Deloitte.

Private Business in Ireland
Challenges and Opportunities

December 2015

Contents

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Introduction

All commercial success stories, from the largest technology companies in the world to a lucrative, local, family-run grocery business, arise from a strong sense of entrepreneurial spirit. Fortunately, that spirit is strong in Ireland and our nation has developed into an entrepreneurial hub, benefitting from a competitive environment for investment.

Indigenous businesses in Ireland will be critical to the country's continuing economic recovery, providing employment in all cities, and towns. In our view, supporting these businesses to stay in business longer and to scale their businesses internationally is of fundamental importance. Budget 2016 announced a number of positive developments of relevance to the indigenous business community. However, we believe further work is needed to provide fairness and equity to entrepreneurs. Irish tax policy must ensure that Ireland remains a competitive location for foreign direct investment; however, it is equally imperative that entrepreneurial risk-taking and innovation are recognised and rewarded.

Overall, there are numerous forces driving a successful entrepreneurial landscape in Ireland, including a skilled workforce, financial and technological resources, and infrastructure. Irish businesses also need a well-designed strategy, which takes into account the future development of the business, with the necessary incentives and appropriate safeguards in place, to support their continued growth, success and longevity.

Having undertaken analysis through a survey of over 60 senior individuals in Irish business, we have gathered valuable data and insight from Ireland's leading entrepreneurs, which has enabled us to identify the most critical issues facing businesses in Ireland today.

Based on this analysis, we have identified a number of areas that we consider to be vital to the success of a company as it progresses through the various stages of its life cycle. Without proper planning or implementation, however, these factors may become barriers to establishing successful enterprises in Ireland. We hope this report assists companies in both addressing the challenges, and capitalising on the opportunities, that currently exist.

Daniel Murray

Daniel Murray
Head of Deloitte Private

Key survey insights

TOP PRIORITY

EXPANDING INTO NEW MARKETS

ORGANIC GROWTH IS TOP GROWTH STRATEGY FOR PRIVATE BUSINESSES

RECRUITING+ RETAINING

BIGGEST CHALLENGE

EXPORT CHALLENGES

CURRENCY ISSUES

LACK of KNOWLEDGE FOREIGN MARKETS

ESTABLISHING FOREIGN NETWORKS

CONTACTS+ DISTRIBUTION

UK EXITING EU?

25% SIGNIFICANT NEGATIVE EFFECTS

50% MINOR NEGATIVE EFFECTS

66+% IN FAVOUR OF GOVERNMENT REDUCING TAX BURDEN TO HELP PRIVATE BUSINESSES

FUTURE PLANS?

40+% SUCCESSOR

35% SELL

6% IPO

Early stages

Making the investment

In first-generation businesses, the founder typically makes many sacrifices in order to establish the business and, often in such instances, the individual does not take a full salary or extract profits from the business for many years. It is not until the business stabilises that there is greater potential to accumulate wealth. Thus at the early stages of the business life cycle, survival is key. To ensure that a business will survive this stage, it is important to set out clear goals for the business, including the appropriate business model to pursue, the financing requirements envisaged, and identifying cost efficiencies that may be achieved in the early stages to alleviate cash-flow burdens.

- Sole trade/incorporate?

The first issue that many businesses are faced with is whether to carry on their trading activities as a sole trader or whether to incorporate the business and trade as a corporation from day one of existence. Where a business trade is carried out through a corporate entity, the entity pays corporation tax rates of 12.5 per cent on trading profits. This is a significantly more attractive proposition than being subjected to the higher marginal rates of income tax imposed on the sole trader and affords the business the opportunity to retain more funds to allow the business to grow and remain competitive. The Government has also introduced reliefs for new start-ups in the form of a corporate tax holiday for the first three years following commencement.

Incorporation also provides protection against creditors for the individual's personal assets should their business become insolvent, as the company is treated as a separate legal entity from its shareholders. This protects any shareholders in the business, such as the founder and family members, as it means that creditors are not able to recover debts owed to them by the company from the personal assets of its shareholders, once the shareholders have fully paid up their share capital.

Incorporation is not without its limitations, however, as often banks may require a personal guarantee from the directors or shareholders of the company, which in turn overrides the benefit of having limited liability.

Government incentives

The Government has introduced various tax incentives for start-ups with the objective of fostering an environment that supports entrepreneurship and innovation. The intention behind the introduction of these schemes is to tackle the barriers that many start-ups are faced with in their formative years. The vast majority of start-up companies are loss-making for the first two to three years (depending on the industry), given the initial investment required and the time it typically takes to build up a sufficient level of market share in the company's chosen market to make the company profitable. Cash-flow is the single biggest concern for start-up companies in Ireland in respect of which this relief is targeted. The OECD have reported that more than half of start-ups fail within the first five years of trade. We have referenced the government initiatives put in place to counter the barriers to survival of businesses below, and in turn we have also commented on the improvements which, in our view, are required for these reliefs and incentives to serve their purpose. In our survey of Irish businesses, 25 per cent of respondents did not feel that the Government promotes entrepreneurial activity and indigenous business in general in Ireland.

Corporate tax exemption for start-ups

The Government introduced an initiative for new corporate start-ups a number of years ago. Certain new businesses that commence trading before 31 December 2018 can qualify for a three-year corporate tax-free holiday. The relief provides a credit against the company's corporate tax to the extent of employers' PRSI paid. A company can get full relief from corporate tax where its corporate tax liability does not exceed €40,000, with marginal relief available where its corporate tax liability is between €40,000 and €60,000, and with no relief being available where the corporate tax liability is €60,000 or more.

Our view

Given the struggle that the majority of start-ups face to break-even in the first few years of trading, in our view the current form of relief from corporation tax is of little benefit to these companies that are loss-making, as the benefit of such relief would only be realised if and when those companies become profitable. In addition, the relief is also linked to the payroll liabilities of the company; given that levels of employment are at their lowest in the initial years of trading, the overall effectiveness of the relief is further diluted. However, if the cash value of the relief could be realised by the start-up companies concerned through some form of refundable start-up company credit, then this would greatly enhance the effectiveness of the relief and make it more relevant to dealing with the commercial difficulties (which to a large extent revolve around cash flow) faced by start-up companies. There is a precedent for such a form of refundable tax credit in the R&D legislation and we would propose that the refundable start-up credit could be claimed in the company's corporation tax return each year.

