# National Small Business Recovery Plan

A PLAN TO RECOVER THE SMALL BUSINESS SECTOR AND ENSURE THAT EMPLOYMENT IS SUSTAINED

**2020**

# Contents

# Preparation of this Plan

Following a broad consultation with SME's (through www.smerecovery.ie), accountants and other key stakeholders this plan was developed with the following steering group:

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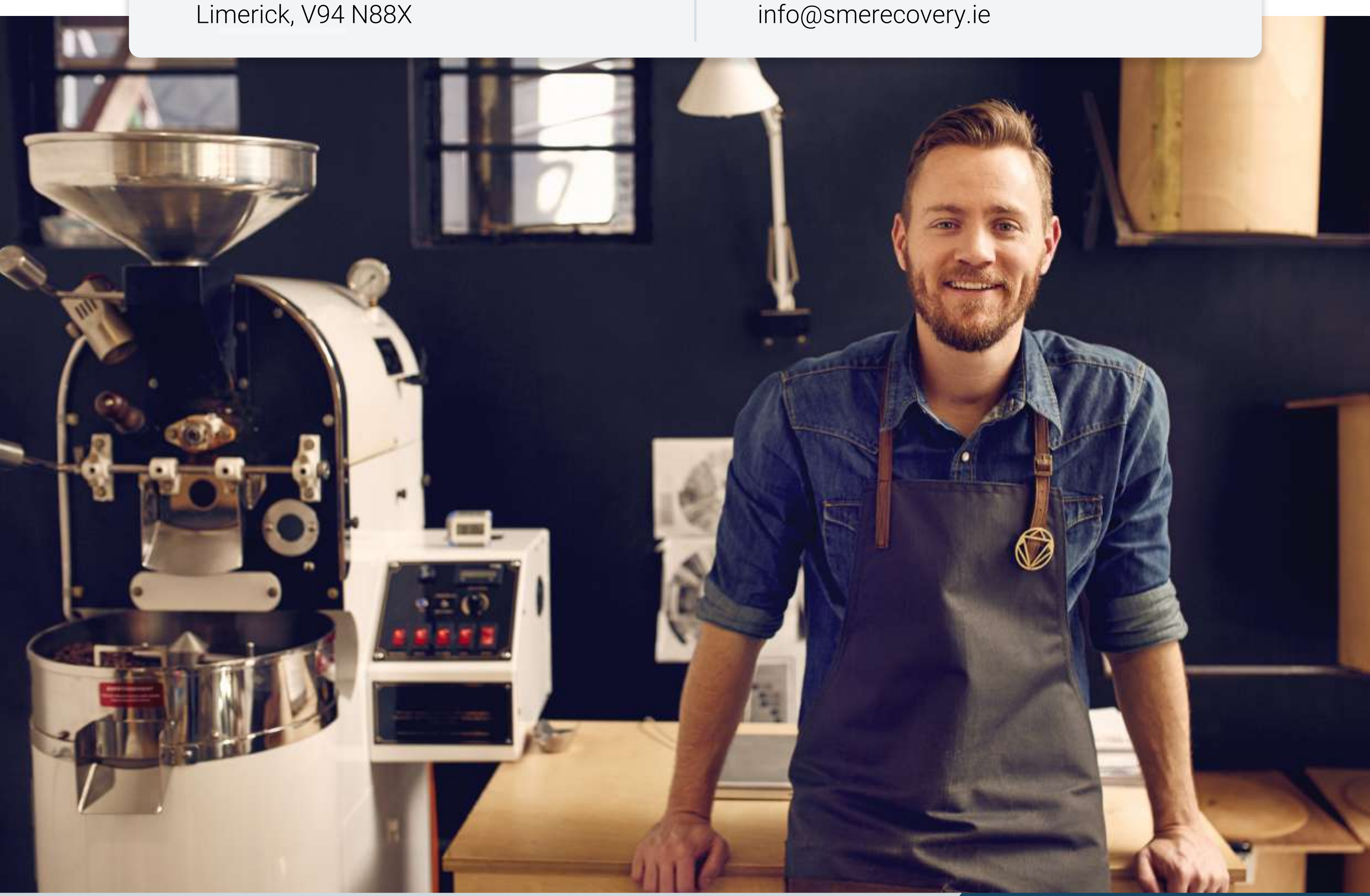


# Chairman's Introduction

We all have our favourite local business. Our friends, or their parents, work or own small businesses too. Indeed, many of us started our careers and may still work for a local business.

Today, many of those small and medium Irish businesses, which account for over 99% of active enterprises, are at risk of being destroyed if we do not act.

The COVID-19 virus which ended so sadly the lives of too many of our fellow citizens, with whose family and friends we mourn, has wreaked havoc too with our health system and in our economy.

In mid-March, for most businesses front doors were shuttered without any certainty if they would ever reopen. Perishable stock dumped. Good-byes said to customers and colleagues.

Some businesses have been able to operate through the crisis, most have not been so lucky. For them, bills and costs have continued to accumulate, trading income has been zero and with that unemployment has soared.

But these losses have arisen, not because of a failure of their business models, but because we, all of the residents of this island, had to ask them to close their doors to protect the health of all of us.

An unprecedented question arises now.

For this display of national solidarity, is it fair for us to ask the owners of these small businesses and their families to bear on their own shoulders alone the weight of these losses? Losses that in many cases are so severe that unabated they will crush even very successful businesses and result in permanent failure. Losses that on account of personal guarantees given on loans may destroy the very futures of those families, so hard worked for.

Or is it not fairer that these losses be shared more equitably between the businesses and between us all?

In the May 2019 Report of the Senate Public Consultation Committee on Small and Medium Sized Businesses in Ireland, Senator Paul Coughlan, Chairman speaking of SMEs said that "it is important that our Government and Parliament do everything possible to support a sector which is such a key source of employment".

We and our politicians now have the opportunity, indeed the duty, to act on that.

In this report, we recommend to our politicians a plan to get small and medium businesses back on their feet. To rebuild dreams and futures broken by their generous act of solidarity.

It will not come cheap but it is a cost we cannot afford not to pay.

It is an investment that will bear dividends into the future and help rebuild shattered communities all over our island.

Supporting these business owners, our friends, so that they can get back to work is the only sustainable way to rebuild our economy.

It must be done with the same strength and urgency which marked our public response to the health threat to our nation.

Ar scáth a chéile a mhaireann na daoine.

# Executive Summary

The small business sector employs over a million people in the state and has been hardest hit by the current Covid Crisis – A crisis not of their making.

