Evaluation of Concept of Community Banking in Ireland

Submitted to

Department of Finance

Prepared by

Indecon International Economic Consultants

Indecon

www.indecon.ie

December 2019

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Introduction and Scope of Research

Indecon International Economics Consultants ('Indecon') is a leading firm of research economists. Indecon was appointed by the Department of Finance, following a competitive tender process, to undertake an independent evaluation of how the concept and objectives of community banking, and local provision of banking and financial services, may be furthered in Ireland.

The background to this evaluation is that the Programme for a Partnership Government contained a commitment to investigate the Sparkassen model of local public banks that operate within well-defined regions. This commitment was fulfilled by the Department of Finance and the Department of Rural and Community Development with the publication of the joint report on 'Local Public Banking in Ireland'.[1] However, the Government agreed that the Department of Finance would commission an independent external evaluation of how the local community banking concept may be furthered in other ways. This independent Indecon evaluation:

- analyses whether there is market 'failure' in the local provision of financial services;
- examines the local provision of banking and financial services;
- reviews the range of existing state supports designed to address market failure; and
- provides policy recommendations for consideration.

The evaluation was informed by an extensive programme of engagement with a wide range of organisations and individuals. This included a public consultation process supported by the Department of Finance, a national stakeholder forum event hosted by Indecon, and direct consultations with stakeholders. In addition, detailed independent analyses and statistical modelling of the empirical evidence were conducted using a range of official and other datasets. Indecon also developed new econometric models to identify the factors influencing the supply and demand for banking services.

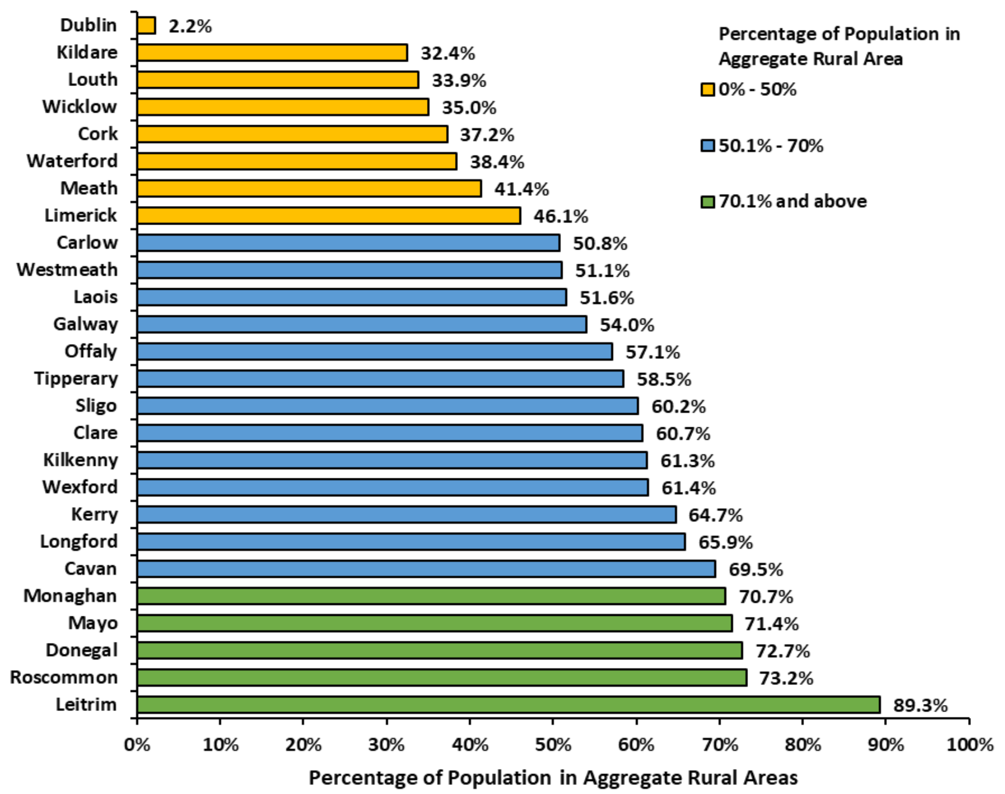
Assessment of Existing Financial Services Provision

In assessing whether there is 'market failure' in the local provision of banking and financial services in Ireland, it is instructive to first examine the levels of existing provision of financial services, as well as the wider economic and demographic context in which the sector operates.

Indecon's analysis highlights the extent of population concentration in Ireland, where nearly 40% of the total population of the State resides in Dublin and Cork. In addition, there are marked differences in the percentage of the population in each county living in rural areas. High levels of rurality and the resultant low levels of population density have implications for the number of bank branches which are commercially viable. This also impacts on the viability of credit union services and the An Post network of post offices.

[1] Local Public Banking in Ireland – An analysis of a model for developing a system of local public banking in Ireland. Department of Finance and Department of Rural and Community Development. July 2018. See: https://www.gov.ie/en/publication/14fce4-local-public-banking-in-ireland/.

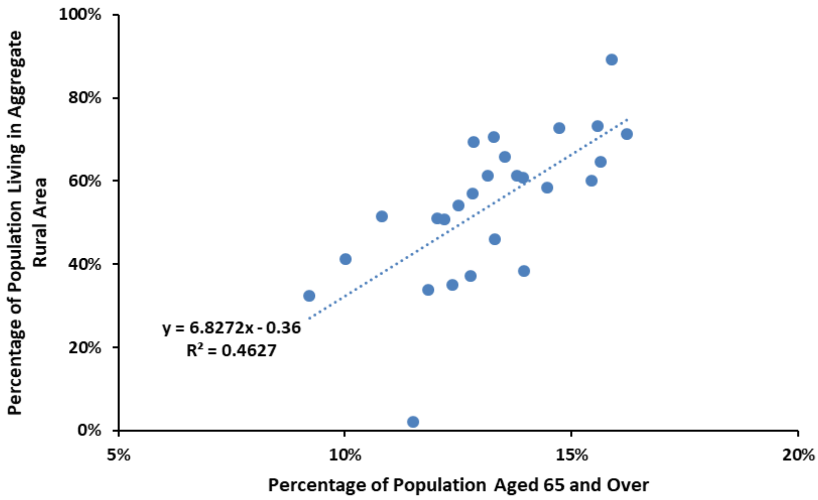
% of Population Living in Aggregate Rural Areas (2016)



Source: Indecon analysis of Census data

Indecon notes that the percentage of the population living in rural areas has declined, while these areas also have a higher percentage of older individuals. A related issue is the level of internet/broadband access, as online banking can help reduce the need to use a local bank branch for certain services. The evidence indicates that over a quarter of households in some of the more rural counties do not have internet access, while many rural counties also fall significantly below the urban and national averages in relation to higher speed broadband access (see table overleaf). In the absence of other supports, poor internet and broadband access restricts the ability of these households to access online financial services, and increases the risk of financial exclusion. The National Broadband Plan (NBP) is designed to address the challenges posed by poor broadband availability in rural and other under-served locations. The overall goal of the NBP, the contract for which was signed by the Government on 19th November 2019, is to deliver a high-speed broadband service to over 540,000 premises throughout Ireland that are currently without such a service. The plan aims to bring high-speed connectivity to those living in rural areas who cannot obtain such a service from commercial operators. The importance of the NBP in the context of community banking services is that the investment in high-speed internet services will facilitate the development of online banking delivery channels and make it easier for consumers and businesses to access these services.

% of Population Aged 65 and Over Compared to Percentage of Population Living in Rural Areas



Source: Indecon analysis of Census data

Data on the enterprise sector indicates that there are over 266,000 SMEs registered in Ireland, and the number of such enterprises has been growing. Over 90% of enterprises in Ireland are micro-enterprises, employing fewer than 10 persons. 55% of these enterprises are based outside of Dublin and Cork.

An analysis of the provision of credit to Irish-resident enterprises indicates that the stock of credit owed by Irish resident SMEs have fallen from €59 billion at the end of 2012 to €22 billion at the beginning at 2019, a decline of 62.7% over this period. However, there has been significant growth in new lending, and by 2018 new lending to SMEs amounted to €5.3 billion, compared to €2.17 billion in 2013.

In order to meet the needs of the population and of the enterprise sector, there is an extensive branch network and a wide range of services provided by banks, credit unions, An Post and non-traditional providers. Indecon's research indicates that there are 1,912 branches operated by banks, credit unions and post offices in Ireland. Over 63% of these branches are provided by credit unions or An Post, whilst banks account for nearly 37% of local branches. While Dublin has the highest absolute number of branches of financial providers at 393, the number of branches per SME, and as a percentage of the population, is low in Dublin. The evidence also shows that there is a higher number of branches per SME and per capita in many of the counties where a significant percentage of the population resides in rural areas.

Existing Financial Services Institution Branch Coverage relative to Number of Active SMEs					
County	**Number of Banks, Post Offices and Credit Unions**	**Percentage of Total**	**Number of SMEs**	**Percentage of Total**	**Number of Branches Per 1,000 SMEs**
Leitrim	27	1.4%	1,906	0.7%	14.17
Donegal	99	5.2%	8,130	3.0%	12.18
Longford	22	1.2%	1,950	0.7%	11.28
Roscommon	35	1.8%	3,103	1.2%	11.28
Mayo	79	4.1%	7,285	2.7%	10.84
Offaly	35	1.8%	3,438	1.3%	10.18
Laois	31	1.6%	3,101	1.2%	10.00
Limerick	93	4.9%	9,546	3.6%	9.74
Tipperary	76	4.0%	7,956	3.0%	9.55
Waterford	51	2.7%	5,457	2.0%	9.35
Cavan	37	1.9%	4,042	1.5%	9.15
Carlow	25	1.3%	2,738	1.0%	9.13
Kerry	80	4.2%	8,837	3.3%	9.05
Monaghan	30	1.6%	3,314	1.2%	9.05
Sligo	30	1.6%	3,326	1.2%	9.02
Westmeath	39	2.0%	4,777	1.8%	8.16
Galway	118	6.2%	14,543	5.4%	8.11
Cork	240	12.6%	29,993	11.2%	80.0
Louth	52	2.7%	6,619	2.5%	7.86
Clare	55	2.9%	7,056	2.6%	7.79
Wexford	62	3.2%	7,975	3.0%	7.77
Kilkenny	36	1.9%	4,658	1.7%	7.73
Wicklow	51	2.7%	8,270	3.1%	6.17
Meath	59	3.1%	10,245	3.8%	5.76
Kildare	57	3.0%	11,204	4.2%	5.09
Dublin	393	20.6%	87,463	32.8%	4.49

***Source: Central Bank of Ireland (credit unions), An Post, Indecon research on individual banks, and CSO* Business Demography Statistics**
Note: The areas highlighted in yellow represent counties where there is less than 50% of the population living in rural areas. The blue represents areas where there is between 50.1 – 70% and green are areas where there are over 70% living in rural areas.