Employment and Investment Incentive Scheme (EIIS)

Due to our recent economic environment, debt funding from third-party financial institutions may be limited and so making alternative means of funding available is essential. The Government's response to this barrier to trade was through the introduction of the EIIS scheme to provide for income-tax relief for investors on investments up to a maximum of €150,000 per year up until 2020. Relief of up to 40 per cent is available in two tranches, subject to meeting various conditions on trading activities that commenced after 1 January 2015 (i.e. where it can be proven that employment levels have increased at the company after a period of three years from investment, or where it can be shown that the company used the capital expenditure for research and development.) Any unused amounts of the relief can be carried forward by the investor as far as the year 2020.

Our view

While the Employment and Investment Incentive Scheme is a welcome source of finance for businesses, from an investor's perspective the scheme has one major disadvantage as the shares acquired under it rank behind trade creditors on liquidation. In addition, when comparing this relief to the corresponding UK relief under its Enterprise Investment Scheme, the Irish offering to investors is inferior. The tax reliefs available in the UK include an income-tax deduction on investment of up to £300,000 in any year, and also a capital gains tax exemption on sale. Relief from inheritance tax may also be available. The Irish EIIS scheme contains restrictions for pre-trading companies that stipulate that funds received must be applied in incurring qualifying R&D expenditure for the purposes of section 766 TCA 1997 and the use of the money must contribute directly to the creation or maintenance of employment in the company. A removal of these restrictions would be welcomed and would be more aligned with the objective of assisting entrepreneurs with their respective business initiatives.

Financing for start-ups

Enterprise Ireland

Enterprise Ireland (EI) is the government organisation which is responsible for both the domestic and international development and growth of Irish businesses. It provides different schemes and funding programmes for start-up businesses, including those designated as high-potential start-ups (HPSUs) that have the potential to sell an innovative product or service internationally and, that have the potential to create 10 jobs and €1 million in revenue within three to four years of start-up. EI can support companies a number of times during their initial years, including situations where there is already venture capital and bank debt in place. Enterprise Ireland clients are appointed a dedicated EI development adviser to assist with applications for funding and guide them through their relationship with EI.

Venture Capital

Venture Capital (VC) is medium- to long-term capital provided by professional firms to growing unquoted companies in return for an equity stake in the company. Unlike the legal rights of traditional lenders to interest on a loan and capital repayments, venture capitalists seek a stake in the company with their shareholder return dependent on the growth and profitability of the business. Venture capitalists are interested in companies with competitive products/services and which have significant potential for fast growth managed by an experienced team who are capable of creating profitability.

The Irish Venture Capital Association (IVCA) is an association which represents VC firms in the Republic of Ireland and Northern Ireland. Full members are venture capitalists who provide equity funding, while associate members include firms that provide advisory services in the area of VC.

Active VCs in Ireland include:

- ACT Venture Capital Limited
- Atlantic Bridge
- Delta Partners Limited
- Development Capital
- Draper Esprit
- Dublin Business Innovation Centre
- Enterprise Equity Venture Capital
- Fountain Healthcare Partners
- Frontline Ventures
- Greencoat Capital
- Investec Ventures Ireland Limited
- Kernel Capital
- MML Growth Capital Ltd
- NDRC
- Seroba Kernel Life Sciences
- SOS Ventures and
- Western Investment Fund.

Enterprise Ireland and venture capitalists provide financing during the early stages of a business. Once the companies achieve a more stable financial profile, they may seek financing for further growth through venture capitalists or through alternative lenders and private equity investors in the Irish market, as discussed further in the "Growth stage" section of this report.

The Start-up Relief for Entrepreneurs (SURE)

The Start-up Relief for Entrepreneurs (SURE) is a tax-relief initiative introduced by Finance Act 2014 to facilitate shareholders of new start-ups who had previously been subject to Pay-as-You-Earn (PAYE) tax in the previous four years and who will take up full employment in the start-up company. The claimant may be entitled to an income-tax refund of up to 41 per cent of the capital they invest under the scheme over the six-year period prior to the year of investment in the scheme. In order to avail of the relief, the new company must carry on a qualifying trading activity.

Our view – The SURE scheme

We believe that the scope of trades that qualify for this relief is too narrow and should be expanded to include companies engaged in the provision of professional services, such as architects, auctioneers, opticians and veterinary surgeons, etc. Including the above types of companies would provide valuable financial support for many qualified professionals to start up their own business. Such a measure would enhance the national entrepreneurial spirit. In addition, such a measure would create further potential for employment for the national economy and would be likely to create a positive multiplier effect on the domestic economy through direct domestic investment. It is important to draw the comparison with the corresponding relief available in the UK, i.e. the Seed Enterprise Investment Scheme (SEIS). Provided all of the conditions are met over the appropriate time periods, the tax reliefs available include income tax relief of 50 per cent of the investment made (up to an annual investment limit of £100,000 per individual) as well as a CGT exemption on sale of the SEIS shares. Capital gains on other assets can also be either reduced, or potentially made exempt, where an SEIS investment is made, depending on the tax year in which the gains are or were realised and when the SEIS investment is made. While the income tax relief available under the SURE scheme is competitive with the corresponding UK position under the Seed Enterprise Investment Scheme, currently the CGT reliefs available on investments made in companies qualifying under SEIS are significantly more competitive than the Irish equivalent under the SURE scheme, which does not provide for any form of CGT relief on the shares in the start-up company by the investor. From a competitiveness point of view, we would recommend that the SURE scheme be updated accordingly to provide similar CGT reliefs at the level of the investor, as is the case in the UK under the Seed Enterprise Investment.

Managing your cash flow

Only six per cent of respondents have considered working capital management as a source of financing their businesses over the coming twelve months. We have outlined below some incentives that should aid businesses to manage their working capital more efficiently.