SME's not only provide vital employment at a local level but are key to our social fabric and the functioning of our communities. We must act now to prevent wholesale failure of the small business sector and the social and economic devastation that will bring.

We propose a carefully designed suite of measures that will ensure:

1) the current surge in unemployment is reversed and sustainable jobs created.
2) an appropriately capitalised small business sector to support the post-Covid recovery.
3) tax revenues are sustained by ensuring that both small businesses and employment are not destroyed.

The measures are based on the following principles:

- **SME's are vital to our social fabric** – they provide critical jobs at a local level across the country and anchor our communities. They provide innovation and ingenuity at the heart of our communities. See Annex 1 for further detail on this how important SME's are to our society.
- **An SME Bailout is Required** – SME's now need a bailout with recovery funds (capital and liquidity) on favourable terms of at least €15bn to reboot the recovery of society and our economy.
- **SME's need a post crisis boost to demand** -- There is no point in having well capitalised SME's ready to do business if there is no demand.

This plan has been developed in coordination with business representative groups, business advisors, accountants, and small businesses themselves. Some of the key proposals are:

- **New Governance** National level Coordination of the response to SME distress and failure
- **SBCI Mandate** Expanded mandate for the SBCI with a significant improvement in the scale and terms of liquidity funds available to SME's
- **Compensation Fund** A national small business compensation fund to fairly compensate SME's for the losses incurred from the Covid Crisis, with compensation netted against any emergency lending provided to SME's
- **Demand Boost** A range of measures to boost demand in the economy
- **Ongoing Stabilisation** range of measures to support the continued stabilisation of the small business sector in the coming two years.

Small businesses lack scale and the related benefits scale brings to large businesses. As a result, they require specific policy interventions in a coordinated manner (not sector by sector). This plan reinforces the social contract between government, small businesses and employees. By sustaining this contract through the recovery phase, after income supports expire, the impact of the Covid crisis can be mitigated for the benefit of all.

As a society we have a time-limited window to recapitalise our small business sector and return hundreds of thousands to employment. To do this we need radical and unorthodox policy intervention, delivered quickly.

**Derek Foley Butler**
Founder and Coordinator

# Key Principles

The government's response to the crisis to date has understandably focused firstly on health measures then secondarily helping household incomes for those who lost their incomes and jobs when the economy was put to sleep. Over one million are now unemployed, receiving income support.

But balance sheets and incomes of business owners forced to close to save lives are very distressed. Reserves and savings are being eaten up by on-going bills while income has disappeared. This is a very dangerous situation which needs immediate attention.

**Key Principle 1 – SME's are vital to our social fabric.** They provide critical jobs at a local level across the country and anchor our communities. They provide innovation and ingenuity at the heart of our communities. See Annex 1 for further detail on how important SME's are to our society.

**Key Principle 2 – An SME Bailout is required.** SME's now need a bailout with recovery funds (capital and liquidity) on favourable terms of at least €15bn to start the recovery of society and our economy.

**Key Principle 3 – SME's need a post crisis boost to demand.** There is no point in having well capitalised SME's ready to do business if there is no demand.

The government needs to quickly recognise the small business sector is in a financial crisis and, in so doing, introduce legislation that provides for radical measures to save our local businesses and the jobs they provide.

The legislative instruments should clearly define small businesses as those that qualify for extraordinary support to compensate for COVID losses and that the financial emergency during which any special contract override measures are available will last at least 2 years.

The measures should be on a par with the best in the euro area so that our SME's are not disadvantaged by the crisis and the current surge in unemployment is temporary.

***Key Action: The three principles above need to be adopted at the heart of any National Recovery Plan and enshrined in legislation.***

# Consolidated List of Actions

*Key Action: The three principles above need to be adopted at the heart of any National Recovery Plan*

*Key Action: Use the strength of the Irish fiscal position going into the crisis and the flexibility of EU State and Fiscal rules to fund a recovery programme of scale comparable to the best in the eurozone.*

*Key Action: Introduce legislation to support recovery actions to stabilise the small business sector.*

*Key Action: Reconvene the SME State Bodies Group and Initiate a small business emergency coordination steering group (SBECG)*

*Key action: Targeted policy initiatives should be taken for each phase of the emergency*

*Key action: SBCI to be provided a renewed mandate to take increased (not limitless) credit risk either by the provision of guarantees or low interest funding in scale.*

*Key action: The SBCI needs to provide funding through the banks and non-bank funders.*

*Key Action: Introduce a Business continuity funding scheme providing highly flexible working capital to businesses that can continue to trade through the Covid crisis.*

*Key Action: A non-usage penalty for any unused funds should be applied to any distribution partner for SME liquidity.*

*Key Action: Introduce a Business reactivation funding scheme providing highly flexible working capital to businesses that need to reactivate after the Covid crisis.*

*Key Action: Work should begin immediately to pre-approve small businesses for recovery funding so that funds are in place before they restart their businesses.*

*Key Action: Incentivise small businesses to pay creditors within 90 days by providing a 3% VAT rebate for invoices paid on time.*

*Key Action: All negative credit reports for missed repayments to be suspended for 12 months.*

*Key Action:  Do not kick the can down the road on who bears the COVID losses. - Set up a Small Business Compensation Fund to rebuild SME balance sheets.*

*Key Action:  Resource and capitalize the Fund credibly from the outset to pay for losses the SME sector cannot bear on its own.*

*Key Action:  Agree quickly the principles of which losses more fairly belong to society and not to individual businesses which had to close for the common good.*

*Key Action:  Agree powers and resources for the Revenue and NTMA to administer claims.*

*Key Action:  Quickly pass legislation if required to create and capitalize the Small Business Resilience Compensation Fund and provide in Budget 2021 for an on-going business levy to build up a sufficient resilience fund against future shocks.*

*Key action: Key measures to boost aggregate demand need to taken in the recovery phase.*

*Key Action: Put all outstanding tax at 28th February 2020 on a long-term payment plan for impacted firms.*

*Key Action: Introduce negotiating tool for small businesses to secure an emergency rent reduction.*

