

Office of the Dublin Commissioner for Startups

Submission on Startup Investment Incentives 2017

Summary

- While the EII scheme is performing relatively well, it is difficult for early-stage companies to compete with more established firms in attracting investment.
- The scheme can be leveraged so as to be made more suitable for early-stage companies.
- We recommend a preferential rate of 50% tax-relief for investors in companies less than three years old, up to a maximum of €150,000 per company.
- Estimated Exchequer Cost: €5 million.
- Benefits: An increased number of well-funded early-stage companies that can drive employment growth and the speed of Irish innovation, and
- The conversion of passive bank deposits into active investments in Irish business, encouraging angel investors to support Irish startups by providing funding, mentoring and access to their professional networks.

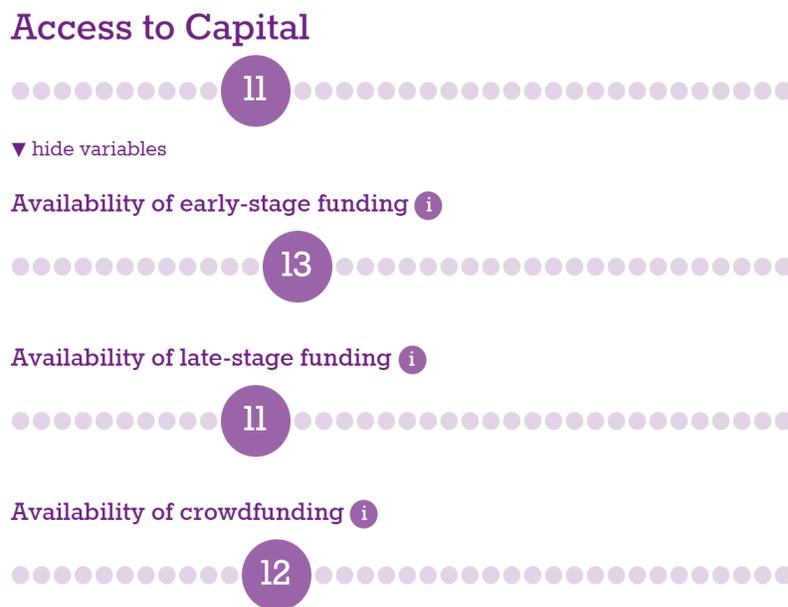
Introduction

In July 2015 the Dublin Startup Leaders Group, representing over forty organisations, made a submission to the Department of Finance calling for improved incentives for investment in very early-stage companies. In particular, the submission highlighted the difficulty that young Irish tech companies face in raising angel funding in the region of €100,000- €200,000.¹ This ‘funding gap’ remains a major constraint to job creation and poses a competitiveness threat for Ireland. This risk is even more pressing now that the UK will no longer be bound by EU state aid rules and can introduce even more attractive investor incentives.

¹ Dublin Startup Leaders Group (2015), ‘Response to Public Consultation Process by the Department of Finance’, 3. Available from <http://startupdublin.com/content/docs/Policy-Submission-Dublin-Startup-Leaders-Group-10.07.2015.pdf>

The problem exists both in terms of debt and equity funding. Bank credit remains largely inaccessible to companies under three years old, who lack traditional forms of collateral. The latest figures from the Central Bank suggest that the total stock of outstanding credit to SMEs is actually declining, as entrepreneurs repay loans more quickly than they are drawing them down.² In a recent review of 35 European cities Dublin was ranked eighth overall for startups, but was let down by poor access to capital as demonstrated by Figure 1 below. This is not just attributable to population size, since comparable cities such as Amsterdam and Copenhagen performed much better.³

Figure 1: Dublin Ranking among 35 European Cities



² Central Bank of Ireland (2016), 'SME Market Report', 2016 H1. Available from <https://www.centralbank.ie/publications/Documents/SME%20Market%20Report%202016H1.pdf>

³ European Digital City Index (2015). Available from <https://digitalcityindex.eu/city/12>.