Top tips to assist with cash flow management for start-ups

Government grants

It is important for start-up businesses to approach State bodies and make enquiries as to their entitlement to receive funding or support from the various bodies. Agencies such as Enterprise Ireland, IDA Ireland, Tourism Ireland, County and City Enterprise Boards are among a list of agencies that provide funding and support for businesses. Enterprise Ireland provides funding for those businesses that qualify as a HPSU. Qualifying businesses under the HPSU scheme are start-ups that have the potential to develop a product or deliver a service available for sale to foreign markets. As mentioned earlier, the applicants must have the potential to create 10 jobs and €1 million in export sales within three to four years of starting up.

VAT Cash Receipts Basis

In order to avoid cash-flow difficulties, it is worthwhile to consider availing of the VAT “cash-receipts” basis to avoid the cash-flow difficulty of accounting for VAT on a supply when the invoice has not been paid by the customer.

Previously, VAT had to be paid over to Revenue at the appropriate time irrespective of whether the trader had received money from the customer for the goods supplied. This placed a heavy cash-flow burden on a trader. It is now possible to elect to calculate and account for VAT liabilities on the basis of cash received during a taxable period in respect of certain activities.

Professional Services Withholding Tax (PSWT) – interim refunds

PSWT is deducted from payments made by certain government agencies for certain professional services they have received (e.g. work carried out by architects, engineers, accountants, consultants and solicitors) at the standard rate of income tax, which is currently 20 per cent. Credit for PSWT deducted is normally claimed when a company submits its tax return. It is possible for a taxpayer to pay PSWT in an amount that exceeds their tax liability in that period, which can lead to financial hardship as a considerable period of time can pass between the time when the tax is deducted and when it is offset against the company’s corporation tax liability. To combat this issue, it can be possible for a company to claim an interim refund.

Research and Development (R&D) Tax Credit

The legislature has provided for a tax credit of 25 per cent of the expenditure incurred by a business carrying on activities that meet specific scientific or technical criteria. The calculation is made retrospectively for the year preceding the current financial period. The resulting credit is then deducted from a company’s corporate tax liability. It can, in certain circumstances, be received as a cash payment from Revenue.

Our view – R&D tax credits

Currently under Irish law, certain unused R&D tax credits can be claimed as a cash repayment over three years. This effectively ties up cash flow and may create a need for businesses to seek funding from external sources, which would normally have an additional cost attached. In our view, tying up much-needed resources over a three-year period should be reconsidered, with a view to reducing the term over which the cash refund can be given (for example, to 12 months). It is also our view that further consideration should be given to a move towards quarterly refundable credits rather than providing this support only once a year. This could have a profoundly positive effect on the cash-flow of start-up companies and make the risky early stage of developing a company more manageable.

Establishing the business

Once the business has now emerged from its start-up phase, its focus is to establish itself as a business of the future. A key factor in the continuing growth and expansion of businesses in the modern environment is a strong, innovative finance function. This trend is indicative of the responses received in our survey. A total of 19 per cent of respondents stated that their top priority for the next 12 months was to expand into new markets while a further 12 per cent responded that their mission for the coming year was to grow by acquisition. In serving these demands, working more efficiently and seeking the most competitive financing alternative is key to progression. Gone are the days were the finance function was seen as a necessary evil and a resource focused solely on lowering costs. In order for an organisation to become and remain successful it requires Finance to run in sync with the business model and create conditions within the company towards which it can be steered to success.

Changing the way we think

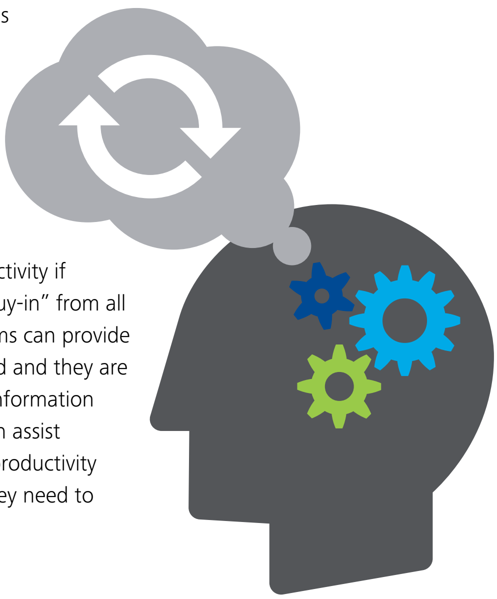
When a company is earning profits and growing, it is easy to re-invest in the operations side of the business and ignore finance and other ancillary functions. Having a finance function that is dynamic as opposed to outdated can make the difference between long term success and failure. Do you have a finance function that provides the stimulus for innovation, rather than focuses on the accuracy of their forecasts? Finance that focuses on profitable revenue streams and asks the question: Are these in decline? What should we now be focusing our resources on? Are there new potential revenue streams we are missing out on? These questions are the questions of an integrated and dynamic finance function that is working in and for the business rather than assessing it from the outside in.

The traditional school of thought focused Finance leaders on creating the appropriate internal controls within the business to ensure that Finance could report accurately and on a timely basis as well as working with operations to develop a risk management and control framework. Recent market events have demonstrated that simply mitigating risk through internal controls is now outdated; seismic market events can have an impact on even the most robust of companies that have effective internal controls. Now we should be focusing on how a company can bounce back from a market event, how can a company discover and take advantage of new, as of yet undiscovered opportunities. Survival simply isn't enough anymore in today's environment, a company needs to be resilient and responsive to change.

Another area in which Finance can assist the leaders of the business is an innovative and adaptive approach to resource allocation. A company producing profits year on year can decide to ramp up its activities or expand too quickly, leading to cash shortages and a dependence on short-term external finance that can ultimately create a going concern issue.

Finance can mitigate these risks with the appropriate investment. Many questioned senior management when Apple disclosed that it had over $100 billion in cash and cash equivalents, with some calling for this cash to be distributed to its shareholders. However, holding this amount of cash means that Apple can move quickly into new and emerging markets and invest significantly in R&D if the right project comes on-stream. Finance should also advise management on appropriate financial contingencies within the business, which, as well as supporting survival in worst-case scenarios, can also support investment and adaption in the future.