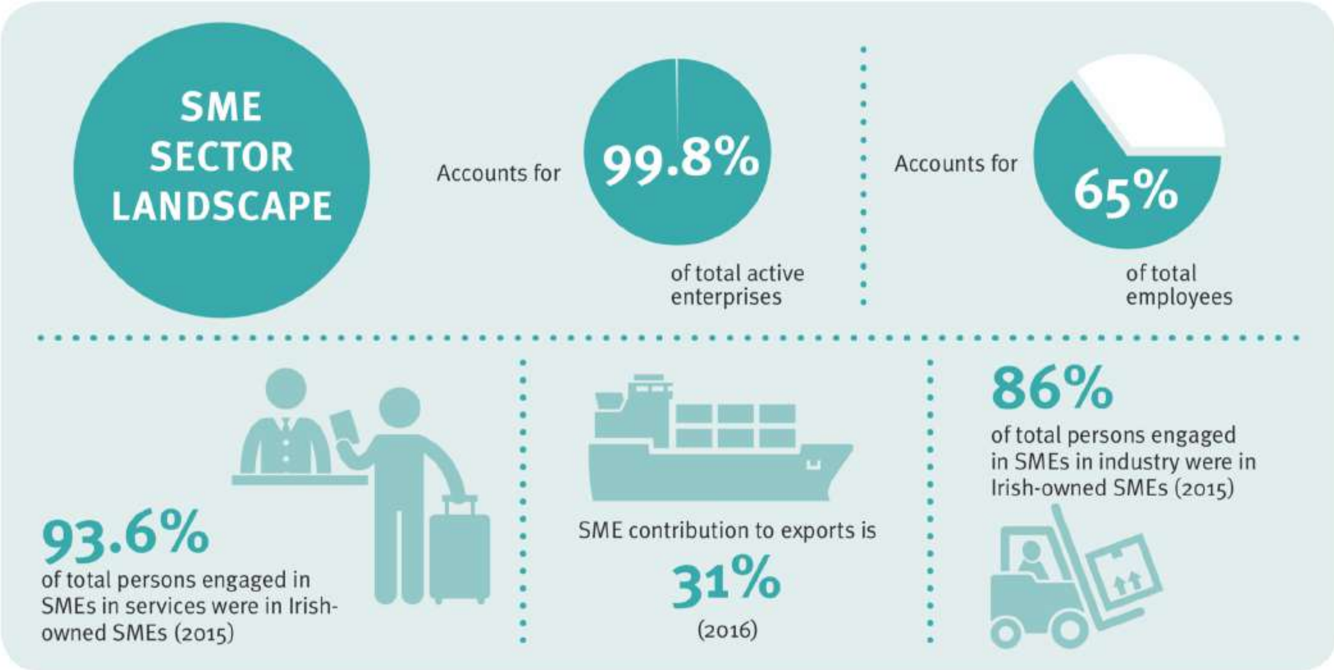
*Key Action: All rates costs should be deferred for 2020 and reduced materially for 2021.*

*Key Action: All legal and union impediments to move employees form full-time to part-time should be removed on a temporary basis. The same should apply to salary reductions for salaries over average industrial wage.*

*Key Action: Introduce a less onerous examinership and liquidation process.*

*Key Action: Introduce incentives to encourage equity investment in small companies.*

# 1. Context and Coordination




SOURCE: Seanad Public Consultation on Small and Medium Sized Businesses Report 2019

## 1.1 European Context

The European Commission, the EIB and the ECB have made funds available to the government at favourable rates. But SMEs cannot get direct access to those funds unless the Government uses them in delivering an effective bailout package for Irish busineses.

Our government needs to lower the cost to the Irish taxpayer of any fiscal measures by drawing on these funds to help SMEs. The low annual interest cost of such funds allows for time before the cost of such measures needs to be recouped from the recovering economy. Recoupment can happen by way of repayment of loans given to SMEs or from general taxation or from recovery measures on business specifically to recover the cost of fiscal transfers to SMEs which have suffered COVID losses.

The EU fiscal rules have been relaxed to also allow greater intervention and the EU commission has highlighted Article 107(b)(2) of the State Aid rules which already allows Governments to provide compensation to businesses for COVID damage provided it is limited to damage and not over-compensation.

**Article 107**

**(ex Article 87 TEC)**

1. Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

2. The following shall be compatible with the internal market:

(a) ...;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

***Key Action: Use the strength of the Irish fiscal position going into the crisis and the flexibility of EU State and Fiscal rules to fund a recovery programme of scale comparable to the best in the eurozone.***

## 1.2 Pre-Crisis SME Health Context

While FDI employment is important, the SME sector provides most of the employment in the State outside the protected government sectors. By their nature, however, even pre-Covid crisis the SME sector operates with low levels of capitalisation. There was low resilience to withstand a significant recession, never mind a crisis of the magnitude that the SME sector is facing. This level of capitalisation is a function of how SME's operate across Europe. Annex 3 highlights the financial reality of small businesses that lack the scale of bigger businesses.

## 1.3 Crisis Coordination and Management

To ensure urgency and a sharp effective response, we need to set a short period for this crisis management of a minimum of 2 years. One legislative template for this crisis is the Financial Emergency Measures in the Public Interest (FEMPI) Acts. This allowed the government to take extraordinary measures to make radical changes in the public sector. This is an example of a legislative framework that allows for radical action to be taken if there is sufficient intent at a policy-making level. The same radical approach is now required for small business to regain health and sustain employment. Because some normal protections may need to be suspended, application of these measures should be focused by clearly defining "small business".

***Key Action: Introduce legislation to support recovery actions to stabilise the small business sector***

Once the health crisis has abated, the jobs and small business crisis will take centre stage. But it cannot wait for action.

An SME State Bodies group such as existed during the troika period with all the main state actors, this time involving DBEI, DoF, DPER, SBCI, Central Bank, Enterprise Ireland, a representative of the LEO, Credit Review Office should be reconvened immediately to meet bi-monthly in private but report in public about actions been taken and progress.

A small business emergency coordination steering group, chaired by the Minister for Finance bringing together all the small business representative bodies and the main state actors together will drive priorities and emergency actions over a 2-year period.

***Key Action: Reconvene the SME State Bodies Group and Initiate a small business emergency coordination steering group (SBECG)***

# 2. Bailout for SMEs (not Banks) needed this time

## 2.1 Building Blocks

Our recommended recovery plan is built on core building blocks:

- **Unanticipated Attack** COVID-19 closures have been an unprecedented attack on previously healthy small and medium sized businesses, for which no one could have planned.

- **Show of solidarity** The business closures with its disastrous impacts was an act of solidarity to protect the wellbeing of everyone. It was no one's fault but now we must reciprocate that solidarity to the SMEs and their owners.

- **Large Scale Response** Like the 2011 financial measures, this response must have power and scale to retrigger confidence in the future and not be a series of too small iterative steps.

- **Recreate jobs** Strong and rapid recovery by our viable SME's across the country is essential to rebuild our economy and society, to reduce the massive spike and costs of unemployment and maintain mental health.