A core stated objective of the Programme for a Partnership Government (2016) is the creation of 200,000 jobs by 2020.⁴ Startups will play a crucial role in this regard, since employment growth is disproportionately driven by young, high-growth firms. 50% of the employment growth in the UK from 2002 to 2008 was generated by just 6% of high-growth companies.⁵ The key task from a policy perspective is therefore to ensure that those companies with the best potential for very high growth (startups) attract the investment they need from an early stage. The National Digital Research Centre (NDRC) has pointed to a pronounced gap in the Irish funding ecosystem for companies between the accelerator and seed funding stages. This is particularly problematic from a macroeconomic perspective, since firms backed by angel investors have been demonstrated to create more jobs and to exhibit both higher survival and successful exit rates than firms without this support.⁶

The Employment and Investment Incentive Scheme (EIIS) has proved successful in many respects, and much of the investment fall-off observed during the recession has been recovered (see Figure 2 below).⁷ However, there are still several aspects that could be improved, particularly for young, high-risk startups. Firstly, the managed funds like BDO and Cantor Fitzgerald that avail of the scheme tend to invest in mid-cap companies between three and five years old, making them quite risk-averse. The scheme also attracts investors in projects that are already low-risk by their nature, notably windfarms. This is perfectly understandable from the perspective of the investor, since the effective impact of the scheme is to narrow the relative gap between the net returns achievable on higher and lower-risk companies. The risk/reward ratio

⁴ Programme for a Partnership Government (2016).

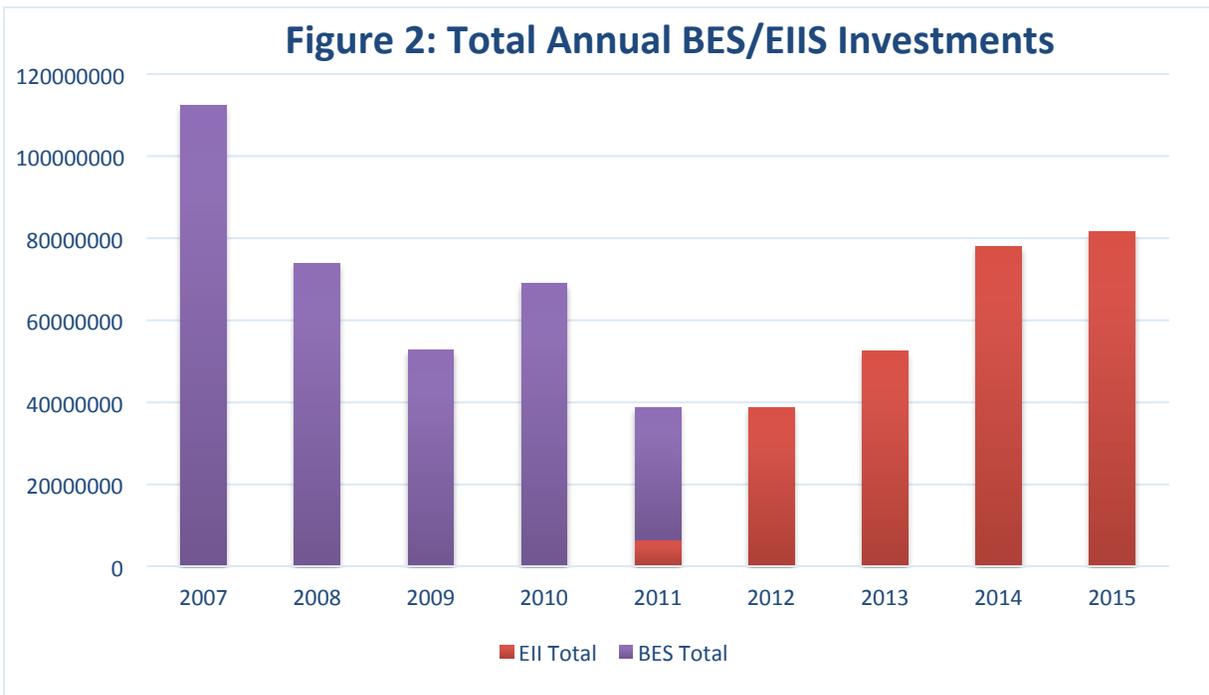
http://www.merrionstreet.ie/MerrionStreet/en/ImageLibrary/Programme_for_Partnership_Government.pdf

⁵ Citie (2016), 'City initiatives for Technology, Innovation and Entrepreneurship: A Resource for City Leadership', June, 6. Available from http://citie.org/assets/uploads/2015/04/CITIE_Report_2015.pdf.