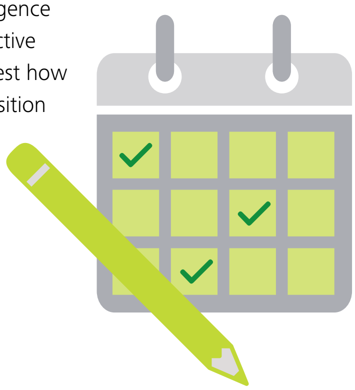
A simple annual budget is an outdated model of resource allocation. Companies that have switched to responsive and flexible approaches have demonstrated improved performance and greater adaptability against their market peers. They have the flexibility and resources available to respond instantly to risks and opportunities that require additional spending. In the current environment, businesses are looking to introduce business and management information systems in order to further develop and progress their business into the future. These powerful systems can drive the link between Finance and Operations to the next level in terms of connectivity if utilised correctly and there is "buy-in" from all stakeholders. Information systems can provide present real-time data as needed and they are adaptable to new or modified information requirements. These systems can assist companies in maximising their productivity and focusing them on where they need to allocate resources.



Planning for the future

Depending on the ultimate goal of a business, a strong and integrated finance function could be a necessity rather than luxury. Any company, considering their succession planning as either being a take-over or an IPO must focus on developing their internal finance function from the start. This requires significant investment in something that a company might not see the ultimate reward of until years down the line and requires long-term focus and planning from management and owners. Potential investors demand due diligence and transparency of operations and security, introducing complex processes that often require a large investment of resources. Having a strong finance function already in place can help to build investor confidence in a company and ease the transition phase if considering an IPO.

When asked what the top three priorities were for their business in the next 12 months as part of our survey for this report, the main areas of focus were: expanding into new markets; raising new capital; and growth by acquisition. Companies need to be aware of their own finance functions for each of these possible growth strategies; if expanding into new markets does the business have the capabilities/experience/systems to provide adequate support for the proposed expansion? Looking to expand through capital funding requires investors with confidence in your long-term business plan and, if looking at growth through acquisition, companies should be completing detailed due diligence work on prospective acquisitions to test how smooth the transition process will be in integrating a new company into the current group/company structure and processes.



Corporate governance

In addition to a strong finance function, many investors – and indeed the general public – are looking for companies to have a corporate governance structure that inspires confidence. Following the financial crash in '08/'09 many in the media and public apportioned partial blame for the crash on poor – or indeed a complete lack of – effective corporate governance. Corporate governance reform is top of the agenda for many investors and now more so than ever, a strong Corporate Governance function, including qualified independent board members and transparency of related-party transactions, is critical. The introduction of non-executive directors ('NEDs') can be a daunting process for many family-run or start-up companies with the perception of an external individual coming onto the Board of Directors being an unthinkable option. This is, however, becoming a more pressing issue following the enactment of the Companies Act 2014 on 1 June 2015, which is bringing with it certain conditions regarding NEDs and Audit Committees. Any company/group with gross assets greater than €25 million and turnover greater than €50 million in the current and preceding years will be either required to establish an Audit Committee or explain the reasons for not establishing an Audit Committee. If an Audit Committee is set up, it is required to include at least one non-executive director, who is a non-executive director of the company.

Despite some companies' initial reservations about the appointment of a NED to their Board, there are also significant benefits. A NED can add significant value by providing an independent, external opinion on key issues, and indeed bring a clarity of thought that can lead to better business decisions.

How do you find the right NED for your business? This question links back in to a company's requirement for a strong and focused long term strategy and what gaps exist in your organisation, which you will need to address for the future. Linking back to the survey of Irish businesses, the top priority noted for companies in 2015 is to expand into new markets in the next 12 months. If looking to move internationally or even into a new market domestically, you may want to co-opt a NED with international or experience in those particular markets. Much like how a strong finance function gives investors confidence in the business, the appointment of a NED with the relevant expertise and experience can add immense confidence – and therefore value – to a business through increased confidence among investors, lenders, and customers.

In today's marketplace, we are seeing that technology and risk management are the key areas where companies feel they could potentially require more robust strategies and increased expertise, and these are just a couple of areas where the right NED can really add value to an organisation. There is a lack of real understanding of cyber-risks at all levels in organisations; from boards not having technical representation to understand the risks being raised or indeed not being raised, right down to staff not being cyber-aware and trained in how to spot and react to threats. There is currently a wave of payment diversions where we are seeing traditional sorts of frauds moving online, along with 'ransom' attacks, primarily 'ransomware' and DDoS threats.

Encouragingly, in Ireland there are many accomplished business professionals, with varied experience and commercial acumen who could fulfil such a role in your company. In addition to the required skills, it is important to ensure that the right cultural fit exists between a NED and your company. Do you both subscribe to the ethos of the company and what it is trying to achieve overall? Do you believe there will be a productive working relationship? While this does not mean that you will always agree, you must be confident that you can disagree in a constructive way! Overall, the relationship must drive the business forward, and it is critical to consider the dynamic of this relationship when bringing somebody on board.

Finance functions across the country need to assess their current structure and ensure they themselves are constantly innovating in order to remain relevant in today's marketplace. Key management are often not receiving the right data on a timely basis in order to make fundamental decisions in the modern fast-moving environment. For a company that is establishing itself as a market leader, it is time to move away from the finance function of old that was viewed as a cost-reducing, budget-setting model, and to focus on creating a dynamic and integrated function that produces results that are in line with the company's long-term objectives. They need to deliver ways of enhancing performance, driving real communication, sustaining resilience and providing a more connected and cohesive Finance offering.