- **Avoid contagion** It is better to provide subsidised SME liquidity to pay bills than to see contagion rip across the economy and into larger companies, banks and local government funding by squashing bills.

- **Make good losses** While liquidity is important to keep SMEs operating, compensation for losses or more equity to rebuild capital reserves will be the only solution to get our SMEs back on their feet quickly and properly.

- **SME Resilience Compensation Fund** A new Government/EU capitalised SME Resilience Compensation Fund is needed to compensate SMEs for reasonable losses suffered by them.

- **Costs can be Spread** The replenishment of the fund to pay back capital can come over time from SMEs and the broader society.

## 2.2 Bailout for SME Losses

Applying these principles, we recommend a targeted bailout approach with loss compensation consistent with Article 102(2)(b) of the EU Treaty at its centre.

- Funds go only to those SMEs who were viable before the crisis but have suffered unforeseeable COVID-19 losses.

- It uses scarce resources wisely by not having broad based measures which would give windfalls to firms who have suffered less or not at all or by bailing out non-viable firms.

- It does not overburden SMEs with borrowings which they will not be able to repay.

Our proposal involves a series of different bailout measures over three distinct phases. Indicative timings of each will vary from business to business and by sector.

**Stage 1**

Before such payouts can be finalised, during the emergency period, focus is on cash flow and temporary low interest liquidity will be provided by the SBCI and other government schemes to viable businesses which stay current on their bills and maintain employment levels.

**Stage 2**

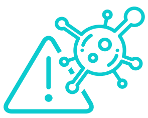
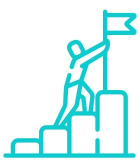
There are a number of familiar measures but the key is the creation of a new Small Business Resilience Compensation Fund, funded by borrowings from the EU, which, as normality returns, makes payouts to compensate SME's for some or all of the losses incurred as determined by the Revenue Commissioners.

**Stage 3**

In the period after the compensation payouts are made, the recovery and growth phase, businesses will begin to repay their SBCI and other loans over a length of borrowing term and with interest which reflects their businesses prospects and allows margin for new investment and growth funded by the private sector providers. Government will introduce measures to stimulate growth and confidence among consumers in the economy.

## 2.3 Three Phases – Different Measures

We see different measures being required for the different phases of the plan, reflecting the different stresses on firms at each stage. Some of these have already been introduced. More is however required.

| Phase of Plan | Principle of intervention | Impacts/Challenges during phase | Measure/Mitigation |
|---|---|---|---|
| Emergency Response Period<br><br>(0-3 months)<br><br> | Restrict cash-flow bleed and prevent insolvency | Immediate shut down of non-essential trading<br><br>Communications to be done with suppliers/clients<br><br>Employee wages/sub-contractor retainers to be paid<br><br>Pay immediate bills owing to government and private sector suppliers (recurring and pre crisis bills) | Government scheme to keep employees connected to business extended until restrictions are removed<br><br>Deferral of some fixed costs – rates, bank loans etc. until government liquidity measures kick in<br><br>Voucher scheme to fund initial advice how to manage shut-down, pay for some costs |
| Stabilisation (3-9 months)<br><br> | Provide liquidity to facilitate on-going trading for pre-crisis viable SMEs | Restricted trading for extended period<br><br>Additional cash flow challenge of employee income top ups<br><br>Ongoing recurring bills of contractors/suppliers<br><br>Reopening costs – new stock in trade<br><br>Slow recovery of customers<br><br>Suspended fixed costs remaining to be paid | Extension of COVID-19 support for employees<br><br>For companies passing a test of pre COVID rapid viability, 0% interest liquidity loans to pay bills from prior periods, keep current on on-going fixed costs and replace perished stock to permit reopening.<br><br>Others, depending on size, assisted through examinership light or liquidation |
| Recovery Period (2021 onwards)<br><br> | Solvency aid to rebuild balance sheet for growth | Remaining suspended fixed costs to be paid, including rates and taxes<br><br>Overhang of losses on business<br><br>Excess liquidity loans | Voucher for advice to finalise post crisis viability plan with LEO<br><br>Ongoing business liquidity government guarantee for loans available (interest tied to business performance – quasi equity)<br><br>Scale back of costs/salaries if required with preference for continuing COVID-19 payment for subsidization of employment for 2021 business recovery<br><br>New SME Resilience Fund providing write off in part of government loans or compensation payment equal to COVID losses as determined by Revenue under scheme principles |

***Key action: Targeted policy initiatives should be taken for each phase of the emergency***

## 2.4 Improved Liquidity Support Measures

Although we commend the government's immediate commitment to small business finance by providing €450m in direct Covid related liquidity funding and €200m in additional future growth loan scheme funding this is:

1) **Inadequate** – We need a much larger commitment of funding to support the small business sector. The UK and US governments have made commitments that are a multiple of the Irish government's commitment. Within the EU, other countries have moved with much greater force and it is critical that to maintain a level playing field, Irish SMEs are equally well protected. The Central Bank have calculated that the liquidity needs for vulnerable Irish business will be in the range of 5.7 billion euros but even that assumes a significant reduction in fixed costs so it could be larger.

2) **Incorrectly channelled** – This needs to be channelled through the banks BUT ALSO through other existing Lending Businesses. The banks will have tighter credit conditions associated with small business credit as a result of the Covid crisis and capital concerns from problems arising on other lending books. They may not have the requisite flexibility to adjust and control credit criteria.

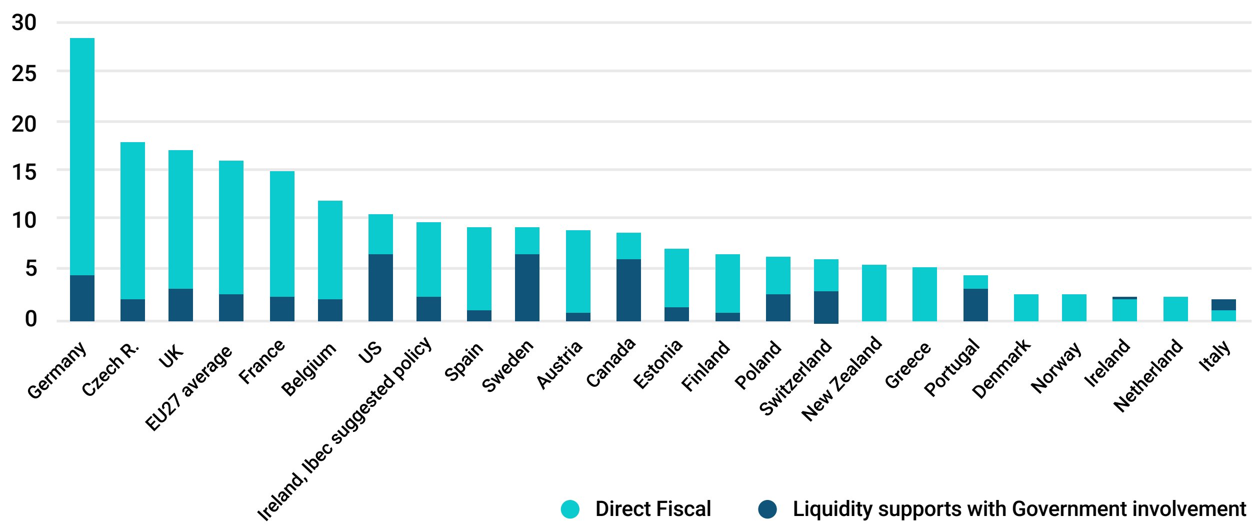
3) **Too expensive** - Because they are bolted onto existing schemes, loans of up to 4% (SBCI) with limited payment breaks have been introduced. All schemes should be at a minimum of 0% interest (perhaps even negative interest rates), low administration charges and extensive payment breaks as outlined below.