Role of Credit Unions as Critical Element of Community Banking

A distinctive feature of the Irish local financial services market is the role played by the credit union movement. Indecon believes that credit unions are critical elements of community banking. This was highlighted by the Irish League of Credit Unions (ILCU), who indicated that credit unions are what Irish people consider to be by another name, i.e., community banking. In our consultation programme, the Credit Union Managers' Association (CUMA), also pointed out that the credit union movement is on the ground and in communities throughout Ireland. Indecon also notes the valuable inputs to our consultation from the Credit Union Development Association (CUDA), which pointed out the benefits of broader availability of banking services in our communities and the role which credit unions play in this context. The number of credit union branches, as well as the number of branches per 10,000 population by county in Ireland, are shown in the table overleaf.[2]

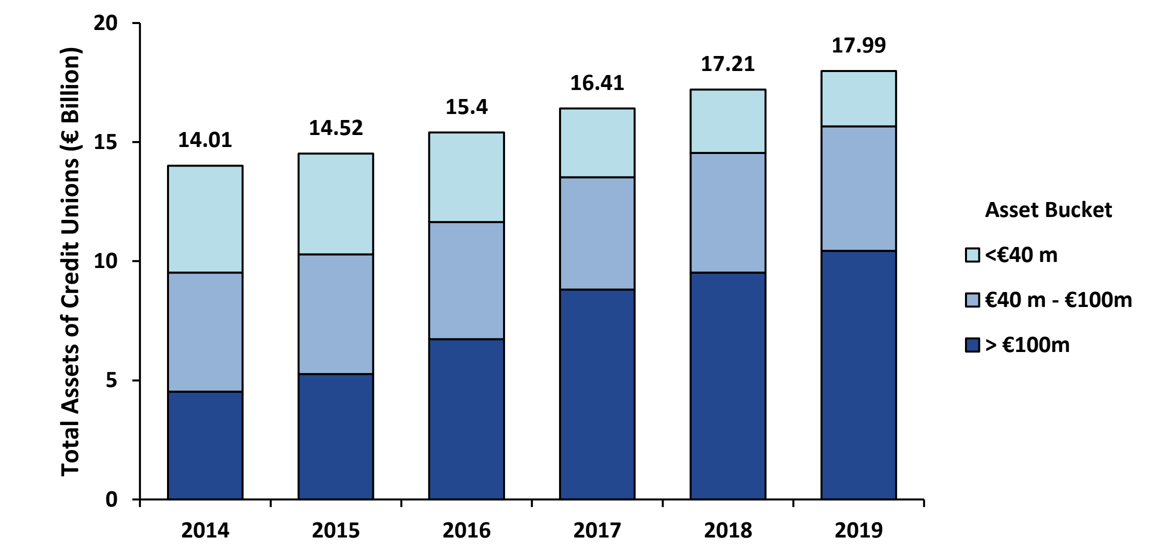
[2] It should be noted that some of credit unions may be a branch of a larger credit union, while others are individual credit union entities.

Number of Credit Union Branches Relative to Population by County in Ireland		
County	**Number of Credit Union Branches**	**Credit Union Branches per 10,000 People**
Leitrim	7	2.2
Monaghan	7	1.1
Longford	4	1.0
Louth	12	0.9
Cavan	6	0.8
Limerick	15	0.8
Carlow	4	0.7
Donegal	11	0.7
Tipperary	11	0.7
Offaly	5	0.6
Roscommon	4	0.6
Waterford	7	0.6
Cork	30	0.6
Mayo	7	0.5
Meath	10	0.5
Kilkenny	5	0.5
Sligo	3	0.5
Dublin	61	0.5
Galway	11	0.4
Wicklow	6	0.4
Clare	5	0.4
Kerry	6	0.4
Laois	3	0.4
Westmeath	3	0.3
Wexford	5	0.3
Kildare	6	0.3
Total	254	0.5

Source: Central Bank of Ireland
Note: The areas highlighted in yellow represent counties where there is less than 50% of the population living in rural areas. The blue represents areas where there is between 50.1– 70% and green are areas where there are over 70% living in rural areas.

The significance of credit unions in the Irish community banking market is reflected in the level of new lending provided by credit unions, which has increased from €1.7 billion in 2014 to €2.5 billion in 2018. There has also been growth in larger credit unions (with assets above €100 million), which accounted for over 56% of the total value of assets held by credit unions in 2018 compared to just under a third in 2013. The increase in the scale of these credit unions offers the potential for the provision of a wider range of community banking services.

Value of Total Assets of Credit Unions by Asset Category (2014-2019)



Source: Central Bank of Ireland

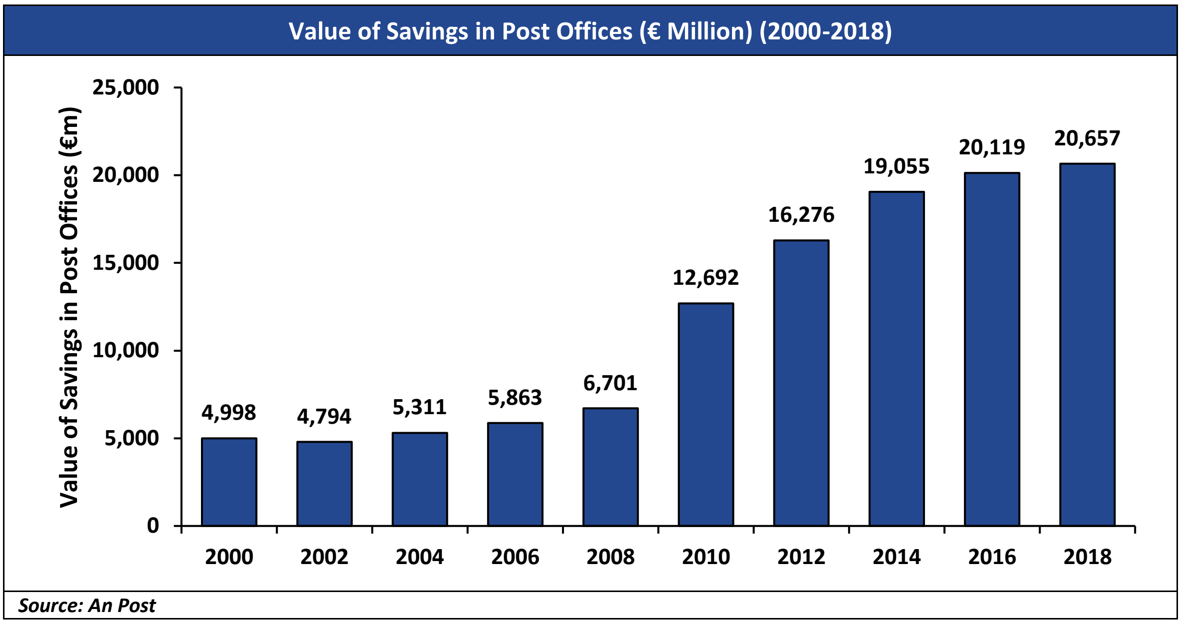
Indecon believes that important recent developments in the credit union sector will further strengthen community banking. These include the home-loan shared services projects by ILCU and separately by CUDA, and the launching of ventures on retro-fitting homes. We also note significant new initiatives by the credit union movement to expand their services, notably Cultivate (agri-lending), Payac (current accounts), CUSOP (payments) and Metamo, the (venture between sixteen credit unions and Fexco).

Development of An Post Financial Services

An Post has a large number of post office branches and is present in every county in Ireland (see table overleaf). New analysis of An Post data by Indecon also confirms that 52.7% of post offices are in geographic areas where there is no commercial bank branch within five kilometres.

Number of Post Office Branches relative to Population by County in Ireland		
County	**Number of Post Office Branches**	**Post Office Branches per 10,000 Population**
Leitrim	13	4.1
Donegal	58	3.6
Mayo	47	3.6
Roscommon	21	3.3
Kerry	47	3.2
Clare	33	2.8
Sligo	18	2.7
Longford	11	2.7
Galway	68	2.6
Cavan	20	2.6
Wexford	38	2.5
Tipperary	40	2.5
Westmeath	21	2.4
Limerick	46	2.4
Offaly	18	2.3
Cork	124	2.3
Monaghan	14	2.3
Waterford	23	2.0
Louth	25	1.9
Carlow	11	1.9
Kilkenny	19	1.9
Laois	16	1.9
Meath	32	1.6
Wicklow	23	1.6
Kildare	25	1.1
Dublin	145	1.1
Total	**956**	**2.0**
Source: Indecon analysis of Census of Population and An Post data		

An Post provides certain financial services for personal customers as well as for SMEs. These include services in the areas of savings, lending, payments and insurance. Indecon's analysis shows there has been growing significance of An Post in the savings market, and the overall value of savings with An Post amounted to €20 billion in 2018. This reflects the role of An Post as an agent for state savings, including for basic savings accounts and longer-term savings options.

