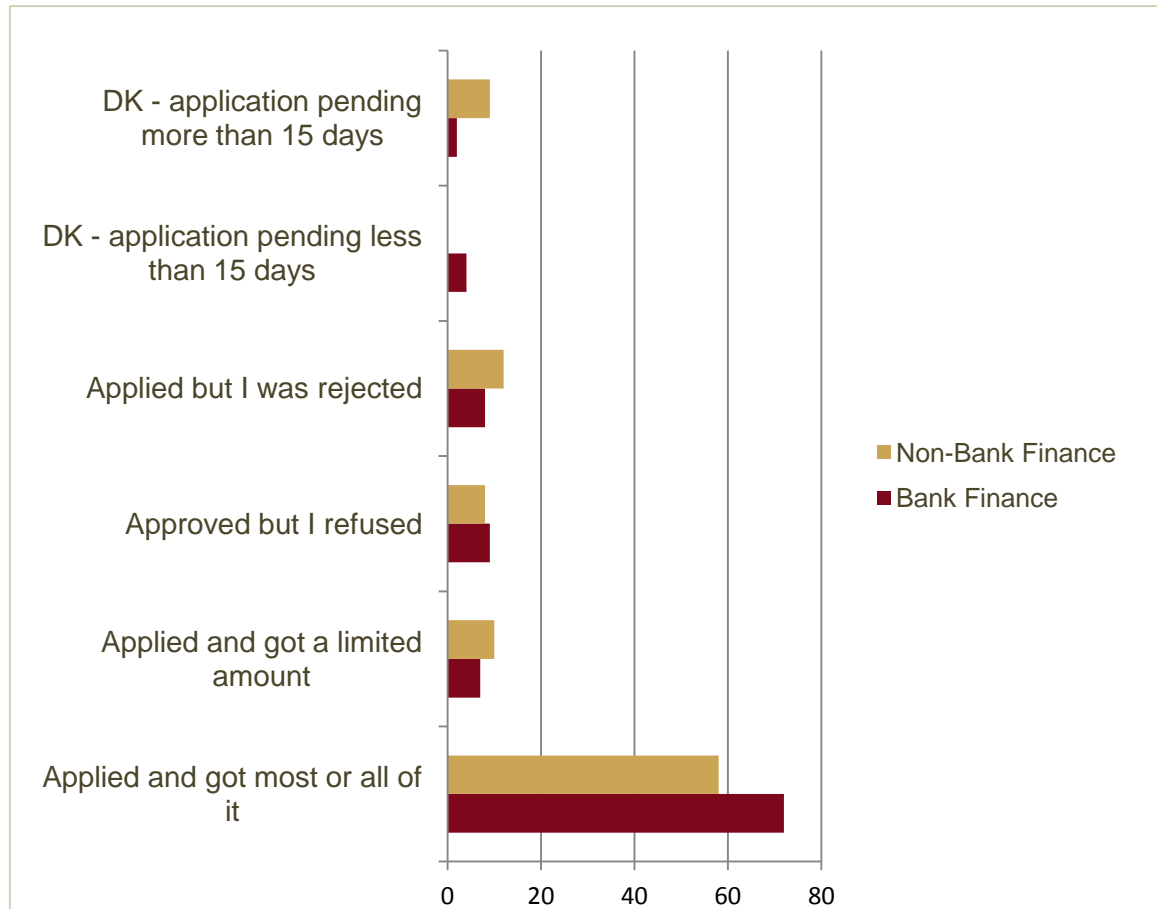


❑ Late payments from customers were considered an issue for 61% of SMEs across Ireland and Northern Ireland

❑ They are particularly a concern in Ireland where 34% of SMEs have seen the payment period from their customers increase and 21% have increased the length of time to pay their suppliers.

7. SMEs views on banks are not based on personal experience

Outcome of applications for finance



❑ Surveys have consistently shown that the majority of SMEs who apply for credit receive a favourable response.

❑ 11% of SMEs with existing bank credit in place avoided approaching their bank in case they tried to restructure their existing arrangements.

❑ Only 28% of SMEs believe that banks are lending to viable businesses.

❑ 43% base their views on media reports and 42% on the experience of their peers.