4) **Not itself sufficient** – Simply providing liquidity to already stressed balance sheets is kicking the can down the road. Businesses not viable pre-COVID crisis need to be resolved perhaps by dangerous examinership but viable firms need equity reserves replenished for COVID-19 losses in addition to funding.

The graph shown illustrates clearly the relative weakness of the Irish response compared to other countries as a % of GDP:

### Measures to support liquidity already in place

Total fiscal and government backed liquidity support packages, % of GDP




Source: IMF policy updated, Ibec calculations

We recommend:

**(a) Expanded SBCI mandate with 100% credit risk assumed.**

The SBCI is an excellent body that has pioneered the reduction in the cost of SME finance and access to specific schemes. They did not have a mandate to lend for this unique credit event. It is time to consider a significantly enlarged mandate for the SBCI. The government can change the SBCI mandate to materially stabilise the small business sector. Without the government assuming credit risk, private capital will struggle to mobilise at sufficient scale to stabilise the liquidity needs of SMEs.

***Key action: SBCI to be provided a renewed mandate to take increased (not limitless) credit risk either by the provision of guarantees or low interest funding in scale.***

**(b) Expanded distribution channels for SBCI funding**

Banks are experiencing stress on mortgage and other retail books that will put pressure on capital reserves. As such they may not be able to respond as needed to help the SME sector.

The SBCI needs therefore to also work with other non-bank providers to channel funding to small businesses. The initial announcement of €200m was based on a Brexit scheme of expected future losses of income rather than a scheme responding to SME cash flow issues at a time when their capital reserves are depleting below lending norms as a result of the shutdown. It did not mandate the banks to lend to any specific sectors or restrict them from changing their credit policies. Of the €6 bn that is being proposed below in guaranteed loan financing a majority of this could be channelled through the banks but a significant proportion should be channelled through non-bank finance providers to increase competition for distribution. These non-bank finance providers are agile, typically digital and have a direct relationship with SME borrowers. They also are focused on SMEs and will not be distracted by more pressing issues in other lending areas, like credit cards or mortgages.

***Key action: The SBCI needs to provide funding through the banks and non-bank funders.***

**(c) Expanded SBCI Schemes**

Many small businesses would be correct to simply shut their doors instead of applying and securing traditional debt on businesses excessively weakened by the shutdown. Even providing lots of lending and reducing the interest cost towards zero to allow the business to support excessive debt would resemble EU efforts to give Greece a break on the debt sustainability without recognising that excessive debt was preventing a recovery of the economy itself. It would prevent the companies taking on other debt for growth as it emerges from this sudden shock and risks a zombie debt burdened SME sector.

We do however need to provide small businesses with readily available and highly flexible low-cost cash flow and liquidity funding solutions in the short term so that they have the confidence and hope to keep going. Loan schemes are more effective than grant schemes for government as they allow for the government to leverage its balance as opposed to current account. With the pressure on the government's current account, where appropriate, loan schemes are the most effective and the government have the vehicle to be able to do it.

***Business Continuity Funding Scheme €1 billion***

For businesses that can continue to operate (even in a limited way) through the delay and mitigation phases of the response they need 'business continuity funding'. This working capital funding should be structured as a 2-year working capital facility with the following conditions:

✔ Must pass a pre-Covid viability test and current resilience test
✔ Unsecured up to €500,000
✔ No repayments for 12 months
✔ Government guarantee available to lending entity of 80% above 250,000/100% up to 250,000 at a zero cost
✔ Ideally, loans up to €250,000 should be at a zero rate of interest to encourage drawdown with only a low administration fee for the lender payable at draw down. Larger loans should be at very attractive rates.
✔ If interest applies, interest only repayments after the first year for 12 months
✔ Remaining balance structured as a 3-year term loan after year 2
✔ No personal guarantees
✔ To be used to pay all suppliers and fixed costs and arrangements may be put in place for larger ones to be paid directly by lending agency.
✔ After 2 years an affordability test is deployed to evaluate ability to repay capital and interest, with any award from SME Resilience Fund going directly to reduce the capital outstanding.

For lending institutions a non-usage penalty for any unused funds should be introduced for any undeployed funds allocated under the scheme to that entity.

***Key Action: Introduce a Business continuity funding scheme providing highly flexible working capital to businesses that can continue to trade through the Covid crisis.***

***Key Action: A non-usage penalty for any unused funds should be applied to any distribution partner for SME liquidity.***

***Business Reactivation Funding Scheme - € 5 billion***

For businesses that can't continue to operate and have been required to shut temporarily by government order or otherwise they will require working capital funding to get started again and keep current on fixed costs unpaid during shutdown and falling due even during months of reduced trading after re-opening.

Funding should be provided as above. An active campaign should start immediately to pre-approve small businesses for funding for when they are ready to re-start their businesses.

This scheme is key to refinance small business and work should begin now to initiate the scheme and pre-approve affected businesses.

***Key Action: Introduce a Business reactivation funding scheme providing highly flexible working capital to businesses that need to reactivate after the Covid crisis.***

***Key Action: Work should begin immediately to pre-approve small businesses for recovery funding so that funds are in place before they restart their businesses.***

Other products such as invoice discounting should also be included in the scheme to ensure working capital is freed up and payment dates lengthened. All participants in the loan schemes must be clear that their role is to distribute long-dated funding and that the government is assuming the credit risk to ensure that the partners individual credit restrictions do not inhibit the channeling of funding. Specific prescribed business viability and resilience criteria must be provided to each lending partner. The Credit Review Office's role can be expanded to act as an arbitrator of such criteria where an SME experiences difficulty.