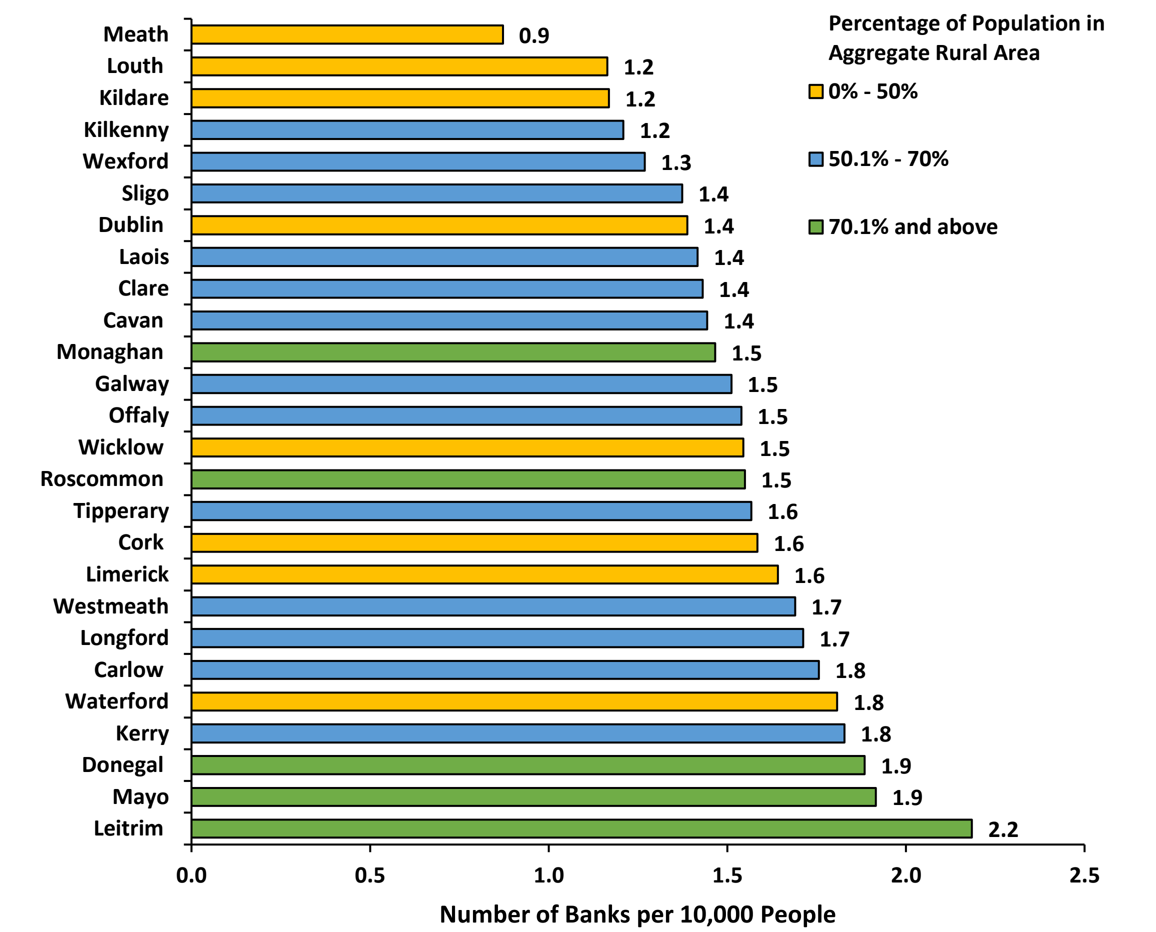


There has been a number of recent developments in relation to the role of An Post in the lending market. In collaboration with Avantcard, An Post launched a new customer lending facility in 2019. This allows customers to apply for loans of between €5,000 and €75,000, with maturities of between one and seven years. The recent introduction of An Post Money Current Account offers the functionality of the traditional bank current account. Indecon understands An Post has ambitious plans to further expand their services as an intermediary.

Analysis of Commercial Banking Providers

There is a large network of 702 commercial bank branches in Ireland. Indecon research shows that some counties including those with high levels of rural population have a high number of bank branches per capita. Despite the overall number of branches, where the population is dispersed, local access to bank branches can be restricted and there is a challenge for the banking sector to sustain the viability of the existing branches in areas of low population. In this context, we note the recent announcement by Permanent TSB that it plans to close around one-fifth of its 77-strong branch network.

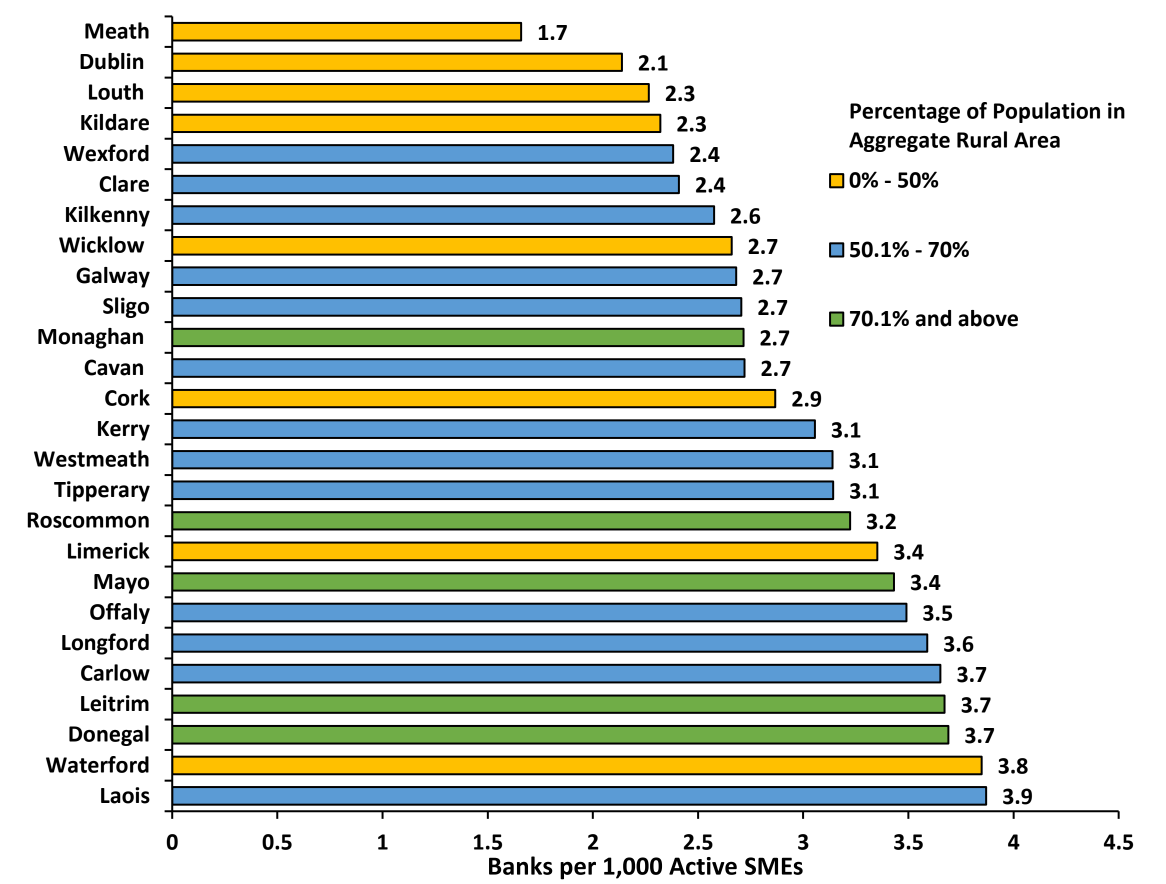
Number of Bank Branches per 10,000 of Population by County in Ireland



Source: Indecon research on individual banks and analysis of Census 2016 data

In considering supports for the SME sector, it is useful to consider the density of bank branches at local level. The figure overleaf indicates the density based on the number of branches per 1,000 active SMEs by county across the State. A notable feature of the results is the presence of higher densities of bank branches relative to number of SMEs in a number of counties where there is also a high proportion of population residing in rural locations.

Number of Bank Branches per 1,000 Active SMEs by County in Ireland



Source: Indecon research on individual banks and analysis of CSO Business Demography data

The main commercial banks in Ireland provide an extensive range of financial services. These include both personal and commercial banking products. Personal banking services provided include: savings accounts, current accounts, consumer lending and overdraft facilities, credit cards, debit cards, mortgages, e-banking services, phone-banking services, insurance, investment and fund management. Commercial banking services offered by banks in Ireland typically include: funding and acquisition, leveraged acquisition finance, property finance, cash management, treasury services, trade finance, project finance, and transaction support.

In addition to the main banking groups, there are a number of other, non-bank financial providers, including online providers of personal credit.

Overview of Existing State Supports

Extensive state supports have been put in place to address perceived areas of market failure in the Irish banking and financial services market. These include supports provided by organisations such as the Strategic Banking Corporation of Ireland (SBCI), Microfinance Ireland, the Local Enterprise Offices and Enterprise Ireland. There have also been measures introduced to reduce the risk of financial exclusion.

The SBCI operates a number of schemes on behalf of the Department of Business, Enterprise and Innovation and the Department of Agriculture, Food and the Marine. These include the Brexit Loan Scheme, the Future Growth Loan Scheme and the SME Credit Guarantee Scheme. A total of €123 million was drawn down in SBCI loans during 2018, with an average loan size of €40,000. Indecon analysis of SBCI data indicates that most of SBCI lending is allocated to enterprises in regional areas outside of Dublin. The SME Credit Guarantee Scheme (CGS) is operated by the SBCI, on behalf of DBEI. Loan facilities are available to eligible SMEs for terms of up to seven years for amounts ranging between €10,000 and €1 million. €5.9 million was sanctioned via the CGS during the first quarter of 2019.

Microfinance Ireland is a not-for-profit lender that provides small loans of up to €25,000 to small businesses with fewer than 10 employees and annual turnover of less than €2 million. From its inception in October 2012 to the end of the first quarter of 2019, Microfinance Ireland processed 4,664 applications for the Microenterprise Loan Fund Scheme. 44% of these applications were approved, with a value of €29.6 million.

Local Enterprise Offices (LEOs) offer a range of supports including: advice, feasibility study grants, technical assistance for micro exporters (TAME), priming grants, business expansion grants and microfinance loans. The financial assistance approved by LEOs in 2018 amounted to €18.2 million, at an average of €14,456 per business project supported.

Enterprise Ireland offer supports for companies at different stages of their development. These include start-up supports and other initiatives. The agency also operates significant seed and venture capital support for the internationally traded indigenous sector.

The Credit Review Office was established in 2010 by the Government, in order to provide a review process for SMEs and other enterprises who are refused credit by banks participating in the NAMA scheme. The Credit Review Office received 958 formal applications between 2010 and 2018. 658 of these cases have reached final conclusion and the office has found in favour of the appeals of the borrowers in 372 of these cases, ultimately leading to credit of €52.9 million being made available to the borrowers.

