



An Roinn Post, Fiontar agus Nuálaíochta
Department of Jobs, Enterprise and Innovation

Microenterprise Loan Fund Bill 2012

Regulatory Impact Analysis

**Prepared by the Department of Jobs, Enterprise &
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1 Description of Policy Context and Objectives

1.1 Policy Context

The Government commitment to establish a Microenterprise Loan Fund targeted at start-up, newly established, or growing micro enterprises is the response to the unmet demand in Ireland for micro-finance. Lack of credit severely restricts opportunities to create and support micro enterprises and help reduce unemployment. Access to finance in the current risk averse lending environment is severely restricted for all business, and is particularly acute in the microenterprise sector where even in good economic circumstances, Banks decline applications for microfinance which do not meet their criteria but which would have proven creditworthy had the loan been granted. The fundamental reasons are lack of collateral, traditionally high bad debt levels, intensity of administrative overhead and time investment required in terms of loan assessment, coupled with high refusal rates and the relatively small size of lending proposition, with loan sizes averaging €16k.

The alternatives to the Banks are disparate and not well known:-

First Step, in existence for twenty years, has been the only national provider of microfinance loans. First Step Microfinance lending is modest at €1-2m per annum with loan volumes of 100-120. Current national experience in microfinance lending indicates that only 1 in every 4 loan applications successfully accesses credit.

Credit Unions lending to business start ups is only sanctioned on an exceptional basis, following on advice from the Financial Regulator who viewed business lending as high risk and not generally appropriate for the Credit Union sector overall.

A number of the County and City Enterprise Boards have operated loan funds at local level, but without any material impact nationally. Their mandate would preclude a national lending function, as they are essentially local organisations whose primary role is business support.

When viewed in a macroeconomic context, microfinance is a very cost effective job creation/protection mechanism generating a high rate of return. In many cases the business promoters and any other staff hired come from the unemployed ranks and are therefore drawing State benefits. Existing employees who choose the entrepreneurial route and set up their own business are also likely to create a residual employment opportunity in their previous organisation. The vast majority of micro-finance applicants are engaged in locally tradable services. While many may not have the potential for growth in terms of internationally tradable businesses, there are significant benefits to be gained by the development of a successful micro enterprise sector. In addition to contributing to the economic and social agenda this yields exchequer gains in terms of employment sustained and created, savings on welfare payments and increased direct and indirect tax payments.

1.1.1 Role of Microenterprise Retail Lending Entity

It is now proposed to establish a Microenterprise Loan Fund with seed capital of €10m. The fund will be managed and controlled by Social Finance Foundation on behalf of the Minister for Jobs, Enterprise and Innovation. The fund will be established as a subsidiary of Social Finance Foundation. It is intended that SFF will be equipped with the necessary levels of finance, systems and skills and supported by an EIF Guarantee Scheme, to ensure high levels of efficiency, expertise and corporate governance. A single lender will (i) minimize overall management costs which are traditionally high with microenterprises, (ii) ensure a clear financial and management information reporting structure, (iii) enhance the possibility for EIF assistance and (iv) allow for a clear identification of the costs involved in operating the scheme.

The SFF subsidiary will have the role of loan application assessment, loan approvals and declines, management of the loan book, and recoveries. It will work with other key stakeholders to deliver a comprehensive microenterprise service to potential clients.

The Loan Fund will only be available to applicants who have had their request for loan finance declined by the Banks, and it would be a prerequisite for any loan granted under the scheme that there should have been a bank assessment of a loan application and a formal refusal by that bank to provide the credit for stated reasons. A link would be established to ensure that in the case of loan declines, the banks will refer applicants to the Fund.