**Existing creditor management**

Businesses should be incentivised to continue to pay existing creditors within a 90-day window. This is key to ensuring there is not a systemic cashflow crisis across the economy. A systemic cashflow crisis may impact vital food supply chains if this is not avoided.

This will work as a VAT rebate i.e. an effective input VAT rate of 26% would be applied by businesses on all input invoices.

***Key Action: Incentivise small businesses to pay creditors within 90 days by providing a 3% VAT rebate for invoices paid on time.***

Businesses that cannot meet repayments for commercial mortgages, leases and other fixed term debt should not have an adversely affected credit rating post crisis. All referring businesses to the ICB and CCR should cease making missed repayment reports for the duration of the crisis (2 years).

***Key Action: All negative credit reports for missed repayments to be suspended for 12 months.***

## 2.5 Small Business Resilience Compensation Fund

The core of the recovery plan is a new EU and government capitalised Small Business Resilience Compensation Fund to recapitalise the SME sector by paying compensation for the sudden COVID-19 losses.


**(a) Do not kick the can down the road.**

Just as we provided for €24 billion of additional capital in the 2011 PCAR bailout for the banks to cover property related losses to protect deposits, including billions of Irish ones, and so that they could access third party funding on their own feet by getting ahead of their embedded crisis losses, we need to provide capital to bail out small businesses to protect the jobs in the sector and fill the gap in business reserves caused by the unavoidable COVID-19 losses.

Without this, like the banks up to 2011, these small businesses will find themselves unable to trade. Suppliers will not give them credit, third parties will not trust them to award them contracts and they will be shut out from market financing or non-government guaranteed bank loans. Jobs will continue to be lost and the key role of SMEs in our communities will disappear.

Typically, small businesses do not generate and retain sufficient profits to be able even over a couple of years to absorb a loss of the magnitude of the COVID-19 losses. To move those businesses quickly off of emergency government cash-flow life-lines, capital to rebuild reserves will be required.

We might think we can alternatively guarantee all of the money the SMEs borrow to pay bills and stay afloat while recovering or dying slowly. But, in the end, this will mean we suffer the same magnitude or even greater losses when this debt becomes eventually too much for them to bear and cannot be repaid.

Instead, it is better to manage for a more rapid recovery and growth strategy, by compensating for the losses upfront and let the viable firms step out of zombie state more quickly and return to growth.

***Key Action: Do not kick the can down the road. Set up a Small Business Compensation Fund to rebuild SME balance sheets.***

### (b) The rescue will not be cheap or simple to do but borrowing from the EU COVID disaster funds will help minimise the cost

The bill will not be cheap as it will only work if done at sufficient scale. Half measures will fail.

Like the PCAR deep dive analysis by Blackrock (a first in Europe for the banking crisis), calculation of the likely bill should be done carefully by the SME Coordination Group above. The Fund must be adequately capitalised to be appropriately generous from the outset.

We know from the bank recap of 2011, the error and recovery time wasted caused by underestimating the capitalisation in the earlier years of the bank crisis.

But not all businesses should be protected. We also know that it is an error to support and not liquidate/restructure non-viable businesses.

It is also necessary to socialise the lion's share of the cost over a large group of shoulders, whomsoever those belong to. To reduce the cost, some of the losses can be left with the sector (like a deductible on an insurance policy) but not so much as to be a burden that prevents them recovering in the first place.

Equally, the exercise will need administration support as losses will have to be verified on a case by case basis across the sector.

Err on the large side. If the initial capitalisation transpires to be too large, we can always return the capital to the EU more quickly than originally anticipated.

***Key Action: Resource and capitalise the Fund credibly from the outset to pay for losses the small business sector cannot bear on its own.***

### (c) What are fair losses to socialise with taxpayers

SMEs were not at fault when asked to stop or reduce trading for the general good. They are no more at fault than the employees whose loss of wage income we paid for as a society. We did not offer overdrafts to employees losing jobs to keep afloat until they got back to work. We compensated them for a fair share of the lost wages.

For traders, it is not just a loss of wages. Their business earnings disappeared in many cases but also fixed business costs continued – rent, insurance, supplier contracts, contractors like IT support, etc.

The Fund will not need to put all businesses back in the position they would have been without shutdown (full protection of profits, managing director salaries/dividends etc.) but should rather compensate for out of pocket losses from the COVID shut down or ongoing business restrictions and a small but fair income for the owner.

This means the Fund should pay for things like:

(A) Fixed costs (other than salaries) which accrued during the shutdown (or depending on the sector for a reasonable period of reduced trading after the restrictions are released) and could not be mitigated, like rent, interest on bank loans. Capital repayments on bank loans can and should instead be financed with the liquidity loans above.
(B) An income for the owner of the business but no more than a COVID payment would be for other employees. It should not cover any top up payments to employees

Less
(C) Any rebates granted by suppliers or the government from accruing costs
(D) Any revenue earned attributable to that period.

Importantly, all businesses will have to have taken actions to mitigate losses and no payout should occur, unless all suppliers, landlords, banks and the taxes have been paid in full.

***Key Action: Agree quickly the principles of which losses more fairly belong to society and not to individual businesses which had to close for the common good.***

### (d) How will it work in practice

The Small Business Resilience Compensation Fund does not need to be a new agency. It could be staffed with a minimum of people if managed by the NTMA which can raise capital for the fund and manage cashflows. Claims will be made and submitted with the 2020 tax returns by each business along the lines of an insurance claim with supporting documentation. The claim will be adjudicated by the Revenue Commissioners.

Once the claim has been adjudicated, the company will receive a credit for the award against the balance outstanding of any government provided liquidity and that credit will be paid to the lender. In the event the award exceeds any such borrowing they can receive a direct payment from the Fund.

***Key Action: Agree powers and resources for the Revenue and NTMA to administer claims***

### (e) Picking up the bill for the losses

The type of exceptional losses we are compensating for need to be socialized like insurance losses. A house fire can wipe out the single owner unless insurance pays and the cost is spread over all house owners when they pay their premia.

By Government borrowing the capital for the fund from the EU or otherwise, we can spread the burden of recouping the payouts over a longer period of time.

The solidarity value to society of the closure measures and the value of stabilising the SME sector and jobs therein, means that we all should not object to contribute through general taxation to replenish the fund and repay the EU capital.

Recovery of the economy will help as PAYE taxes and business taxes will also go up without increases in rates.