Top tips for expansion:

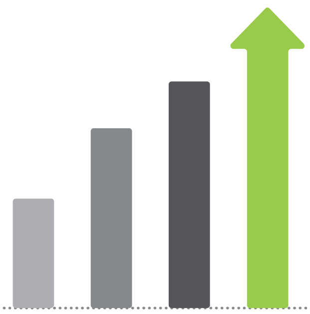
- ✓ Develop a detailed, strategic, long-term business plan
- ✓ Consider the possibilities of organic/acquisition growth
- ✓ Invest in your people
- ✓ Openness to the experience and expertise of NEDs
- ✓ Embrace technology and change
- ✓ Sync Finance and Operations to maximise efficiencies

Growth stage

Financing growth

A. Growth

Once a company is established it may consider and explore further opportunities for growth. A company can grow either organically or through acquisition. Organic growth focuses on investing in the business to create competitive advantage by differentiation, innovation, and expanding its product and service offerings, while acquisitive growth is achieved through acquiring and merging with other companies.



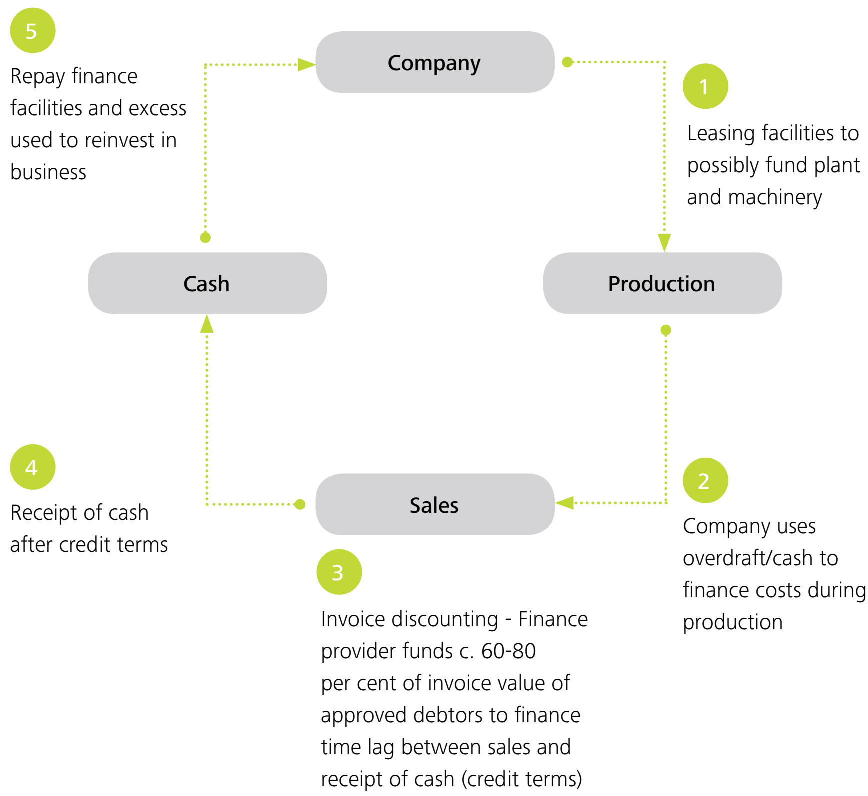
B. Organic growth

A company can grow organically through various methods, both domestically and internationally. Introducing new products and services, expanding into new markets, and decreasing costs are all methods to increase revenue and margins. It is interesting to note that 38 per cent of survey respondents chose organic growth as their main growth strategy for the next 12 months. In order to stimulate the business, a company can use cash generated internally from its trading activities. However, with this comes the risk of overtrading. This is when a company's sales increase at a greater rate than that at which it can finance them and also than for which it has adequate resources. Therefore, it is important for companies to consider other forms of financing.

Options available for early-stage growth outside of cash generated internally include:

1. Overdrafts
2. Asset-backed lending such as:
   - Invoice discounting/debtor financing
   - Leasing

Working capital cycle and short-term financing



Providers of these types of short-term finance include clearing banks, such as AIB, Bank of Ireland and Ulster Bank, as well as alternative asset-backed lenders, such as Close Brothers or Bibby Financial Services.

In addition to these providers, in 2014 the Government set up a new body called the Strategic Banking Corporation of Ireland (SBCI) to provide funds to Irish SMEs. The SBCI is funded by the German promotional bank Kreditanstalt für Wiederaufbau, the European Investment Bank, and the Ireland Strategic Investment Fund (ISIF). The focus of the SBCI is to stimulate the growth of the Irish SME sector through facilitating access to flexible funding, provided through both bank and non-bank specialist on-lenders. SMEs can access SBCI funding through on-lenders, including Bank of Ireland and AIB, with further SBCI on-lenders to be announced over the coming six months.

ISIF was established in December 2014 with €7.6 billion available to invest from the National Pensions Reserve Fund. The focus of ISIF is to invest in projects, companies and funds that have potential for significant growth, innovation, and value improvement. ISIF provide debt and equity finance directly to companies and often work with a co-investor.

C. Acquisitive growth

In the longer term, one of the most effective ways to grow a company is by acquisition. A total of 18 per cent of survey respondents said that mergers and acquisitions would be their preferred option for growth. Through acquiring a company in the same, similar or other industry, a company can potentially benefit from synergies and cost savings by spreading fixed costs over a larger revenue base. It is also a useful way to enter a new market, especially when acquiring a reputable brand with significant market share.

Naturally, a significant level of funding is required to acquire another company. A company's ability to secure capital and the type of capital secured (i.e. debt or equity) will largely depend on the company's cash generation. Repayment capacity and security are assessed to decipher the appropriate level of debt a company can raise and sustainably repay.

The last 18-24 months have seen the emergence of alternative funders (debt and equity) providing a new source of capital to Irish private companies. These alternative funders are providing valuable additional capital to private businesses in Ireland. Many of these alternative funders will work alongside traditional banks in funding a company's financing requirements.