1.1.2 Ministerial and Departmental Oversight

The Chairperson of the SFF subsidiary will be appointed by the Minister for Jobs, Enterprise and Innovation subject to consultation with the Ministers for Finance and Public Expenditure and Reform. An appropriately qualified and high profile voluntary Board of Directors will be established with the approval of the Minister, to comprise individuals with expertise in relevant sectors, including microenterprise, small business, financial and accounting, corporate governance, microfinance lending, bank lending, and enterprise agencies. All Directors including the Chairperson will operate on a pro-bono basis. Such an approach was used in the set-up of the Social Finance Foundation. The Board of the subsidiary will report to the Minister for Jobs, Enterprise and Innovation and will publish Annual Reports and Accounts in the Microenterprise Fund.

It is likely that the C&AG will perform the annual audit of the SFF Microenterprise subsidiary as the seed capital is provided by the Exchequer. Arrangements will be finalised following consultations with the C&AG and Attorney General's office.

1.1.3 Governance Structures

All governance will be overseen by the Minister. A detailed Service Level Agreement will be finalized with SFF to address such items as, management of the fund, investments, lending criteria, accounting procedures, reporting to Minister and impact evaluation etc. The Fund will be designed to ensure high levels of efficiency, expertise and corporate

performance while also avoiding costly or over-bureaucratic structures. Processes will be optimised so that the cost of loan processing is kept to the lowest levels possible.

1.2 Objective of the proposed legislation

The objective of this legislation is to establish a Microenterprise Loan Fund and to provide for SFF to manage and control the Microenterprise Loan Fund on behalf of the Minister for Jobs, Enterprise and Innovation. It empowers the Minister to pay monies provided by the Oireachtas into the fund and to accept gifts of moneys for allocation to the Fund. An Annual Report and Accounts with respect to the operation of the Fund will be prepared and laid before each House of the Oireachtas.

1.3 Objectives of the Microenterprise Fund

The objective of the fund is to provide loans to start-up, newly established, or growing microenterprises, thereby facilitating job creation and retention across the economy in all microenterprises with commercially viable proposals that do not meet the conventional risk criteria applied by banks.

The Microenterprise Loan Fund is not intended to replace any current bank lending. The Banks must constitute the first port of call/ lender of first choice for loan applicants- indeed applicants will be required to produce evidence that they have been refused finance by a bank before their application to this Fund will be considered. The Loan Fund is not intended to address any broad deficiencies in the banks' provision of lending to the SMEs sector, but will form a key component in the suite of new initiatives, including the Temporary Partial Credit Guarantee Scheme, aimed at ensuring a flow of credit to the micro, small and medium enterprise sector.

2 Identification and Description of Options

2.1 Do nothing

This option would perpetuate the market failure in the supply of credit to viable micro enterprises. Furthermore, the Government has agreed that a Microenterprise Loan Fund be introduced. This was announced as part of the Government's Jobs Initiative on 10th May 2011, and was reiterated in the Action Plan for Jobs published in February 2012.

2.2 Introduce a Scheme without Legislation

The Minister has no powers under the Industrial Development Act, or any other Act, to establish an initiative of this nature, involving exchequer funding. The Department of Jobs, Enterprise and Innovation sought advice from the Attorney General regarding the issuing of the €10 million seed capital for microfinance. The advices received from the

Attorney General were that the principles and policies governing any microenterprise fund would need to be set out in statute so that the authorisation of the Oireachtas for the project is clear.

2.3 Stand Alone Legislation

The introduction of a short enabling piece of primary legislation in line with the AG's advices is considered the optimal way to proceed and the Bill will now be drafted accordingly

2.4 Conclusion

Stand-alone legislation is now being pursued.

3 Analysis of Costs, Benefits and Impacts

3.1 Costs to the Exchequer

An exchequer allocation of €10 million has already been approved by Government as seed capital for the fund. The Bill will provide scope for additional exchequer funding if deemed necessary, subject to an absolute cap of €25m before further Oireachtas approval is needed.

3.2 Benefits to the Exchequer

The €10m allocation, supplemented by €15m bank borrowing in tranches of €5m over years 2,3 and 4, will generate €40m in loan expenditure and create 3,800 jobs over a 5 year period. This is based on €8.8m of loan demand and 20% Bad Debts. The return to the exchequer over 5 years is estimated at €46.2m.