For larger business bailouts, the Fund could consider taking non-voting quasi equity positions in the business.

While we could decide to levy a universal taxation measure on business (both income tax and corporate tax) for repayment, we believe it is preferable to do that only to build up a self-insurance fund for business against any future similar event. This would add resilience to our economy against future shocks and operate llike the EU bank insurance deposit fund or even the PRSI fund which builds up funds in good times to pay for unemployment when a shock comes.

***Key Action: Quickly pass legislation if required to create and capitalise the Small Business Resilience Compensation Fund and provide in Budget 2021 for an on-going business levy to build up a sufficient resilience fund against future shocks.***

# 3. Demand measures for domestic focused SMEs and Export supports for the others

Recapitalised firms will still struggle and fail if there are no customers.  There is a risk that the COVID shock to confidence in the economy could result in an urge to save not spend for households or a fear of re-engaging with traders in close proximity or large crowds in public spaces.

Government can do a lot to help re-instill confidence.

We recommend a range of policy measures need to be taken to ensure that once SME's are adequately capitalised and compensated that there is sufficient demand for their goods and services.

Examples of some the measures that have been proposed and should be considered:

**Employment**

Central to boosting aggregate demand is providing confidence around individual's future employment. Consumers will continue to consume at a reduced level if they believe their job is at risk. The most effective tool to stabilise employment is to stabilise the small business sector through the proposals above.   On top of that, capital investment in labour intensive sectors, like construction, with low coefficient of imported raw materials can both help reduce unemployment but create spending power in local communities to help small businesses.

**Tax Measures**

Targeted Tax cuts with the aim of boosting demand. We do not make specific proposals on tax cuts to boost demand as each sector has its own requirements. Our government's finances will continue to be challenged through the crisis and recovery phases but targeted tax cuts to boost demand must be considered that will ultimately benefit the government's finances through increased exchequer returns.

**Capital Expenditure**

Capital Expenditure – European funding should be used to unleash a new waive of capital expenditure across all areas of the economy. This will boost long-term productivity as well as boosting short-term demand.  Additional capacity for public transport to reduce crowding and investment in alternative climate friendly forms of transport like cycling would help alleviate fears of consumers or travelling until a COVID vaccine is available. Investment in SME retrofitting to reach Carbon emission targets should be considered.

**Tendering**

A streamlining of tendering processes for smaller government contracts and reconsideration of how larger projects can be broken into smaller pieces for procurement will have a positive impact on the indigenous SME sector.  Standardised tendering processes make it difficult for smaller firms to compete. Domestic firms benefiting further from state procurement will boost local employment and spending power in local economies.

***Key action: Key measures to boost aggregate demand need to be taken in the recovery phase.***

# 4. Other Policy Measures to support the recovery of SME's

The participants to this report have made other suggestions of policy measures to support the recovery of SME's.  Many will be essential especially if full implementation of the measures set out above are not adopted or can be modified depending on, for example, the levels of compensation payable from the Fund or the cost of the liquidity and the bills for which it is available to be used. Others have merit as additional boosts to a recovery of small businesses in all circumstances.

## 4.1 Outstanding tax payment plan

In a financial crisis cashflow is the critical ingredient to saving businesses from failure. The government is in a unique position to assist with small business cashflow across all heads of taxation.

The decision to allow businesses defer payment is welcome but most small businesses owners will be anxious if as soon as the crisis subsides they will have an immediate and significant tax liability.

For COVID impacted businesses, it will be easier to put all outstanding tax payable (as of February 28th, 2020) on a 24-month payment plan than to arrange for liquidity loans to make these payments. The Revenue Commissioners routinely structure payment plans for small businesses where they are in trading difficulty. This should now be applied as a rule, not an exception, for firms which self-certify that they have been adversely impacted.

***Key Action: Put all outstanding tax at 28th February 2020 on a long-term payment plan for impacted firms.***

## 4.2 Cost Flexing

It is vital that we assist small businesses to flex their fixed costs. This is a vital ingredient to sustaining as many small businesses as possible. Employment costs are central to this. We need to protect the number of jobs and ensure that small business employers (as the biggest employers in Ireland) have the flexibility to do that.

<u>Flexing property costs:</u>

We need to assist most affected small business owners, through the law, to negotiate an 'emergency rent reduction' for ongoing rent liabilities not covered by the Fund and especially those which apply to periods of reduced trading after the restrictions are removed.

This has a material impact on current costs while compensation levels are being assessed.

***Key Action: Introduce negotiating tool for small businesses to secure an emergency rent reduction***

<u>Flexing Rates costs:</u>

There should be a targeted reduction of 20% and deferment of 2020 local rates to support small businesses or low cost liquidity loans provided to impacted businesses to make these payments so that local government funding levels are kept intact.

***Key Action: All rates costs should be deferred for 2020 and reduced materially for 2021***

Flexing employment costs:

All impediments to moving employees from full-time to part-time positions should be removed on a temporary basis. Economically, it is better that we keep as many people employed as possible. The same should apply to salary reductions for salaries over average industrial wage.

***Key Action: All legal and union impediments to move employees form full-time to part-time should be removed on a temporary basis. The same should apply to salary reductions for salaries over average industrial wage.***

Simplified Insolvency and examinership regime

The current examinership and insolvency regime for small businesses is not fit for purpose. It is overly cumbersome and expensive.

Similar to the simplified personal insolvency regime that was introduced in the last crisis we need to introduced a process that is faster and less onerous on SME's to allow for conversations with creditors and bank and non-bank lenders.

This is key for businesses that do not pass a viability test when they are assessed for compensation or which could pass that if creditors, landlords and bank lenders agreed fair rescheduling arrangements or write offs of historic unsustainable debt.

***Key Action: Introduce a less onerous examinership and liquidation process.***

## 4.3 Policy incentives to encourage equity investment

A key issue prior to this crisis was the lack of capitalisation among small businesses.

New incentives (to be shared outside of this proposal) should be introduced to incentivise business owners to 1) retain profits in their small businesses and 2) invest capital as equity and not debt/ directors loans.

Equity investing in small companies should also be streamlined to attract equity investment and the state should consider the creation of a fund for equity investment along the lines of Enterprise Ireland investments but for a much wider range of domestically focused trading companies.

***Key Action: Introduce incentives to encourage equity investment in small companies.***

# 5. Costing and funding

The proposals above have not yet been fully costed as the situation changes daily. They are, however, required to prevent a wholesale failure of the small business sector and the impact on employment and our society.

They represent important structural changes to the government support of the sector in terms of compensating for the COVID losses and providing a platform for recovery and growth.