Available methods of financing

Lender	Senior Lending	Working Capital/ Leasing	Unitranche	Mezzanine	Equity
Commercial banks	✓	✓	✗	✗	✗
Asset-backed lending	✗	✓	✗	✗	✗
Alternative funders	✓	✗	✓	✓	✗
Private equity	✗	✗	✗	✓	✓

Overview of alternative funders

Lender	Investment focus	Individual capital provided
Ireland Strategic Investment Fund	Commercial focus to support economic activity and employment in Ireland in sectors including infrastructure, energy, water, real estate, housing, tourism, food/ agriculture, technology, healthcare, and finance	€10M +
Broadhaven Credit Partners	Residential development funding and investments in wider Irish corporate and SME community	€10M - €50M
BlueBay Ireland Corporate Credit I Limited	Loans to larger SMEs and mid-sized corporates in Ireland	€5M - €45M
Carlyle Cardinal Ireland Fund	Irish SMEs in buy-outs or growth equity opportunities, focusing on technology, media and telecommunications, clean-tech, healthcare, and consumer brands	€2M - €50M
Renatus Capital Partners	Ireland's SME sector, owner-managed, and family-owned trading companies	€1M - €3M
MML Growth Capital Partners	Growth capital to private businesses in Ireland for expansion, acquisitions, recapitalisations, and shareholder reorganisations	€2M - €12M
BroadLake Capital	Management buyouts, growth capital and special situations, targeting companies where they can add value by providing strategic and operational support to management teams in addition to pure capital investment	€1M - €10M

Advantages and disadvantages of alternative funders versus traditional banks

Advantages

- Flexibility
- Structure of funding allows investment across the capital structure
- Greater structural flexibility in terms of lower/no amortisation requirements and no cash sweeps
- Swift deal execution – direct access to a few key decision-makers
- Ongoing support from the funder and willingness to increase exposure to a single credit for subsequent expansion (Capex requirements, M&A financing)
- Integrated approach with the same deal team originating and monitoring the loan

Disadvantages

- Higher cost of funding
- Funds can't provide clearing facilities, which must be provided separately
- In case of distress, will the alternative lender continue to support the borrower, sell their stake, or seek to acquire control of the equity?

Our view

The high street banks are lending again to viable businesses at various debt levels, which differ from industry to industry. The banks have employed sector specialists across their business and corporate banking teams and have streamlined decision-making processes in place. Origination teams are also seeking new lending opportunities.

However, high street banks' lending is conservative and is likely to remain so for the medium- to long-term due to increased regulation. This has resulted in a funding gap, not just in Ireland but across Europe. This funding gap is being serviced by the emergence of alternative funders who provide stretched senior or unitranche facilities, as well as mezzanine finance. These facilities are more expensive, but can provide more flexibility in terms of covenants and repayments and can also provide a higher quantum of debt. This is in line with the results of our survey of Irish businesses, with 20 per cent of the respondents expressing how better lending terms would be helpful to their business.

But the level of debt being taken on, whether from high street banks or alternative funders needs to be sustainable and reflect the risk profile of the business. Where debt is not appropriate, new equity should be considered. However, shareholders are reluctant to take on equity as a source of capital and therefore SMEs may not be capable of achieving their growth ambitions and targets. There are a number of private equity providers who can take both majority and minority stakes in businesses. They offer experience and networks, both domestic and overseas, as well as fresh capital. New debt is also possible, with senior banks and alternative funders providing funding alongside fresh equity. In Europe, the typical equity contribution required for an acquisition is 40 per cent, alongside debt funding of 60 per cent.

The Irish debt market has seen a big change in recent years, with more financing options now available to companies. Priorities of survey respondents include expanding into new markets, raising new capital, and growing by acquisition. The increasing availability and variety in financing options will help this to become achievable. We believe that companies that utilise the new funding market will achieve a competitive advantage.

Exit strategy

Sale, diversification, succession

All business founders will face the decision of exiting their business or hiving off part of a business to further the development of other business interests. Some may wish to diversify into new markets, while often times, the founder may wish to make way for the next generation, and will therefore put in place measures to facilitate an appropriate transition to their successor(s). The results of the survey show that over 50 per cent of the companies surveyed employ family members as key shareholders. Succession planning is therefore a very important consideration for these companies and we have provided helpful succession-planning initiatives in this report.

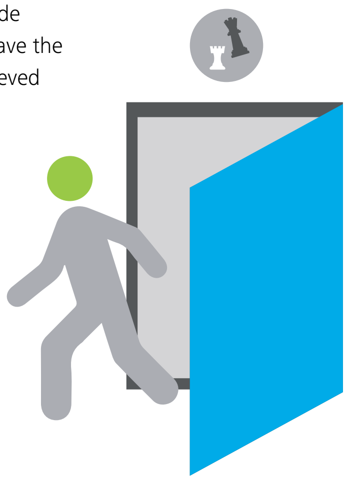
Exit structuring considerations

A. Diversification

When the business reaches a stage in its life cycle where it has become well established and is flourishing, business owners are faced with the decision of diversifying their funds into other investments or using funds to develop the business further, usually a decision based on the highest expected rate of return. Many businesses feel that there is a commercial requirement for diversification (i.e. to diversify by investing in other assets within the corporate structure or by extracting value from the business so that assets and wealth are held outside of it and thus not subject to trade risks).

Where the business is carried out through a corporate entity, it is very important from a corporate tax perspective that the business can satisfy the Revenue Commissioners that the majority of its activities are trade related and that not more than 50 per cent of the activities are investment-holding activities. This is also a reason why businesses may wish to extract surplus cash value from their companies.

Where surplus value has accumulated within a company due to re-investment in non-trade assets, it may be appropriate to segregate the non-trade assets or investments into one company and have the trade sit in another company. This may be achieved on a tax-neutral basis and could facilitate a sale of the trading business with a retention of the investment business for the family, or it might even facilitate succession to the trading business by certain family members, while the investment business is held separately, to provide either for the business owner in retirement or a transition to other family members.



Re-investment of proceeds – our view

The recent Finance Bill introduces a reduced rate of CGT of 20 per cent on disposals of a business up to an upper limit of €1 million of chargeable gains from 1 January 2016. While this measure should provide a level of relief to small entrepreneurs and business owners, it will do little to encourage entrepreneurs to build and retain businesses on a larger scale, given the upper limit of €1 million. Due to the financial downturn that took place in recent years, the commercial reality for current enterprises is that in many instances people will have to remain in business for longer before realising a significant return on their earlier investment and this commercial reality is not currently recognised through the tax system applicable to entrepreneurs. It is generally in the enterprise's interest that the entrepreneur remain actively involved with the enterprise for as long as possible.