A further injection of €10m in year 5, supplemented by €15m bank borrowing in tranches of €5m, will generate over €90m in loan expenditure, finance 5,500 micro-enterprise loans and generate over 7,700 jobs over a 10 year period, thus fulfilling the Government commitment.

Exchequer gains in terms of employment sustained and created, savings on welfare payments and increased direct and indirect tax payments have been calculated at €23,000 per job.

While the majority of micro-finance applicants are engaged in locally tradable services and may not currently have the potential for growth in terms of internationally tradable businesses, they provide a solid enterprise base on which the SMEs and HPSUs of the

future can develop. There are clear societal and community benefits in addition to the economic and job creation objectives.

No of Enterprises assisted	5,500
No of Jobs created Direct	5,500
No of Jobs created-indirect	2,200
Total Job Creation	7,700
Cost per Job	2,625
Return to exchequer	€92.4m

3.3 Industry Benefits

Based on a 10 year model this Fund will enable the lending organisation to lend over €90m, help the establishment and growth of 5,500 micro-enterprises and create 7,700 jobs at a cost per job of approx €3k.

3.4 Employment

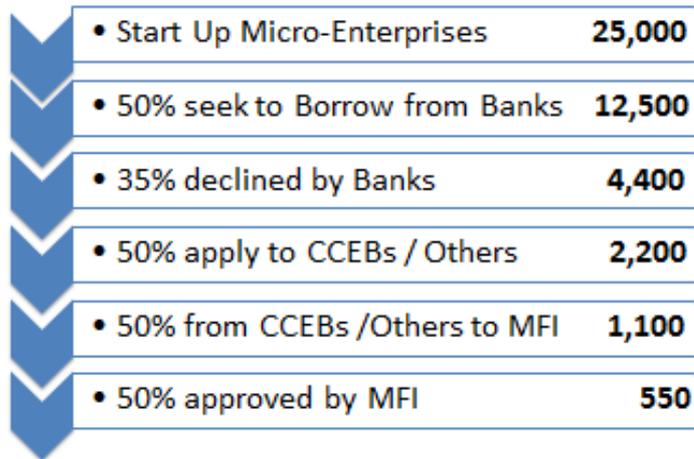
Based on a 10 year model this Fund will enable the creation of 7,700 jobs.

4 Consultation

A range of stakeholders were consulted to obtain their views on what volumes of business might ensue from the creation and promotion of the Government's initiative. These included the EIF, IBF, Central Bank of Ireland, SFA, ISME, BOI, CEBs and the Companies Registration Office.

Estimates of the demand for microfinance have been developed based on a number of variables, including the number of start-up micro-enterprises, the proportion that seek to borrow from Banks and the proportion that are declined by Banks. Based on the information gleaned from these sources, including data on company formation and registration of business names the following level of demand is estimated on the basis of 25,000 microenterprise start ups annually:-

Demand Funnel for Microfinance



Base Case Based on existing microlending experience, the average Microenterprise loan size is €16k. Thus, it is estimated that in the **Base Case** (most likely outcome) total lending would be €8.8m to 550 micro-enterprises per annum.

Low Case Banking sources indicate that only 35% of Micro-Enterprises seek to borrow (rather than 50%), which reduces the number of loans approved to 400 p.a. with a value of €6.4m.

High Case Using the banking estimates that only 35% of Micro-Enterprises seek to borrow but using the decline rate quoted by ISME of 63%, increases the number of loans approved to 700 p.a. with a value of 11.2m.

5 Enforcement and Compliance

The proposed Bill provides for the management and control of the fund by SFF on behalf of the Minister. It is proposed to enter into a Service Level Agreement with the Social Finance Foundation (SFF), to enable the Minister specify strict terms and conditions by which the SFF must comply.

ENDS