The actions above will aggressively support small businesses through the emergency, recovery and normalisation phase.

The "costs" above could hit €15 billion, only some of which is on current spending.

Most of the above intervention is balance sheet investment in the small business space. This pales into insignificance when compared to the economic and social cost of a material increase in unemployment and systemic small business failure. It is to be remembered that small businesses are represented right across every city, town, village and parish in the country.

They are actions to be implemented for a fixed period through a small business financial crisis emergency bill. The sources of available funding are:

- Existing government contingency funds
- New government borrowing
- European Emergency funds
- Existing no-deal Brexit funds
- Current taxation

The important message is that these sources of funds are designed to facilitate solidarity in our society.

The COVID crisis has emphasized more than any other crisis in living memory the importance of solidarity and togetherness in our society.

Those who were at serious risk and whose health was impacted by the virus needed to be protected or helped to recover to full health by the actions of the whole community.

Now, as a next step, it is only appropriate that those in our community who were most negatively impacted financially by those collective actions should be protected from irreparable harm and helped to recover with the same urgency and solidarity which has marked our public response to the health threat to our nation.

Ar scáth a chéile a mhaireann na daoine.

## ANNEX 1 – IMPORTANCE of SME's TO SOCIETY


SOURCE: Seanad Public Consultation on Small and Medium Sized Businesses Report 2019.

| | CT Liability | Companies returns | Total CT Liable | Employees | Earnings | Income Tax | USC | Employer PRSI | VAT |
|---|---|---|---|---|---|---|---|---|---|
| | € | Number | €m | Number | €m | €m | €m | €m | €m |
| All Enterprises | | 164,201 | 8,105 | 2,120,485 | 52,393 | 9,303 | 1,990 | 6,748 | 9,081 |
| FMCs Only | | 5,925 | 6,258 | 468,731 | 17,540 | 3,770 | 793 | 2,484 | 3,210 |
| Irish MNCs | | 362 | 373 | 84,911 | 2,460 | 459 | 96 | 340 | 167 |
| **SMEs** | | **157,914** | **1,474** | **1,566,843** | **32,394** | **5,074** | **1,101** | **3,924** | **5,704** |

Source: Revenue Commissioners Corporation Tax Analysis 2019.
These figures exclude the agriculture and public sector.

## ANNEX 2 – TYPICAL SMALL BUSINESS FINANCIAL MANAGEMENT

There are key principles that underpin the financial management of SME's. At the core of how small businesses work financially is:

1) Their ownership structure – typically small businesses are owned by a single person/handful of people whose livelihoods are based almost exclusively on the success of the business. These people are also the last to get paid.
2) The lack of scale – Big businesses get scale benefits from bulk purchasing, cheaper credit, greater access to capital among other items. The economics of small businesses mean that they are more expensive to run but are equally very nimble and creative. Because of the lack of scale, margins are tighter.
3) Lack of capital – All small businesses are started with a minimal amount of equity capital – very often the legal minimum. This is because there is no incentive for small business owners to invest in the equity of the business. Rules (Tax, solvency, dividend rules) make the extraction of equity capital and reserves very difficult.

The following is a real example of a small business that has failed.
The following observations can be made:

**P&L**

- There is almost 5 million in revenue flowing through this business.
- This business works in a very competitive sector
- It has a Gross Margin of 68% which must cover all of its variable costs. Although employment costs are in principle variable costs they behave as fixed because there is a minimum amount of staff required for the business to operate. Employment costs only behave as flexible costs when the business is past a breakeven point
- Property costs account for 10.6% of this businesses revenue
- Existing debt and leasing costs account for 4% of their revenue
- This business is constantly trying to ensure that the business is generating sufficient gross margin to cover their costs.
- The business is making very little profit but is employing 250 people.

**Balance Sheet**

- There is almost no equity in the business despite it repeatedly turning over €4m+ per year.
- The business routinely carries very little cash
- There is an excessive amount of debt relative to equity.
- There is a significant amount of director's loans into the business. Directors have lent money instead of investing in their business through equity.
- The balance sheet does not recognise the contingent liabilities of property leases.
- The balance sheet does not recognise any brand or other intangible assets that this small business has. Most small businesses do not know how to account for these or their accounting frameworks do not allow for them.

**Why did this business fail?**

- This business had a network of 6 operating locations and when their property leases came up for a 5 year review and a material increase in lease costs were passed on the business failed.

**What do we learn?**

- The business did not have enough gross margin to cover these added fixed costs
- The business was completely under-capitalised for a €4m turnover business.

| P&L | FYE 31/12/2019 | |
|---|---|---|
| Turnover | € | 4,887,624.00 |
| Cost of Sales | € | 1,622,004.00 |
| **Operating Profit/Gross Profit** | **€** | **3,265,620.00** |
| Salaries | € | 2,075,513.00 |
| Administration costs | € | 1,071,639.00 |
| **Total** | **€** | **3,147,152.00** |
| **EBITDA** | **€** | **118,468.00** |

| **Balance Sheet** | **31/12/2019** | |
|---|---|---|
| Plant & Equipment | € | 1,839.00 |
| Fixtures & Fittings | € | 417,538.00 |
| Land & Buildings | € | 252,913.00 |
| Motor Vehicles | € | 7,136.00 |
| Other | € | 199,416.00 |
| **Fixed Assets** | **€** | **878,842.00** |
| Inventories | € | 59,701.00 |
| Cash | € | 19,700.00 |
| Trade Debtors | € | 188,580.00 |
| Other | € | - |
| **Current Assets** | **€** | **267,981.00** |
| Trade Creditors | € | 429,889.00 |
| Bank Facilities | € | 70,737.00 |
| Other Liabilities | € | 364,532.00 |
| **Current Liabilities** | **€** | **865,158.00** |

| | | |
|---|---|---|
| Long Term Debt | € | 194,597.00 |
| Other Debt | € | 32,320.00 |
| **Long Term Liabilities** | **€** | **226,917.00** |
| **Net Assets** | € | **54,748.00** |
| Equity | € | 750.00 |
| Retained Earnings | **€** | 53,998.00 |
| **Total Retained earnings and equity** | **€** | **54,748.00** |

**Contagion effects of the failure of this Enterprise:**

First Level Impact

- Five Main Street locations vacant
- 250 employees laid off
- Trade creditors and other debt providers out of pocket

Second level impact

- Loss of rates to local authorities
- Loss of income to Landlords
- Loss of VAT, PAYE/PRSI and Corporation Tax to the state
- Cost of Unemployment benefit to the state
- Loss of demand in the broader economy due to unemployment