Assessment of Potential Market Failure in Financing of SMEs

It is important to consider whether any unmet credit demand by enterprises in Ireland is due to market failure and/or other reasons, for example, project unviability. An unwillingness of financial institutions to lend because of project unviability is a feature of any functioning market and would not represent market failure or merit public policy interventions. The European Commission has defined market failure as follows: "The concept of market failure refers to non-functioning aspects of the market which result in an inefficient allocation of resources and entail the underproduction or overproduction of certain goods and services."[3] Market failure can arise due to a lack of competition or undercapitalisation of banks, or due to the presence of information asymmetries. Absence of competition can result in higher interest rates, which may discourage viable investments. Undercapitalisation of banks can result in a risk-averse approach to financing of potentially viable projects.[4]

Market failure arising from asymmetric information between the borrower and the lender means that lenders' ability to price risk is impaired, and some SMEs and micro-enterprises may be discouraged from applying for

[3] European Commission and European Investment Bank, Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period. April 2014. See: https://www.fi-compass.eu/sites/default/files/publications/manual_vol-I_ex-ante-assessment-general-metholology.pdf

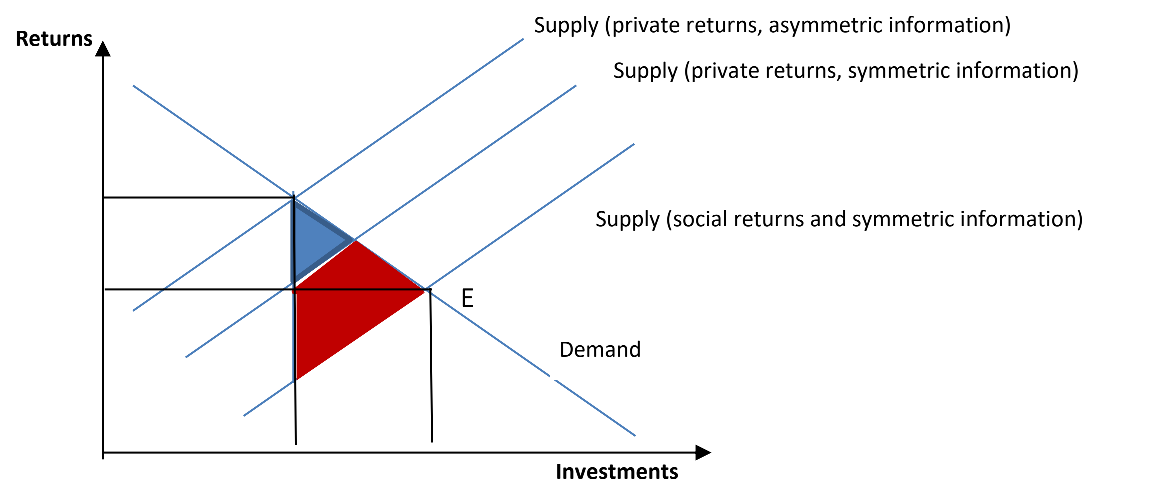
[4] Indecon's analysis of core Tier 1 capital ratios in Irish banking indicates that Irish banks have higher levels of capital than other EU countries (19.3% compared to 16.2% in EU). This should in theory enable the banks to be open to considering all viable lending opportunities, however, the banks also have to keep high levels of solvency to absorb any losses associated with legacy non-performing loans.

loans because of a lack of awareness of the availability of credit. International research by Nguyen (2014) suggests that local branches can help overcome information asymmetries.[5]

Market failures in finance can also arise due to positive externalities not taken into account by the lender. For example, financing of viable enterprises to enable increased investment can result in positive spill-overs to the economy. One additional area of potential market gap concerns individuals who face financial exclusion.

The next figure presents a graphical depiction of the effects of market failure on credit supply. The economic inefficiency arising from the presence of such market failure can result in a lower amount of credit provided or higher interest rates. This *inter alia* refers to projects where more credit would be provided or where a lower interest rate[6] would apply if the lenders could accurately assess and monitor the credit risk of the borrower (symmetric information), or if the lender could be rewarded for the social benefit generated by the enterprise/project funded (positive externality). This also includes cases where viable micro-firms are discouraged from applying for loans due to information gaps. This could arise because of a lack of information on the willingness of banks and other providers to lend, a distrust of such providers or perceived difficulties with application processes. A similar issue applies if the level of competition between providers is restricted resulting in higher interest rates. The economic deadweight loss for society is represented in the figure as the blue-shaded area. The additional loss to society due to externalities is denoted by the red-shaded area in the figure. The level of supply of credit is also influenced by the capital requirements in the banking sector.

Economic Efficiency and Market Failure in Finance



Source: Indecon

To help inform a judgement as to whether there is market failure present in the provision of banking and financial services for the enterprise sector in Ireland, Indecon has undertaken a detailed analysis of the demand for credit by the SME sector. Despite the overall levels of new lending there has been a decline in the application rates for bank finance by the SME sector. Application rates for bank finance were 35% in March 2014 and declined to 20% by September 2018. Micro-enterprises have consistently lower application rates than the other types of SMEs. The key issue is what are the reasons for this decline in demand for credit. The evidence examined by Indecon shows that the main reason SMEs did not apply for finance is because they did not need the credit. However, for a very small percentage of SMEs the reasons for not applying are: perceptions that credit is too expensive; lack of trust in the banks; a belief that banks are not lending; belief

[5] Hoai-Luu Nguyen, 'Do Bank Branches Still Matter? The Effect of Closings on Local Economic Outcomes', Department of Economics, Massachusetts Institute of Technology, December 2014. See: https://economics.mit.edu/files/10143. See: 2014 Hoai-Luu Nguyen https://economics.mit.edu.files/10143.

[6] Indecon's analysis shows that interest rates on SME lending are higher in Ireland than in some other EU countries.

that the application process is too difficult; or that banks take too long to make decisions. While these represent only a very small percentage of firms who did not apply for credit, when applied to the totality of enterprises in the economy this suggests that approximately 9,715 SMEs may have been discouraged from applying for lending because of these reasons. Some of these firms, even if they applied for credit, may not have been accepted for valid reasons, but we note that bank finance rejection rates fell from 22% to 15% for SMEs between 2014 and 2018.

While overall application or rejection rates are of interest, it is important to empirically estimate the key determinants impacting on credit supply and demand. Indecon has undertaken rigorous new econometric modelling to identify the reasons behind companies applying for bank finance controlling for other factors, as well as the determinants of success in loan applications. Indecon used a probit model to estimate the probability that a firm will apply for bank finance, and whether a firm that applied for finance will be successful in their application. This model controls for the size of the firm (using the number of employees as a proxy), and the sector of the firm (as application and success rates vary by sector). The model also included a number of business performance measures. The results indicate that the size of firms is a statistically significant variable in the baseline model, in that enterprises with higher levels of employment are more likely to apply for bank finance.

Rural areas have a high weighting of micro-enterprises and these businesses have limited banking relationships. Irish Rural Link highlighted this issue in the consultation process. If micro-enterprises do not apply for credit, this could impact on overall investment levels in the economy. Indecon's analysis of the available evidence, however, suggests that for most enterprises a lack of internal funds rather than access to credit is the main constraint but for some firms access to credit is a barrier. This is consistent with the recent important ESRI research on exploring investment patterns for SMEs.[7] The ESRI paper suggests that a financing gap exists for one in five enterprises. For 11.2% of these firms, the ESRI research indicates access to external finance was seen as a barrier.

During Indecon's stakeholder consultation, it was suggested that the commercial banks, in providing credit, are focusing on what they perceive to be lower-risk lending. This is not surprising, as risk is appropriately a key criterion for any lending institution, and is likely to be given even more emphasis as the major banks attempt to reduce high levels of non-performing loans. The econometric modelling undertaken by Indecon is consistent with this, as it highlights the significance of firm size and business performance in influencing the level of credit provided. Lower risk and higher performing firms are also likely to have invested in a range of skills and business management processes. Indecon's new econometric evidence shows that the more business management practices the firm undertook, the more likely they were to apply for and to secure bank finance. This is particularly relevant as a SFA paper indicated that only 46% of firms surveyed said they had good or expert knowledge of financial literacy.[8] Enhancing skills and knowledge within SMEs to improve business performance is therefore likely to be an appropriate policy intervention, and one which will impact on access to credit. The results of Indecon's econometric modelling also suggest that the rurality of the population in the county in which the enterprise is located is not in itself statistically significant, when other factors are controlled for. Indecon, however, notes that the econometric modelling is restricted to using county-level data on rurality and it would be useful to have data to model distances to the nearest bank branch before reaching a definitive conclusion regarding the importance or otherwise of local bank branches. Our results may also reflect the higher levels of bank branches relative to SMEs in many rural counties.

[7] Gargan, E., Lawless, M., Martinez-Cillero, M., O'Toole, C., Exploring SME Investment Patterns in Ireland: New Survey Evidence.

[8] Financial Literacy among Irish Micro, small and medium-sized businesses SFA 2019. Report prepared with project partners TU Dublin, Microfinance Ireland, SBCI and Skillnet Ireland.

Econometric Analysis of Factors Influencing Supply and Demand in SME Credit Market				
VARIABLES	(1) Baseline Application Model	(2) Full Application Model	(3) Baseline Success Model	(4) Full Success Model
Log(employees)	0.0394***	0.0308***	0.0405***	0.0382***
	(0.00335)	(0.00446)	(0.0100)	(0.00945)
banksper1000smes	-0.000628	-0.000396	-0.0210*	-0.0148
	(0.0110)	(0.0114)	(0.0121)	(0.0125)
Year = 2017	-0.00200	-0.0106	0.0198	0.0218
	(0.0164)	(0.0154)	(0.0244)	(0.0248)
Year = 2018	-0.0180	-0.0307	0.0422	0.0643**
	(0.0193)	(0.0188)	(0.0314)	(0.0278)
Profit in last six months = 2, Broke even in last six months		0.00921		-0.0839***
		(0.0168)		(0.0303)
Profit in last six months = 3, Made a loss in last six months		0.0582***		-0.147***
		(0.0211)		(0.0558)
Profit in last six months = 4, Refused		-0.0867		
		(0.0586)		
Profit in last six months = 5, Not sure		-0.0407		-0.190**
		(0.0327)		(0.0782)
Turnover in last 6 months = 2, Turnover decreased in last six months		-0.0605***		-0.0479
		(0.0197)		(0.0330)
Turnover in last 6 months = 3, Turnover remained the same in last six months		-0.0559***		0.0227
		(0.0113)		(0.0179)
missedrep = 1, Have missed at least one repayment in last six months		0.219***		-0.217***
		(0.0366)		(0.0702)
missedrep = 2, Don't know		-0.0961**		-0.207*
		(0.0394)		(0.125)
Number of Bus Man Practices = 1		0.0418**		0.0489
		(0.0210)		(0.0712)
Number of Bus Man Practices = 2		0.0478**		0.00743
		(0.0243)		(0.0712)
Number of Bus Man Practices = 3		0.0957***		-0.00660
		(0.0217)		(0.0759)
Observations	4,558	4,558	919	917

Source: Indecon analysis of SME Credit Demand Survey and CSO Business Demography statistics

Indecon's analysis of the evidence indicates that the overall availability of credit to the enterprise sector in Ireland has significantly improved, while most firms do not apply for credit because it is not needed. However, there are information asymmetries and other factors which are likely to have contributed to the low levels of credit applications, particularly among smaller or micro-enterprises.

One additional area of market gap concerns those in society who face financial exclusion. During our stakeholder consultation the Citizens Information Board indicated that there is a segment of the population who continue to be excluded from financial services and products. This is likely to reflect wider societal and economic issues. Individuals may also be financially excluded due to lack of access to the internet and, as previously noted, many households do not have such access. This point was also made to Indecon in our consultation by the Irish Congress of Trade Unions, which noted that it should not be assumed that internet banking is a viable alternative for many people. The ICTU indicated that there are many low-income groups, elderly persons or people suffering from social exclusion who have no regular access to the internet. The National Disability Authority has also indicated that social inclusion and community participation in financial services is an important issue for people with disabilities, where travel to other locations may not be a feasible option.