We recommend that some form of tapered tax relief similar to that previously introduced in the 1970s be implemented into our tax law. This tapered tax relief could operate in such a manner that the applicable rate of CGT would be reduced on a pro-rata basis, depending on the length of ownership in the relevant assets by the individual concerned. While this form of relief was introduced decades ago in particular circumstances, it remains relevant to our current need to stimulate growth in the Irish entrepreneurial landscape. A similar relief would reward commercial longevity, signal Ireland as an excellent place to operate as an entrepreneur and stimulate direct domestic investment, which should give rise to increased domestic employment in the future.

B. Termination payments

In order to access value from the company in advance of a sale, the shareholders should give consideration to taking a termination payment from the company. The ex-gratia termination payment, which is paid at the discretion of the employer company, can be structured in a manner in which it may be possible to secure tax-free treatment in relation to all, or a part of, the termination payment. The lifetime limit that any person can take is €200,000. The Standard Capital Superannuation Benefit (SCSB) is a benefit that typically accrues the most value to individuals who have been running their businesses for many years. The SCSB is calculated by taking into account an individual's average annual salary for the last 36 months of their employment, their number of years of complete service and the net present value of the tax-free lump sum from the company pension scheme (if any), where the individual wishes to retain their rights to take a tax-free lump sum from the pension scheme.

For business owners who are considering disposing of the business in the coming years, one consideration would be to increase their salary and their spouse's salary (to the extent that their spouse is actively involved in the running of the business) so that the individual and their spouse may receive a higher level of exempt payment under this exemption in three years' time, or any time thereafter.

C. Pension planning

Given the recent reduction in the Standard Fund Threshold (SFT) from €2.3 million to €2 million, individuals may wish to consider crystallising any private pension funds that they have not accessed to date, in order to ensure they do not accumulate additional chargeable excess tax through further contributions and/or investment growth. Given this additional chargeable excess tax can rise to 70 per cent in some circumstances, it is important that an individual's private pension funds are reviewed to ensure that the individual does not cross the SFT so that their exposure is limited.

D. Valuing the business

Business owners should consider the application of the value of the business on their ultimate retirement or exit from it. There are three general approaches to estimating the value of a business: the income approach; the market approach; and the cost (or asset-based) approach.

Income approach – the most commonly used income approach to value a business or asset is a discounted cash flow (DCF) analysis. A DCF analysis involves forecasting the cash flow stream of the business over an appropriate period and then discounting it back to a present value at an appropriate discount rate.

Market approach – an analysis of market multiples of firms engaged in similar businesses, therefore, yields insight into how investors might evaluate an investment in the subject business.

Asset approach – the balance sheet is adjusted to market value by individually valuing all of the tangible and intangible assets of the business and then deducting the market value of all of the company's liabilities. A common application of the asset approach is in valuing an investment or property holding company.

E. Crystallisation of capital losses

Where the business owner currently has underperforming investments, he or she could dispose of these investments and then offset the capital losses against any gains arising from the subsequent liquidation or sale of their trading business, where retirement relief has been exhausted or does not apply. This would lessen the charge to capital gains tax arising on the sale or disposal of the business.

Family matters – addressing the family dynamic

Another consideration with respect to extracting value from the company is whether other family members are stakeholders or potential stakeholders in the business. Extracting too little value may cause strife among family stakeholders who may have envisaged higher levels of return, and in turn such conflict could negatively affect the business. Extracting too much value, however, may seek to satisfy the expectations of certain family members in the short term but such extraction may, in the long run, result in the business suffering. In this regard, it is crucial to the survival of the business that an analysis be carried out as to the level of financial reinvestment required to fuel the business, and the amount of value that should be held outside of the business so that the family is less reliant on it and thus has some protection in the event of any deterioration in its performance or value. It is important for business owners to place a realistic value on their business. This will usually involve a decision as to whether it is best to sell the business or transfer it to family members.

Transition from parent to child

Many family businesses are run such that the founder retains the top role, making all the decisions and essentially runs a 'one-man band'. This carries a significant risk - in the event that anything should happen to the founder, his or her successors will struggle to continue the business as smoothly as it was run by its predecessor without the benefit of the successors having had an active involvement in the business. In this regard, it is essential for business owners to put an exit strategy in place that allows for the involvement of the next generation in key business functions. Business owners should consider putting in place appropriate training or support and should step into the role of mentor to their successor. This would ensure that the next generation is provided every opportunity to make the transition into an effective successor and that the management of the business continues to be well run.

Family constitution/shareholder agreements

In situations where the business owner is considering passing the business to the next generation, it is important to put in place a governance structure that outlines the family's shared expectations, values, and their clear goals in relation to the operation of the business. These structures are vital in situations where the business is transferred to multiple individuals, who understandably will have differing views to one another over the course of the shared ownership of the business. A family constitution captures these values and provides a clear guide that will allow for the family to work together in harmony.

Key features of a family constitution would usually include:

- Outline of the goals and values of the family in relation to the family business
- Identifying long-term objectives of the family business
- Decision-making policies
- Dealing with potential conflict
- Asset and dividend distribution
- Inclusion of minor family members in the business at a future date
- Involvement of family members in the business.

A family constitution is not a legally binding document; however, such a document clearly sets out the family's agreed goals and, when read in conjunction with the shareholder agreement, which is a legal document, can carry great influence in the carrying on of the family business' activities.

The shareholders' agreement outlines the shareholding of each shareholder in the company. It can set out the relevant voting rights that are attributable to each share and/or provide a policy in respect of dividends or value being paid to shareholders. Typically, it also provides a framework for resolving disputes and establishes procedures for the transfer of shares at a future date.

