Small Firms Association

The Voice of
Small Business

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on the UK's Withdrawal from the European Union

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"The Implications for the Irish economy of hard and soft exit scenarios"

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INTRODUCTION

Chair, Senators,

Many thanks for the invitation here today to share with you the experiences to date and concerns identified by our members in the context of Brexit.

Small firms are the backbone of the economy and represent 98% of the 238,000 businesses in Ireland, employing more than half the private sector workforce, and accounting for more than half the employment in 21 counties around the country. We account for one-third of the total value of the Irish economy.

The UK is a key marketplace for our small exporting companies, with 43% of exports from all indigenous exporters going to the UK market. It is a learning ground when they're starting up, and it is not easy to diversify into other markets farther afield without significant resources, and in the food sector, differing tastes also acts as a barrier. It is also noteworthy that despite the best efforts of our state agencies, small firms account for only 6.4% of Irish exports, so my remarks today reflect both the direct concerns of those exporters, but perhaps more importantly the potential knock-on implications of Brexit for the entire domestic economy in Ireland. For example, the UK is our biggest market for tourism visitors, which has an impact on local economies right around the country. Furthermore, the threat of recession in the UK post-Brexit is very real and we would be very concerned about the knock-on implications of that for our entire domestic economy, given our interconnectedness.

SFA MEMBER INSIGHTS

41% of SFA members reported in November that Brexit had already had a negative impact on their firms. 68% expected a negative impact in the next six months. A minority of 10% think Brexit will be positive for their business.

In relation to the specific impacts of Brexit on our member companies, over half have already postponed investment decisions, with 37% stating that this is a likely impact into the future. 37% have already experienced a loss of business in the UK market, whilst 45% anticipate this to be an impact into the future. 30% have already experienced a loss of business in the Irish market, with 45% again anticipating this to be a likely impact into the future. Some 20% of members have already moved to increase sourcing of raw materials in the UK market, as a means of creating a natural hedge against volatile exchange rate movements, whilst 18% anticipate doing this into the future, which means negative implications throughout their Irish supply chains. A minority of 4% have already or are considering moving some or all of their production/operations to the UK, with negative implications more generally for workers here, with 7% indicating that it is likely they will have to put workers on short-time/layoff and 2% already having had to make some staff redundant.

MOST SIGNIFICANT CHALLENGES

Asked about the most challenging aspects of Brexit for their business, the most consistently raised issues in the immediate term are:

#1 Exchange rate volatility
#2 Investment confidence
#3 Cost and tax competitiveness versus UK

Since the Brexit vote, sterling has been extremely volatile and has devalued significantly. This has devastated small firm exporters, who had little or no hedging in place, and in particular the low margin food sector, has had to withdraw from unprofitable contracts immediately, and has consequently had to serve protective notice on employees.

To take just one example from an SFA member, encompassing all these issues (e-mail received November 2016):

"Commodities net margins are about 1 to 2%; PCFs (Prepared Consumer Foods) are about 3 to 5%. Currency has dropped 28% since last December. On these figures, most exporters are now severely loss making, particularly small firms in the PCFs Sector, and thousands of jobs will be lost. Companies are already starting to cull jobs, and in some instances, withdrawing from some UK Accounts. This will only accelerate over the coming months. In our own case, we have already initiated withdrawal on €2.7 million of revenue, as they are tight margin/high cost to service. A lot of producers, particularly in the PCF sector, which make up about 20% of total exports to the UK, (70% of what the PCF sector produce goes to the UK) cannot switch to the continent, as there is no market/want for their products there. The UK is the only natural export market for products in the PCF sector in particular, and for Start Ups in the Food & Drink Industry in general. Meat/Beverages/Chocolates, travels well across markets, PCFs do not. Hedging at this stage is of limited value, because the markets have priced in .90 to parity already, so the horse has well bolted, and any hedging done already is due to run out in January 2017.

On the other side, UK Companies are now aggressively targeting the Irish market, and Irish Companies are desperately trying to switch purchasing to UK Suppliers to cut costs, so there will be a double, if not triple whammy, as the other thing going on, is companies examining whether they can switch operations to the UK. This has being on-going for quite a while, because of greatly lower costs in the UK, but is now bound to accelerate. However, it's not without its difficulties, and again, may only suit the bigger companies.