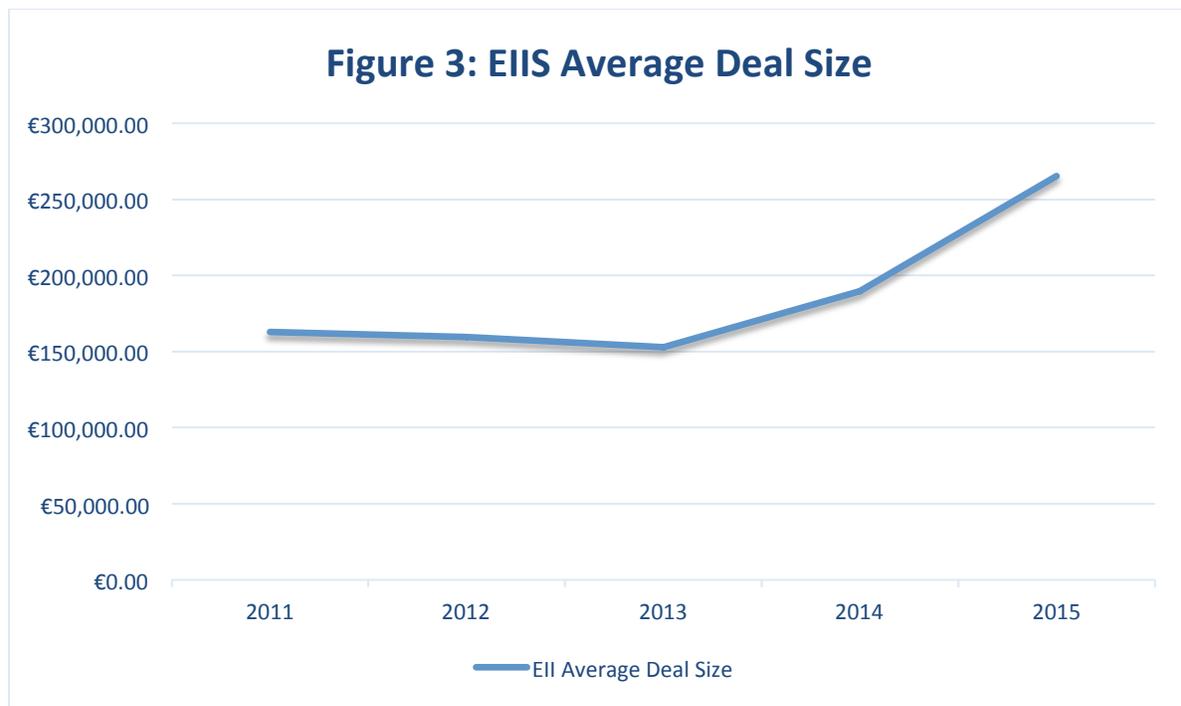
⁶ Dublin Startup Leaders Group (2015), 'Response to Public Consultation Process by the Department of Finance', 3. <http://www.nber.org/digest/mar16/w21808.html>. Accessed 6/9/2016.

⁷ Data from <http://www.revenue.ie/en/about/publications/bes-scs-shares.html>.

incentives are therefore skewed in favour of investment in lower risk opportunities.⁸ The preference for larger companies seems to be growing, as evidenced by the increase in the average deal size since the introduction of EIIS (see Figure 3).



⁸ Imagine company A has a 2% risk of failing each year and a 4% annual return, while company B offers twice the rate of both risk and return (4% and 8% respectively). If the investor uses EIIS the net rates of return rise to 14% for company A and 18% for company B, but the probability of company B failing remains twice as high as company A.



The scheme currently offers investors tax relief of 30% in year one and a further 10% in year four. In order to encourage investment in newer, riskier companies, we recommend the introduction of a preferential 50% rate of tax-relief for firms under three years old. This would match the headline rate of the SEIS (Seed Enterprise Investment Scheme) in the UK, which was deemed so successful that it was made permanent in 2014.⁹ We estimate that the additional nominal annual cost to the Exchequer would be €5 million, or 22% of the costs associated with EIS in 2015. Given the potential employment benefits it is quite possible that the additional economic activity generated could result in a negligible net cost (see Appendix 1).

⁹ George Osborne (2014), *Budget Speech*. Available from <https://www.gov.uk/government/speeches/chancellor-george-osbornes-budget-2014-speech>.

Furthermore, we recommend that the entire relief should be made available to investors in companies less than three years old in the year of the investment. This would make investment in high-risk startups much more attractive, since it would simplify the process, reduce the administrative burden, and free up investor funds more quickly. In combination these two changes would make young companies considerably more competitive in attracting pre-seed investment, and could play a key role in fostering the new, hi-tech companies that will drive Irish economic and employment growth over the coming decade.

Significant credit is due to the stakeholders who have advocated and honed the offering to develop the scheme we currently have, and it is essential that the incentive is further refined to maintain and strengthen Ireland's competitive position as a location for tech startups. This office, along with other key stakeholders, will continue to play its role in supporting employment and export growth, and is delighted to input constructively into relevant policy matters.

We look forward to discussing this document further with the Department of Finance.

Sincerely,



Niamh Bushnell

Dublin Commissioner for Startups