Leveraging off tax reliefs on the transition of a business to the next generation

The taxes to be considered on the transfer of a business or shares in a business are: capital gains tax (CGT); capital acquisitions tax (CAT): and stamp duty. If a parent transfers assets to their children, even if no consideration is provided by the children, the value of the assets transferred by the parent will (in most cases) be deemed to be at market value for the purposes of CAT, CGT and stamp duty. A slight divergence exists in private companies. The current rate of CGT and CAT is 33 per cent. CGT is chargeable on the amount equal to the difference between the market value at the date of sale/gift and the cost of acquiring the shares. Given that most companies are incorporated with nominal share value, generally, the amount of CGT payable, equates to 33 per cent of the value of the shares transferred. CAT will be calculated on the value of the shares in excess of the child's available tax-free threshold. Each child is entitled to receive up to €280,000 tax free from their parents, with the remaining value taxable at the 33 per cent rate. Where a transaction gives rise to both CAT and CGT, any CGT paid may be claimed as a credit against the CAT. However, the assets transferred must be retained by the child for a period of two years to avoid a claw back of the credit. The current rate of stamp duty on shares is one per cent, and two per cent on business assets.

Normally, where shares in a trading company are transferred by a parent to children, retirement relief from CGT can apply so that little to no CGT is payable. The level of relief is dependent of the age of the transferor. Where the parent has attained the age of 55, but not yet attained the age of 66 years, they can make a gift of the shares in their company to their children free of CGT. Where, however, the parent has attained the age of 66 years, a cap of €3 million is placed on the shares; to the extent that the shares hold a value larger than €3 million, a CGT charge would arise.

Business relief from CAT can apply to the transfer of relevant business property, to reduce the amount on which CAT is calculated by 90 per cent. Where the company involved holds excess cash, business relief from CAT will be restricted so that the relief will only apply on the trading assets. Cash will be considered excessive if it is not required for the purposes of the trade.

In addition, where the shares are disposed of within six years of the transfer, both retirement relief from CGT and business relief from CAT may be clawed back.

Our view

Retirement relief is currently drafted in such a way that individuals are encouraged to leave their businesses early, which is not aligned to the commercial reality facing Irish entrepreneurs as a result of the recent economic downturn. In this regard, as outlined above, we would recommend that this issue be addressed through the introduction of a form of tapered tax relief similar to that previously introduced in the 1970s by the then Minister for Finance.

Alternatively, if the Government do not see tapering relief as a viable option, we would recommend that a relief akin to the UK Entrepreneurs' Relief CGT regime for entrepreneurs be implemented in Ireland. Such a relief should be drafted in such a way as to include conditions similar to those set out in the existing retirement relief provisions in the context of the working director requirements applicable to a disposal of shares.

In the case of disposals within the family that currently fall within the €3 million restriction on the market value of assets that can be disposed of tax free by an individual older than 66 years of age, we are of the view that this value restriction should be removed, as this acts as a barrier for passing the business on to the next generation.

As a result of the financial downturn in Ireland over the past number of years, family businesses have been very cautious and have accumulated cash in order to ensure the sustainability of their businesses. However, from a CAT perspective, there are currently certain restrictions on the availability of business relief on the retained cash in a business. Due to the restrictions, in the event of a transfer of the business/company to the next generation, 33 per cent of this accumulated cash may be lost to CAT, instead of being re-invested in the business. We recommend that business relief be amended, such that cash retained for the purposes of the business including funds required to grow the business, can qualify for business relief subject to such cash being re-invested in the business within a period of, say, five years.

Conclusion

Ireland has a long, proud history of successful entrepreneurship and of creating world-class products, services and brands both for our domestic market and international markets. As mentioned in this report, Irish entrepreneurs work hard to create successful businesses, but it has often proved to be easier or more lucrative to sell them upon reaching a certain size rather than scaling them up to become global firms. This is unfortunate, as it means that many of the benefits deriving from those businesses migrate overseas. More can certainly be done at the level of government policy, including in tax and financial regulation, to encourage Irish entrepreneurs to scale up and stay involved with their businesses, rather than to sell.

While Ireland undoubtedly has strengths in a number of areas, there remain obstacles to entrepreneurship, including accessing funding, inequitable taxation and issues related to succession planning. In order to further encourage business owners to make and maintain their investments, and in turn to scale their business internationally, it would be helpful to provide incentives to our entrepreneurs. Initiatives such as the CGT tapering relief and a renewed form of the corporate tax exemption, EIIS scheme, and SURE scheme would be warmly received by our country's business owners.

In addition, a renewed outlook on the application of the R&D credit is required. At present, the relief is not appropriately tailored for start-ups that wish to invest significant capital.

Businesses can improve their cash-flow efficiencies by availing of various initiatives that have been brought into effect by legislation and through state aid. Many state bodies provide financial assistance for qualifying entities. In addition, applying the cash receipts basis for VAT purposes is most effective for qualifying entities and removes the heavy cash-flow burden on businesses that otherwise were accounting for VAT without having received payment from the customer.

As business owners seek to exit from their investment, many planning opportunities are available for consideration. Important factors to bear in mind are whether the business owner intends to completely divest their interest, either through a sale of the business or a wind-down of the business. Alternatively, the founder may wish to appoint a successor, be it a family member who will carry the business to the next generation, or a valued employee who will continue to drive the founder's vision and further grow the business. Numerous issues are at stake, and it is crucial that the founder has a clear vision of their exit strategy and is informed of the implications of divesting their interests, passing them onto the next generation, and diversifying their investments.

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We would welcome a focus on creating a world-class indigenous business sector with the same focus and energy that has been given to promoting FDI in Ireland so successfully.

Ireland has been extremely successful in recent years at promoting itself as a destination for foreign direct investment. Yet, the environment for Irish-based entrepreneurs is not as robust as it could be. We would welcome a focus on creating a world-class indigenous business sector with the same focus and energy that has been given to promoting FDI in Ireland so successfully.

Irish businesses have told us that their current priorities include, among others:

- Expanding into new markets
- Positioning the business for a sale or an IPO
- Retaining talent
- Increasing productivity
- Strengthening management and corporate governance.

How businesses achieve these goals – and the support they receive from Government to help them do so – will have a significant impact on Ireland's continued prosperity and competitiveness.

The Government has certainly made some strides in improving the entrepreneurial climate, and has indicated in Budget 2016 that this is a work in progress, with additional measures needed in the future. We certainly welcome this acknowledgement and hope that the next Government will continue to focus on entrepreneurship as a priority.

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