Conclusions from Evaluation

A summary of Indecon's conclusions from our detailed evaluation of the concept of community banking in Ireland is presented in the table below.

Key Conclusions from Evaluation of Concept of Community Banking in Ireland
1. There is extensive provision of banking services by credit unions, An Post, as well as by commercial banking providers in the Irish market.
2. There are some areas of market failure in the local provision of financial services.
3. There is a wide range of existing supports funded by the Irish Exchequer to assist SMEs and micro-enterprises.
4. There is not a compelling economic case for the establishment of a new state-owned public banking network.
5. There is a range of ways in which targeted measures could assist the provision of local banking services in a cost-effective manner.

1. There is extensive provision of banking services by credit unions, An Post, as well as by commercial banking providers in the Irish market.

Our analysis has demonstrated the important role played in the provision of local banking and financial services in Ireland by a range of non-banking organisations including the credit unions and An Post. Indecon's analysis indicates that in addition to the community banking role played by the credit unions and An Post, the main commercial banks have a large footprint of branches. There is also evidence of new entrants to the SME market including non-traditional providers. Indecon's analysis suggests there is currently wide availability of many core banking services. However, Indecon notes the high levels of concentration in the banking sector and the fact that credit is more expensive than in other countries.

2. There are some areas of market failure in the local provision of financial services.

Indecon's examination of the evidence suggests that despite the extent of the branch network and the provision of services there are some areas of market failure. Information asymmetries exist which are restricting the level of both credit demand and supply. The evidence also shows that a small percentage of enterprises are discouraged from borrowing due to a range of factors such as perceptions that banks are not lending or due to the level of interest rates or issues concerning application processes. There are also market gaps for those at risk of financial exclusion.

3. There is a wide range of existing supports funded by the Irish Exchequer to assist SMEs and micro-enterprises.

Indecon's analysis has highlighted the wide range of existing supports which are funded by the Irish Exchequer to assist SMEs and micro-enterprises. These include supports provided by The Strategic Banking Corporation of Ireland (SBCI) and Microfinance Ireland as well as supports provided by Enterprise Ireland and Local Enterprise Offices. Other initiatives include the establishment of the Credit Review Office and the Credit Guarantee Schemes. In addition, measures have been taken to help enhance financial inclusion including by MABS, credit unions and other organisations.

4. There is not a compelling economic case for the establishment of a new state-owned public banking network.

Indecon's analysis indicates that the absence of a physical branch network in rural areas is not the key factor determining access to credit. Indecon accepts that Irish customers still value face-to-face relationships and the branch network will continue to play an important role in Irish banking. Local branches can help overcome information asymmetries. However, our analysis supports the conclusions of the previous investigation by the Department of Finance and the Department of Rural and Community Development, that there is not a compelling case for significant investment by the State into a new local public banking network. We would have concerns over the ability of such a new state-owned entrant to provide effective competition and the exchequer costs and risks involved would not be justified by our analysis of the causes and extent of market failure.

5. There is a range of ways in which targeted measures could assist the provision of local banking services in a cost-effective manner.

Indecon believes there are measures which could be taken to enhance the provision of local banking services in Ireland. These as outlined in our recommendations include measures to leverage the existing banking network and state infrastructure as well as encouraging new entrants. There are also actions which could be taken by the commercial banks to enhance service provision and reduce information asymmetries. There is also a need for ongoing measures to reduce financial exclusion of vulnerable individuals, but this will require wider action outside of the remit of a community banking response. There is, however, a key role that the credit union sector plays in driving and promoting social inclusion. This was also a point made during the consultation process by the Citizens Information Board.

Recommendations

Indecon has, in line with our terms of reference, presented recommendations to further strengthen community banking provision in Ireland. It is hoped that these recommendations and the analysis in this report will assist in inputting to evidence based policy in this important area. In forming our independent recommendations, Indecon is very conscious of the need to maximise the use of scarce public expenditure and recognise the constraints faced by the Exchequer. We are also cognisant that despite the extent of financial service provision, there are some areas of market failures and there is merit in enhancing the provision of banking services to local communities. The recommended measures represent targeted initiatives to strengthen community banking in the most cost-effective way.

Our recommendations were informed by an examination of potential delivery mechanisms including:

- ❑ Leveraging the existing financial services system in Ireland;
- ❑ Leveraging existing state infrastructure/supports;
- ❑ Facilitating new market entrants; and
- ❑ Online/Fintech-based approaches.

The existing financial services sector in Ireland includes commercial banks as well as credit unions, An Post, and other providers. Indecon believes there is scope for the delivery of an expanding range of local financial services via the existing networks. Of particular importance are the recent initiatives taken by the credit union movement as well as the plans by An Post to expand the services provided. There is also an ongoing role for the main banking groups to help overcome information asymmetries and to ensure that viable micro-firms and SMEs are facilitated to secure credit.

One of the noteworthy features of the Irish financial market is the extent to which state supports have been implemented to address areas of market failure, promote access to finance and to reduce the risk of financial exclusion. This existing infrastructure could be leveraged to enhance access to finance. Some adjustments to the existing state supports could be made to further the provision of local banking services. Using the existing programme infrastructure would represent a cost-effective way of enhancing access to finance.

New entrants to the Irish banking market would help directly address any areas of market failure. This could assist in improving access to credit and would enhance competition. There would be resultant benefits in service provision and in the reduction of the cost of lending in the Irish market.

There is also potential for online or other Fintech initiatives to further expand banking services to local communities. Online or Fintech offerings have an advantage in terms of lower costs. Such online offerings could entail offering decentralised platforms for enhanced financial services provision to communities. Facilitating individuals to access such services would, however, be important and options for face-to-face interactions will also be needed for some parts of the market.

Indecon's recommendations are summarised in the table below and discussed in the subsequent paragraphs.

Recommendations re Community Banking Services in Ireland
LEVERAGING ROLE OF STATE SUPPORTS FOR SMES INFRASTRUCTURE TO ADDRESS MARKET GAPS:
1. Continue to target rural enterprise support in future counter-guarantee loan schemes.
2. Expand Microfinance Ireland's mandate to provide enterprise loans of up to €50,000.
3. Promotion by Local Enterprise Offices of Micro Enterprise Loan Fund.
4. Set ambitious targets for regional impact of any revised Brexit loan scheme.
5. Consider new initiatives to support expansion of SME lending by newer platforms.
REDUCING FINANCIAL EXCLUSIONS AND MANAGING OF EXISTING INFORMATION BY CREDIT UNIONS, AN POST AND LOCAL AUTHORITIES:
6. Expansion of Personal Micro Credit Scheme by member-owned credit unions.
7. Facilitation of new providers to enhance access to credit in communities.
8. Development of initiatives by local authorities as part of digital strategies to assist individuals to apply online for banking services.
ENHANCING COMPETITION:
9. Support the Credit Union Market to deliver Expanded Range of Community Banking Services.
10. An Post to explore and discuss with its parent Government Department, NewEra, and, where appropriate, the Department of Finance, the possibility of investing in partner financial organisations, where such investment is commercially viable and where it would enhance competition in lending market.
11. Extend Exemption for New Community Banking Entrants from Notification of Charges for 5 Years.
REDUCING INFORMATION ASYMMETRIES AND BUILDING SKILLS:
12. Development of Technology Based Lending Tool Kit by Enterprise Ireland and Local Enterprise Offices.
13. Advisory supports by Local Enterprise Offices to include assistance with preparation of lending applications.
14. Skillnet Ireland to offer analysis of lending requirements as a component in their Management Development Programmes.
ENHANCED RESPONSIBILITY FOR COMMERCIAL BANKS:
15. Commercial Banks should consider the establishment of an increased number of Community Banking Hubs or provide alternative methods of banking services delivery in areas where branch closures may have hindered access to banks.

Leveraging Role of State Supports for SMEs Infrastructure to Address Market Gaps

1. Continue to target rural enterprise support in future counter-guarantee loan schemes.

The SBCI Future Growth Loan Scheme was designed to address a market gap in the provision of longer-term lending for SMEs. This has been successfully introduced and there has been extensive utilisation of this by enterprises outside of Dublin and the major cities. Similar schemes should be introduced going forward in order to enhance local banking provision, and Indecon recommends that targeting rural enterprise should be a priority for SBCI, and in future counter-guarantee loan schemes. This should be supported by the setting of ambitious targets for rural areas. Having a strong rural enterprise focus would increase awareness of the availability of lending for the sector.

2. Expand Microfinance Ireland's mandate to provide enterprise loans of up to €50,000.

Indecon notes that Budget 2020 included a provision in the context of a no-deal Brexit to permit Microfinance Ireland to expand its mandate from a maximum loan size of €25,000 to up to €50,000. This is consistent with our judgement that there are some market gaps in the provision of loans for micro-enterprises. The average loan size for micro-enterprises as per the Department of Finance's September 2018 report was €140,571. Indecon believes that the expansion of Microfinance Ireland's mandate will help address gaps in this segment of the lending market.

3. Promotion by Local Enterprise Offices of Micro Enterprise Loan Fund.

Microfinance Ireland (MFI) was established in 2012 to provide small loans (€2,000 - €25,000) for business purposes, to start-up, newly established or growing micro-enterprises employing fewer than 10 people and with turnover of less than €2 million per annum. Since its establishment to the end of 2018, MFI has approved 1,699 loans totalling €28 million. During our consultation programme we understand that it has been estimated that this has helped to create or sustain 4,808 jobs and that 79% of these loans have gone to recipients outside of Dublin. To reflect the risks, the loans are priced at 7.8%. However, if the applications are referred through the LEOS, a lower rate of 6.8% applies. Indecon recommends that promotion by Local Enterprise Offices of MFI loan funds is intensified as it is important that all viable micro-enterprises in local communities are aware of this funding provision.