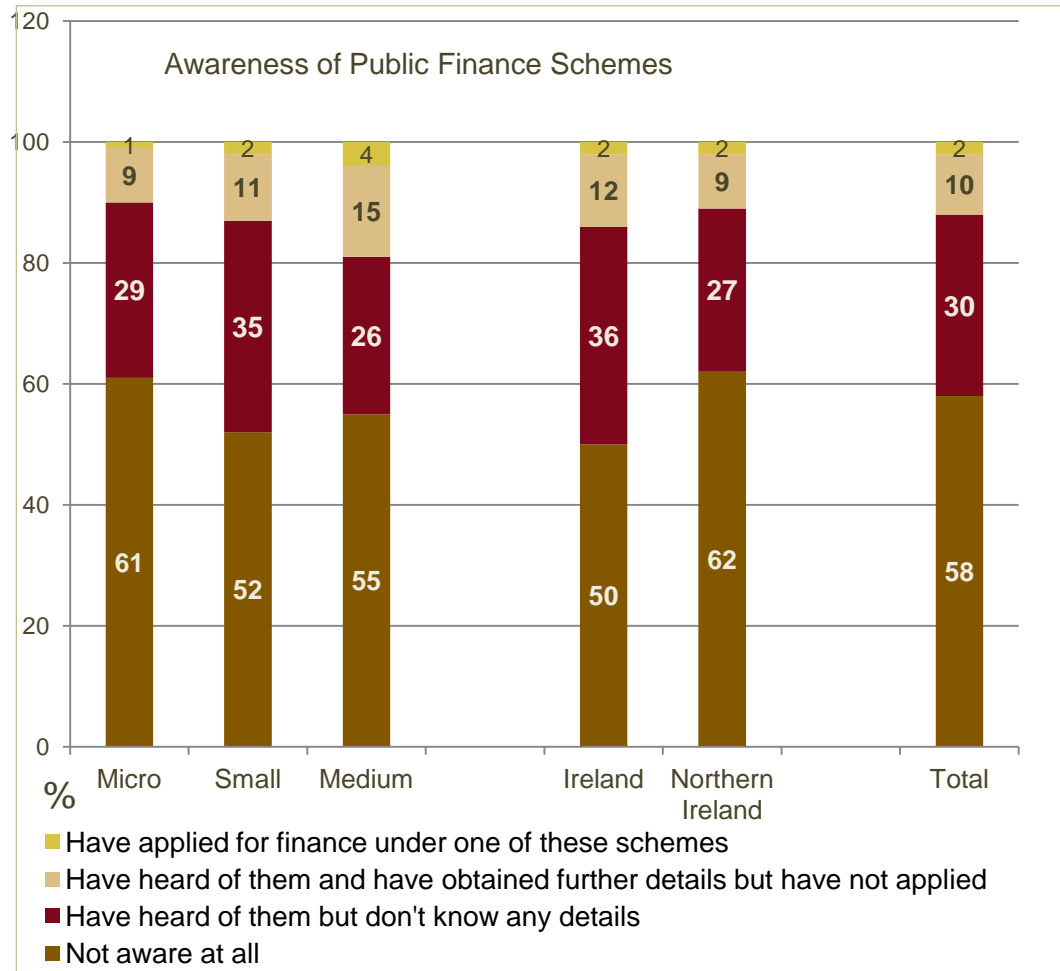
8. Financial literacy is an issue for SMEs and finance providers

Consultations for this study highlighted:

- ❑ A lack of financial skills within many SMEs and a lack of financial restructuring skills courses available to SMEs
- ❑ The fact that the majority of intermediaries involved in advising SMEs are not adequately familiar with the bank application processes, conditions and structures
- ❑ That many SMEs are unable to afford the accountancy fees needed to support making applications for new credit to their bank or and equity source or to restructure existing credit facilities
- ❑ That existing state-funded training or development programmes are focused on particular types of business or high growth business.
- ❑ That finance providers have also capability gaps in areas such as restructuring SMEs balance sheets, preparing review of cash flow, analysis of business plans and development of multi-type finance solutions.

9.

There is a poor knowledge of supports available to SMEs



❑ Direct government funding represents less than 1% of total SME finance.

❑ SMEs and their advisors, business representative groups, accountants and other professional advisors are typically not aware of the public schemes and funds that are available.

❑ In practice, funding schemes are targeted to exporting SMEs or companies trading in specific sectors. But sectors in distress have little support

In conclusion, four key common challenges have been identified

- 1) Improving information quality and flow
- 2) Improving financial literacy and capability
- 3) Widening diversity of financing landscape
- 4) Ensuring the supply is adequate when demand increases

Recommendations

High quality **information** fundamental to improving market for financing

- ❑ **Capture bank lending figures for Ireland and Northern Ireland**
A clear and comprehensive framework for the supply side capture of SME lending, application, approval and rejection rates should be introduced
- ❑ **Capture demand for finance among SMEs in Northern Ireland**
Regular and detailed surveys should be introduced in NI. The InterTradeIreland Business Monitor could be used for this purpose
- ❑ **Provision of better information to SMEs by funding providers**
Better written and clear explanation of rejected applications should be provided. Agencies should improve signposting to alternative finance sources. Development and maintenance of a single repository of supports available to SMEs
- ❑ **Encourage formal credit applications**
Continued work is required to encourage SMEs to pro-actively and formally apply for credit. It is important that SMEs are made aware that a rejected application does not result in a negative credit rating
- ❑ **Promoting alternative sources of finance such as equity/mezzanine**

Improving financial **literacy** and capabilities is critical to the development of diversity

❑ **Non-financial support measures for SMEs**

SMEs need to acquire better financial and development skills. Practical educational programmes could be made available.

❑ **SME voucher scheme**

Further development of the schemes coming into place on both sides of the border to provide an affordable support for SMEs in engaging with banks and dealing with issues such as restructuring.

❑ **Further development of the SME capabilities of banks**

Consider to putting in place a small dedicated team to review SME rejected applications, explore options for SME finance, review informal applications etc.

❑ **Further development of credit review and mediation services**

The development of venture capital and angel investors is key to **diversifying** lending

- ❑ **Continuation of government support for seed and early stage finance in Ireland**

Introduce an investment follow-on fund targeted at participants of seed programmes.

- ❑ **Support of Angel Investment in Ireland**

The establishment of an Irish dedicated co-investment fund or angel fund should be considered (initially led by private investors but with remaining funding provided by co-investment fund)

- ❑ **A venture capital strategy for Northern Ireland**

To inform and develop the equity funds under the Access to Finance Strategy and promotes entrepreneurial activity in Northern Ireland

- ❑ **Investment in seed and early stage capital in Northern Ireland**

The extension of risk capital needs to be supplemented by a range of wider support initiatives to promote innovation and entrepreneurial environment.