Only potential solution is to drastically cut taxes & costs for exporting Companies and ramp up availability of Grants in order to put money back in the Bank for companies to keep them afloat. Providing soft loans will maybe help in the short term, but this is going to be a long term problem, and a lot of companies with UK sales in the millions will not survive a year out. For every million in sales, companies are now having to adjust for about €250,000 per million. So a modest company with say €3 million in UK sales will be hit for €750,000 per year, or about €15,000 per week.

No company, other than the very strongest, can survive that long term."

PRIORITY ACTIONS

The Irish Government needs to step in now to save our export and in particular food sector, which has the potential to be wiped out before Brexit even happens. Financial support schemes targeting the exporting sectors (and not just existing State Agency clients) should be made available as a matter of urgency. We have already met with Ministers and their officials across relevant Government Departments on this repeatedly, yet there are still no tangible outcomes to our discussions. We need Government to persuade the EU to introduce temporary state aid rule changes, as they did during the financial crisis in 2009, which is necessary given the unique circumstances of Brexit's impact on Ireland.

In addition, low cost finance such as the measures developed by the SBCI for the agri-sector should be made available to assist with cashflow in the short-term. A new export financing offering is another important element of Ireland's response to Brexit and should be part of a general intensification of efforts by Enterprise Ireland and other State Agencies to help small exporters (and not just their existing clients). These companies also need support for innovation and to diversify their markets, as 43% of exports from all indigenous exporters are bound for the UK market.

The Government should also launch a public awareness campaign on the importance of buying Irish and shopping local. The SFA successfully ran such a campaign with "Love Irish Food" in the run up to Christmas, but this needs to be sustained to combat cross-border trade and cheaper food imports from the UK taking the place of Irish food products in supermarket aisles here. Helping companies to begin to and increase their on-line trading presence, is particularly important and the on-line trading voucher scheme should be extended to all small firms (those employing less than 50 people vs. the current restrictions of having just 10 employees.)

SHORT/MEDIUM/LONG TERM ACTIONS

At a macro level, we recognize the significant progress that has already been made by our Government in getting Irish issues prioritized by both the EU and UK negotiating teams. It is vitally important that Ireland continues to be at the heart of negotiations between the EU27 and the UK on their exit deal. The EU must recognise Ireland's special position as being the only country to share a land border with the UK and have due regard for the stability of our peace process. Issues affecting the border with Northern Ireland and businesses who operate close to the border must be given the attention and sensitivity that they deserve. The common travel area between Ireland and the UK predates our EU accession and must be preserved in any deal that emerges.

However for the purposes of my presentation here today, I would like to focus particularly on the issues the Government can tackle that are within our own locus of control. Going forward, we need Government to become obsessive about our cost-competitiveness and tax competitiveness vis-à-vis the UK.

The No. 1 priority for all our members this year is cost-competitiveness, but following many years of recession, it is arguable how much more they themselves can achieve by operating LEAN business principles. They are more concerned by external costs rising, over which they are price-takers and have no control, and many of which Government policy has a significant impact on. For example, labour costs are the biggest concern, and government policy around minimum wage, joint labour committees, and its own public sector pay deals have major knock-on implications into private sector wage demands. Insurance costs are rising significantly and are now threatening the viability of some businesses, with the average company experiencing a 36% increase in motor insurance alone this year. Other concerns include the 2% differential in interest rates paid by Irish small firms for bank finance vis-à-vis their European counterparts, unfair commercial rates and reduced access to public procurement opportunities for small firms.

Tax competitiveness with the UK is exclusively within the remit of the Oireachtas and we would ask all of you to work collaboratively in introducing measures to address this in Budget 2018. We need to make Ireland an attractive place to work and invest, so reducing our personal taxes and implementing innovative employee share options schemes is a necessity. We need an equivalent CGT Entrepreneur's regime of 10% on the first Stg£10mn, and a general reduction in the CGT rate to 20% to encourage business transactions and new investments into business.

In conclusion, I would argue that it is in our interest that the UK remains as close a part of the single market and customs union as it can achieve in the negotiations – we are advocates for a soft Brexit. But equally we must be moving now to build new allies with a view to the future EU post the UK's departure.

Thank you for listening and I look forward to discussing these issues in more detail with you.