4. Set ambitious targets for regional impact of any revised Brexit loan scheme.

As part of any revised Brexit loan scheme, there is merit in setting ambitious targets for its regional impact. This would assist in meeting market gaps by SMEs in local communities in securing lending for viable projects. The focus on regional impacts would be aligned with the case for supporting regional development.[9]

5. Consider New Initiatives to Support Expansion of SME Lending in New Platforms

The three main commercial banks have a very high share of the non-property/unsecured direct SME lending market. In addition, many of the incentives provided by the State to support access to finance are channelled through the pillar banks. While the main banks are an important route to market, the level of take-up would be enhanced by the provision of lending by non-traditional lenders. Providing tailored supports to assist the new type of lenders would enhance competition in the Irish banking market. Non-traditional online and other

[9] In its detailed review of the economic appraisal model used by the enterprise development agencies, Indecon proposed differential weighting of regional enterprise investment decisions. See 'Indecon Review of the Enterprise Agencies' Economic Appraisal Model in Ireland' – report prepared for Irish Government/Department of Business, Enterprise and Innovation, 2018 (https://dbei.gov.ie/en/Publications/Publication-files/Review-of-the-Enterprise-Agencies-Economic-Appraisal-Model.pdf).

lending players have a different source of liquidity and risk capital from the main banks and this impacts on their pricing. Indecon believes that the impact of these players on community banking, particularly in SMEs lending, could be enhanced by the provision of a funding platform which would benefit from SBCI first-loss-risk- sharing approach and that this should be considered. A condition of providing any such facility should be that it reflected by way of a loan price discount so that SME benefit. Indecon understands that SBCI has access to unused COSME Counter Guarantee Capacity from the EIF as well as from its own capital and this could potentially be introduced without any exchequer support. However, providing a limited amount of exchequer support to form a loss reserve and or to facilitate set-up costs would increase the rollout of this initiative.

Reducing Financial Exclusions and Managing Existing Information by Credit Unions, An Post and Local Authorities

6. Expansion of Personal Micro Credit Scheme by member-owned credit unions.

The Personal Micro Credit Scheme provides for small scale loans by credit unions to borrowers who have difficulty in accessing low cost credit. Loans under the scheme known as ‘It Makes Sense’ loans range in value from €100 to €2,000 and have a maximum interest rate of 12% in line with credit union legislation. This scheme directly addresses a market gap referred to in our conclusions for people who would otherwise be financially excluded. The Programme for a Partnership Government supports the rollout and extension of the Personal Micro Credit Scheme and Indecon’s analysis would support this action. Indecon understands that as of April 2019, good progress has been made with 110 credit unions at 264 locations representing almost 50% of credit unions. Greater participation in the scheme is, however, recommended. Indecon also notes the ongoing work of the Personal Microcredit Task Force, which was established by the Social Finance Foundation and includes representatives from the Department of Employment Affairs and Social Protection, the Department of Finance, the Central Bank as well as the credit union development and management associations. Among the work of the task force is the examination of potential solutions to address the challenges involved in the further rollout of the Personal Micro Credit Scheme.

7. Facilitation of new providers to enhance access to credit in communities.

Indecon believes there may be potential for An Post or other community-based providers to increase access to credit. This could build on An Post’s recently introduced services in partnership with AvantCard which offers personal loans and credit cards through the network of local post offices. Indecon would be supportive of An Post or other new providers taking on a greater role in community banking in such areas.

8. Development of new initiatives by local authorities as part of digital strategies to assist individuals to apply online for banking services.

Local authorities are developing digital strategies which include actions to assist local communities. As part of these strategies, Indecon recommends the development of new initiatives to assist individuals to apply online for banking services. These could be developed in conjunction with the national library network and with local community organisations. During our consultation process, the point was raised that there is a cohort of the population among which, for a number of reasons, use of online channels is regarded as problematic. Assistance to individuals to apply online for banking services would help reduce financial exclusion.

ENHANCING COMPETITION

9. Support the Credit Union movement to Deliver Expanded Range of Community Banking Services.

It was suggested during our consultations that there is a need for "substantive recognition of the role of the credit unions" in meeting emerging market gaps. Indecon is fully supportive of this and believes that it is essential that ongoing policy decisions and regulations are framed in a manner which ensures no discrimination against credit unions in their plans to develop a wider range of community banking services where they have the capabilities and financial strengths to do so. Policy should therefore support the credit union movement to deliver new community banking services. This will require collaboration between credit unions and measures to encourage the adoption of new services where feasible. In addition to their traditional role in savings and personal lending, the introduction of current accounts and targeting lending in the house loan and SME markets would enable the credit unions to provide all the main areas of community banking. This will require investment in technology and skills, and Indecon notes that there has been recent progress in these areas. The full potential of the credit unions will also require an appropriate regulatory and policy context. Indecon believes that the CUAC Report Implementation Group on how the credit union movement could deliver more services to their communities provides a useful roadmap in this area. Indecon notes that the Central Bank has recently revised the lending regulations for credit unions. Ensuring that regulation supports the long-term sustainability of credit unions is appropriately the independent prudential function of the Central Bank. The priority is to ensure the ongoing viability of the sector. How to achieve this while providing incentives for investment in the structures required to develop commercial lending is an important issue for consideration by the Central Bank and the sector.

10. An Post to explore and discuss with its parent Government Department, NewEra, and, where appropriate, the Department of Finance, the possibility of investing in partner financial organisations, where such investment is commercially viable and where it would enhance competition in lending market.

An Post is a provider of certain financial services to retail and SME customers. As An Post has in excess of 500 post offices in locations where there are no banks within 5 kms and is an important part of the local community banking infrastructure. An Post has an ambitious growth strategy for its An Post Money business. We understand that this is likely to require An Post to partner with other organisations to provide lending propositions in mortgages, unsecured SME lending and technological capability. This may be facilitated if An Post co-invests from its own resources in equity in partner financial organisations. Indecon believes this could enhance community banking in Ireland and should be supported. Indecon would, however, recommend that such investment should only be made where it is commercially viable and where it would enhance competition in the lending market for SMEs and micro-enterprises.

11. Extend Exemption for New Community Banking Entrants from Notification of Charges for 5 Years.

The Central Bank (Supervision and Enforcement) Act 2013 provided that relevant new credit institutions establishing business in the state after 1 August 2013 are not subject to Section 149(1) and are not required to notify the Central Bank of charges imposed for their services for a period of three years after the credit institution commences business in the State. In order to facilitate any new community banking organisation who may wish to establish in Ireland, and taking account of the need to facilitate the commercial viability of any new entrants and also to minimise administrative burden, we recommend that consideration is given to extending the exemption for any new community banking entrants from Section 149(1) for a five-year period. Indecon accepts that this is not a major barrier but any initiatives which could at the margin facilitate new entrants should be encouraged.

Reducing Information Asymmetries and Building Skills

12. Development of Technology Based Lending Tool Kit by Enterprise Ireland and Local Enterprise Offices.

Increasingly technology can assist in the evaluation of credit risk and in the preparation of credit applications. The background is the requirement on lenders to evaluate risks for new SME lending applications. This is important as supporting non-viable projects would simply increase loan defaults and would not be consistent with increasing economic efficiency. An issue, however, raised in the consultations was that for micro-enterprises and some SMEs preparing applications for banking lending is challenging. This can arise from the lack of specialised skills in SME. Some of these constraints could be eased by the use of technology which could assist SMEs to prepare cash flow projections based on existing financial information. Indecon recommends that consideration is given to the merits of developing a technology-based lending kit is to assist SMEs in local communities to apply for business loans.

13. Advisory supports by Local Enterprise Offices to include assistance with preparation of lending applications.

There is a case for Local Enterprise Offices to assist smaller firms with the preparation of lending applications. Small businesses in the past have been helped by local bank managers with this task. Indecon recognises that some Local Enterprise Offices currently undertake this role as part of their wider supports. In addition, InterTradeIreland reflecting this market gap, organise workshops on preparing lending applications and this could reduce the number of discouraged borrowers to apply for credit for viable projects. Indecon recommends wider supports in this area.

14. Skillnet Ireland to offer analysis of lending requirements as a component in their Management Development Programmes.

The new econometric evidence completed by Indecon for this project has demonstrated that a number of factors are statistically significant in influencing the demand for credit by firms in Ireland. These include whether firms keep regular management accounts, whether they have an existing business plan, and whether they estimate requirements for cash flow for the coming months. All these factors are essential in preparing effective lending applications. They are also likely to give SMEs confidence that they can afford lending costs and to make informed decisions. Indecon recommends that Skillnet Ireland offer support for training including the analysis of lending as a composition in their Management Development Programmes. There may also be merit in Skillnet Ireland supporting targeted discreet skill development for SME management in this area.

Enhanced Responsibility for Commercial Banks

15. Commercial Banks should consider the establishment of an increased number of Community Banking Hubs or provide alternative models of banking services delivery in areas where branch closures may have hindered access to banks.

While there is a tendency to assume that any market gaps should be addressed by Government action, Indecon believes that there is also a need for an appropriate response by the existing major commercial banks. This should ensure at least a minimum level of service to local communities, whereby credible options for face-to-face interaction with banks' lending personnel are made available. Indecon recognises that the banks have developed options other than traditional branches which include workbenches, event facilities, mobile banks and partner spaces with other organisations as well as more mobile customer advisors. An extension of these into a wider network of community banking hubs or other initiatives could open up additional opportunities for the banks and also address the market gaps which exist as a result of some micro-enterprises and SMEs not having close proximity to a major lender in the market. In this context Indecon understands that the main banking groups allocate relationship managers to SMEs based on a range of criteria including levels of existing or potential business exposures and that the criteria varies between banks. These relationship managers can help expedite the process concerning lending decisions and other bank services to enterprises and can encourage viable lending proposals. We also recognise that there are business advisers in branches where individuals can discuss lending or other requirements and various other channels in which enterprise can meet banks to discuss their requirements. Indecon believes there may be a way in which local provision can be enhanced by the banks by giving a greater weight to the allocation of relationship managers or regional business advisers where bank branches are not readily accessible. This could involve increasing investment in providing convenient voice, digital and other booking systems for business advisors to explain lending criteria and offering an increased number of site visits for SMEs and micro-enterprises in regional areas. Most of the banks have mobile colleagues who are willing to travel to meet customer needs throughout the country. Pro-active offers to meet SMEs and micro-enterprises based in regional areas to explain how to apply for bank services and to understand their business should be rolled out on a regional basis.

1 Introduction and Background

1.1 Introduction

Indecon International Economics Consultants ('Indecon') is a leading firm of research economists. Indecon was appointed by the Minister for Finance and Public Expenditure and Reform, following a competitive tender process, to undertake an independent evaluation of how the concept and objectives of community banking, and local provision of banking and financial services, may be furthered in Ireland.

1.2 Background

The background to this evaluation is that the Programme for a Partnership Government contained a commitment to "thoroughly investigate the Sparkassen model of local public banks that operate within well-defined regions." This commitment was fulfilled by the Department of Finance and the Department of Rural and Community Development with the publication of the joint report on 'Local Public Banking in Ireland'.[10] The report examined how the German Sparkassen system could potentially be implemented in Ireland based on a proposal from Irish Rural Link and the Savings Bank Foundation for International Cooperation, the international development wing of the Sparkassen Group. The report concludes that there is not a compelling case for the State to establish a new local public banking system in Ireland using €170 million of Exchequer funds, based on an analysis of the proposed model. However, the Government agreed that the Department of Finance would commission an evaluation of how the local community banking concept may be furthered in other ways in Ireland, with a public stakeholder engagement forming part of this process.

The evaluation:

- Analyses whether there is a market 'gap' or 'failure' in the local provision of banking and financial services in Ireland.
- Examines the local provision of banking and financial services.
- Reviews the range of existing state supports designed to address market failure.
- Provides policy recommendations for consideration.

1.3 International Context

As background context to this review, Indecon examined a number of community and local banking services models in different jurisdictions. These include:

- Germany
- New Zealand
- Canada
- United States of America

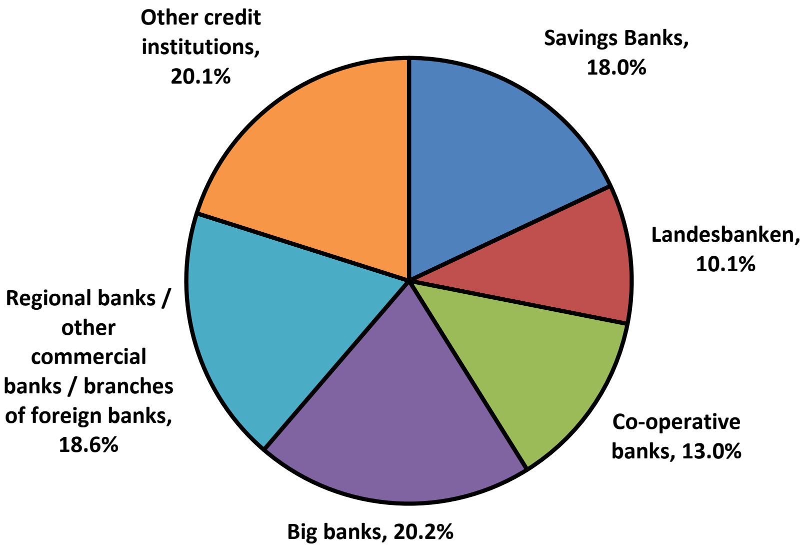
Indecon is very appreciative of the Public Banking Forum of Ireland for providing valuable insights into the important role which Community Banking has played in different countries.

[10] Local Public Banking in Ireland – An analysis of a model for developing a system of local public banking in Ireland. Op. Cit.

Germany

Of particular relevance as context is the very successful experience of community banking in Germany. In Germany the Sparkassen[11] banks are responsible to the municipality or local authority. There are a number of strengths of the Sparkassen model in the context of the German banking system. These include a focus on the regional economy and strong cooperation within the Group sustained by a joint liability scheme. Community banking in Germany has developed a market position with has enabled them to generate economies of scale and of scope.[12] There are more than 400 Sparkassen in Germany with approximately 7,000 branches. These account for 18% of the German banking market.

Figure 1.1: Market Shares of Banking Sector in Germany (2018)



Source: 2018 Annual Report of the Savings Banks Finance Group

In considering the potential application of the Sparkassen model to Ireland, Indecon recognises that the scale of the Sparkassen model in Germany is reflective of the structure of the German banking sector where the larger commercial banks are focused on the corporate sector. This has enabled community banks to secure a significant share of the market. Also fundamental to the Sparkassen model are the high levels of savings in Germany which provides a stable low-cost funding base for the Sparkassen banks. Securing economies of scale for a new Sparkassen type network would be very difficult in the small Irish market.[13]

[11] See: http://www.civitas.org.uk/content/files/SimpsonSparkassen.pdf

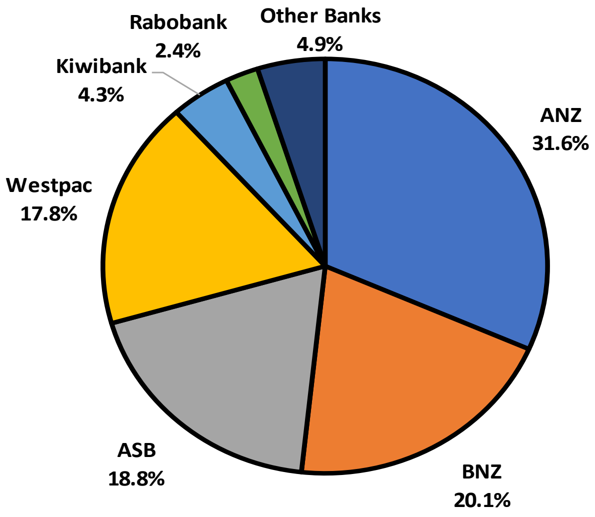
[12] See: https://www.sparkassenstiftung.de/fileadmin/user_upload/_imported/fileadmin/user_upload/pdf/2012_08_ConstitutiveElements.pdf

[13] Research by the World Bank on Community Banking indicated that the market share of Community Banks had a positive impact on GDP. See http://documents.worldbank.org/curated/en/213591468739473626/pdf/multi0page.pdf.

New Zealand

In New Zealand, community banking through Kiwibank was established in 2002 as a locally run bank that would operate in the interest of the population. The bank's focus is on '*social responsibility*' *and 'stand for doing the right thing by their customers and communities'*.[14] New Zealand Post holds a 53% stake in the bank. Kiwibank provides banking services utilising the existing post office branch network and through ATMs nationwide. The Joint Report on Local Public Banking noted that Kiwibank is the 5th largest bank in New Zealand with 301 branches and over 1 million customers and had approximately a 4% share of the banking market.[15] In many ways, the role played by Kiwibank in New Zealand is similar to the role played by the credit union movement and by An Post in Ireland.

Figure 1.2: Market Shares of New Zealand Banking Sector (2019)



Source: Reserve Bank of New Zealand

Canada

Canada represents another interesting model as the banking sector is very concentrated, stable and has a strong presence of credit unions. However, there are a significant number of low-income individuals that do not have access to adequate banking services. In response, a number of community banking projects have developed. These community banking projects attempt to rectify financial exclusion in their respective regions. While these community banking projects in Canada are addressing market failure in helping overcome financial exclusion, they face major challenges. These include the small scale of transactions which means they find it difficult to secure financial sustainability. The role played in Ireland by the credit union movement with support from the Personal Micro Credit Scheme is a potentially effective option to address similar issues which led to a number of community banking projects in Canada.

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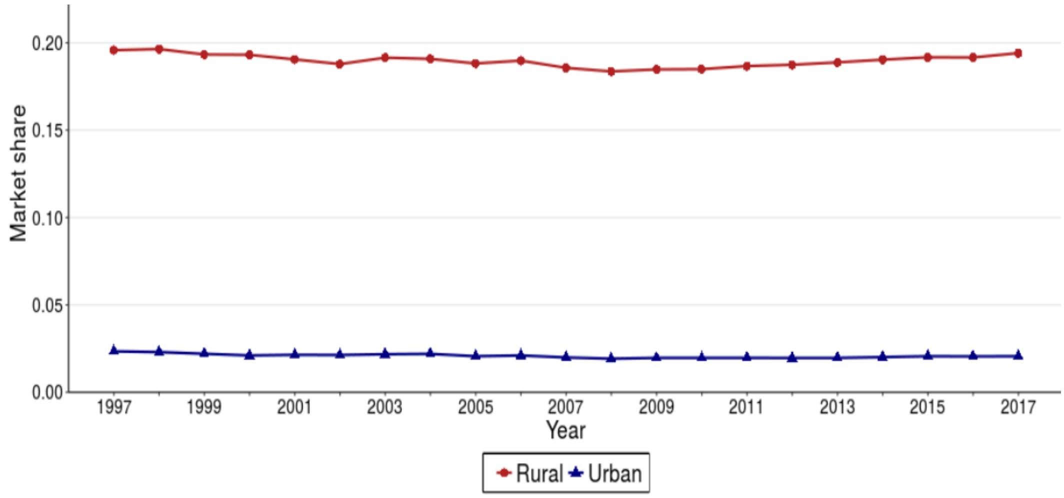
[14] See: https://www.kiwibank.co.nz/about-us/who-we-are/what-we-stand-for/

[15] See: https://www.irishrurallink.ie/wp-content/uploads/2018/07/Joint-Report-on-Local-Public-Banking-v3.compressed.pdf.

United States

Community banks have also been operating in the United States for many years. However, the number of community banks in the USA has fallen by almost 50%. Nonetheless, the average value of assets in both urban and rural community banks has almost trebled since 1997. The evidence also shows that community banks in the United States only have a very small share of the banking market. The Office of the Comptroller of the Currency (2019)[16] has pointed out that there are significant risks for community banks including: credit, interest rate, liquidity, price, operational, compliance, and reputation.

Figure 1.3: Average Market Share Deposits – USA (1997 - 2017)



Source: Federal Reserve Board

1.4 Methodological Approach

This study has been completed based on a detailed methodological approach and work programme, which was designed to address the objectives and specific requirements of the evaluation. The evaluation was informed by a programme of engagement with a range of organisations and individuals. This included a public consultation process supported by the Department of Finance, a national stakeholder forum event hosted by Indecon and direct consultations with stakeholders. Detailed analysis and statistical modelling of the empirical evidence were as conducted using a range of official and other datasets. Indecon also developed new econometric models to identify the factors influencing the supply and demand for banking services.

[16] Office of the Comptroller of the Currency (2019) – ‘A Common Sense Approach to Community Banking’.

1.5 Structure of Report

In Section 2 of the report an overview of the position of local banking services is presented. The subsequent three sections, Sections 3 to 5, examine the role played by credit unions, An Post and Commercial Banking organisations. Section 6 reviews the range of existing state supports and in Section 7 an analysis of the supply and demand credit is completed. In the final section we present our overall conclusions and recommendations.

1.6 Acknowledgements and Disclaimer

Indecon would like to acknowledge the assistance and valuable inputs provided by a number of individuals and organisations during the course of this evaluation. We would particularly like to express our gratitude to officials in the Department of Finance, including Claire O'Brien, John Palmer, Richael Duffy, Lara Mullen, Brian Corr and Gary Tobin. We would also like to thank a large number of individuals and organisations who provided inputs to our review. These include Jean Carberry and Jane Dollard (Department of Business, Enterprise and Innovation); Barbara Leeson and Brendan O'Reilly (Department of Communications, Climate Action and Environment); Laure Garcia (Department of Rural and Community Development); John McKeon and Sarah O'Callaghan (Department of Employment Affairs and Social Protection); Seamus Boland, Noel Kinahan and Siobhan Kinahan (Irish Rural Link); Seamus Maye (International Small Business Alliance); Maol Muire (AIB); Debbie Byrne and John Rice (An Post); Gavin Kelly and Joann Hosey (Bank of Ireland); Leontia Fannin (Permanent TSB); Nick Ashmore and Brian Colgan (Strategic Banking Corporation of Ireland); Maurice Crowley and Marian McCarville (Banking and Payments Federation of Ireland); Geralyn McGarry (Citizens Information Board); Áine Carroll (Competition & Consumer Protection Commission); John Trethowan and Catherine Collins (Credit Review Office); Ed Farrell and John Knox (Irish League of Credit Unions); Lorraine Corcoran (Credit Union Advisory Committee); Kevin Johnson (Credit Union Development Association); Tim Molan (Credit Union Managers Association); Graham Barnes and Caroline Whyte (Feasta – Foundation for the Economics of Sustainability); Gareth Murphy (Financial Services Union); Edel Kelly and Martin Stapleton (Irish Farmers Association); Ned O'Hara (Irish Postmasters Union); Joseph Glynn; Ger Gibbons and Eileen Sweeney (Irish Congress of Trade Unions); Michael Harty T.D.; Charles Larkin (Parliamentary Assistant to Michael Harty T.D.); Garrett Stokes (Microfinance Ireland); Donal Rice (National Disability Authority); Fiona Lawlor (CUSOP); Gerry Duddy (Public Banking Forum of Ireland); Lisa Stapleton (Credit Union Managers' Association / Affinity); Mick Culkeen (Cultivate / SJCU); Brian Moroney (Enterprise Ireland); Seamus Newcombe (Payac); Colin Canny (Flender); and Colette Power (MABS National Development).

The usual disclaimer applies, and responsibility for the analysis and findings in this independent report remains the sole responsibility of Indecon.

2 Overview of Provision of Local Banking and Financial Services

2.1 Demographic Context

In assessing whether there is a market 'gap' or 'failure' in the local provision of banking and financial services in Ireland, it is useful to examine the demographic context in which the sector operates. The following table presents data on the population of each county. There is a high degree of geographic concentration of population in Ireland. Dublin county alone accounts for over 28% of the State's population. Cork is the second largest county and accounts for 11.4% of the population.

Table 2.1: Population of Ireland by County (2016)

	Number of People Living in County	Percentage of State Population
Dublin	1,347,359	28.3%
Cork	542,868	11.4%
Galway	258,058	5.4%
Kildare	222,504	4.7%
Meath	195,044	4.1%
Limerick	194,899	4.1%
Tipperary	159,553	3.4%
Donegal	159,192	3.3%
Wexford	149,722	3.1%
Kerry	147,707	3.1%
Wicklow	142,425	3.0%
Mayo	130,507	2.7%
Louth	128,884	2.7%
Clare	118,817	2.5%
Waterford	116,176	2.4%
Kilkenny	99,232	2.1%
Westmeath	88,770	1.9%
Laois	84,697	1.8%
Offaly	77,961	1.6%
Cavan	76,176	1.6%
Sligo	65,535	1.4%
Roscommon	64,544	1.4%
Monaghan	61,386	1.3%
Carlow	56,932	1.2%
Longford	40,873	0.9%
Leitrim	32,044	0.7%
State	**4,761,865**	**100%**

Source: Indecon analysis of Census data

Indecon notes that the percentage of population living in rural areas has declined. In 1996, nearly 42% of Irish people lived in rural areas but by 2016, this declined to approximately 37%.

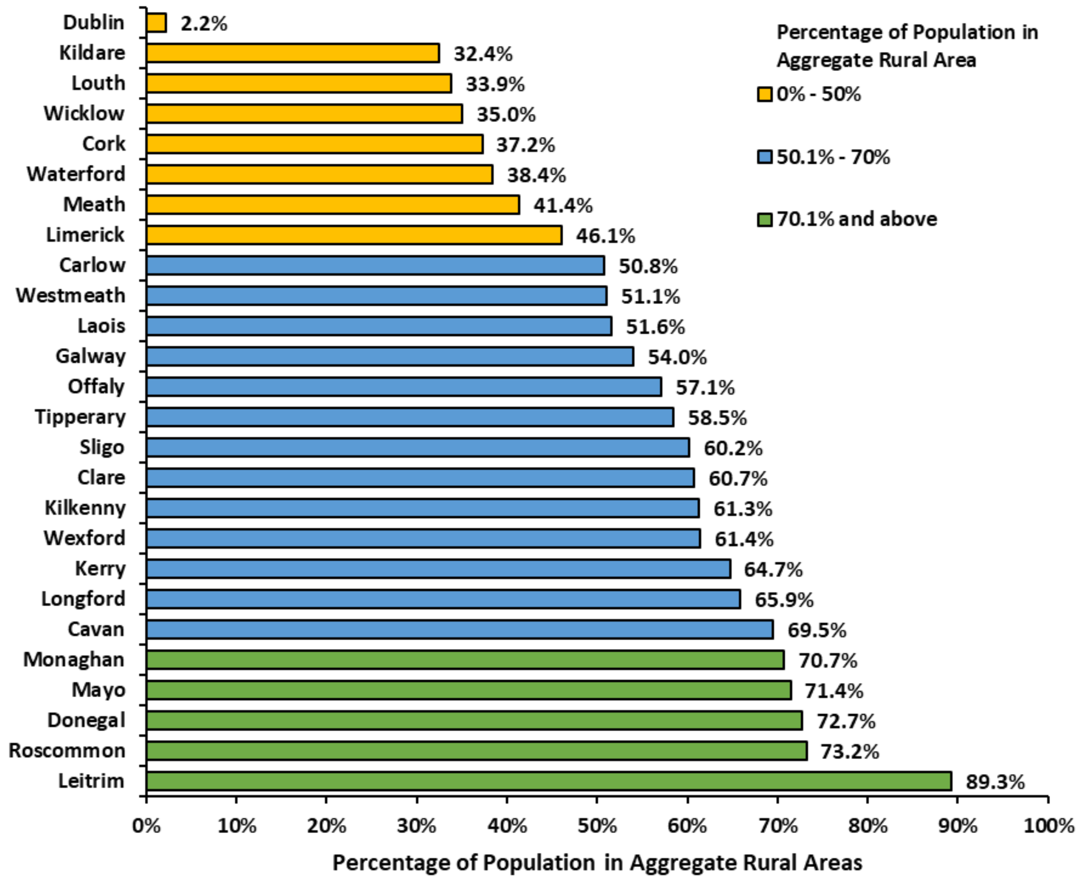
Table 2.2: Population Share in the Aggregate Town and Rural Areas (1996-2016)

	1996	2002	2006	2011	2016
Total Population (Number – '000s)	3,626.1	3,917.2	4,239.8	4,588.3	4,761.9
Percentage of population in Aggregate Rural Area (%)	41.9%	40.4%	39.3%	38.0%	37.3%

Source: CSO Census data

There are marked differences in the percentage of the population in each county living in rural areas. High levels of rurality and the resultant low levels of population density have implications for the number of bank branches which are commercially viable. This can impact on the ease of access for the public and for businesses.

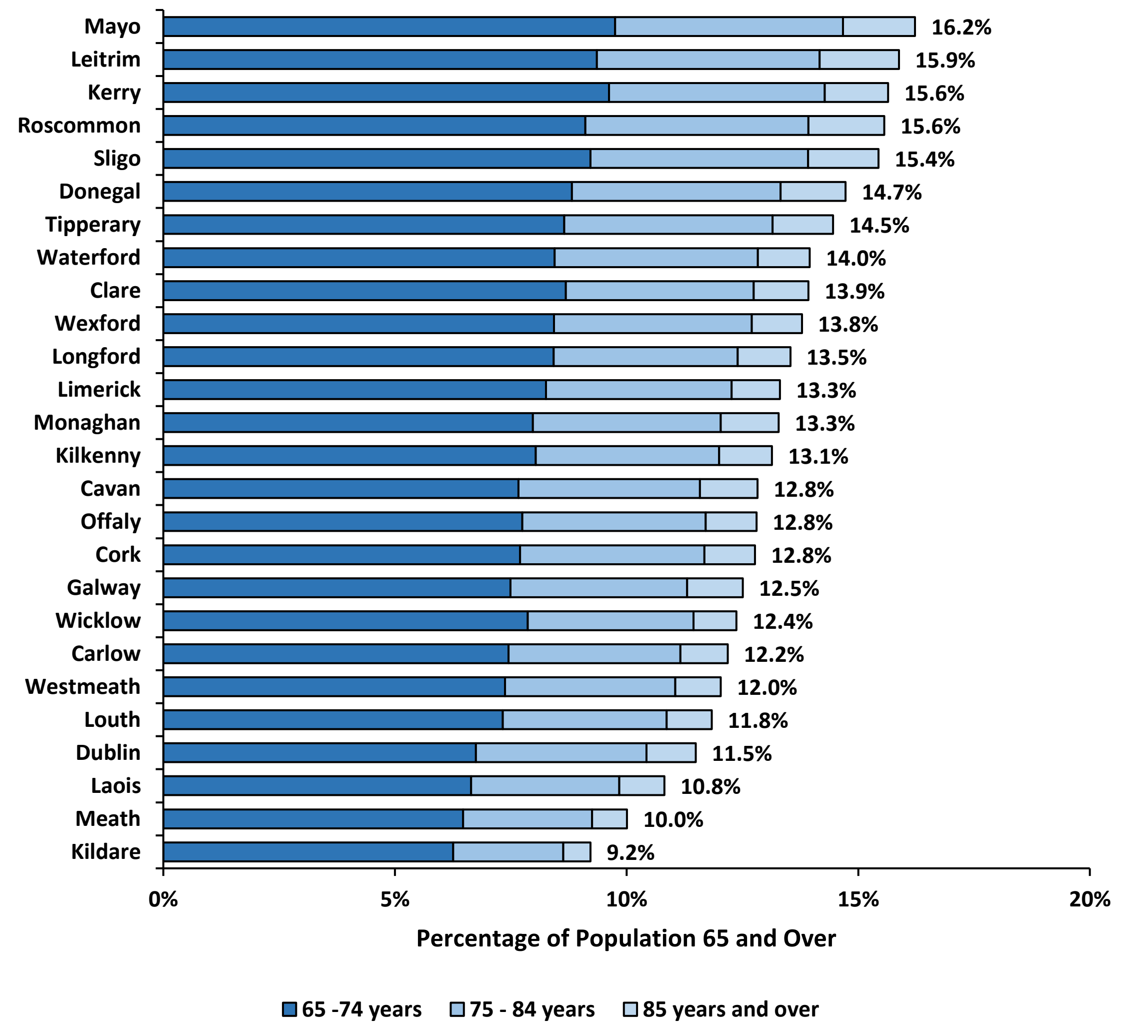
Figure 2.1: Percentage of Population Living in Aggregate Rural Area (2016)



Source: Indecon analysis of Census data

The demographic evidence also shows that counties with high levels of rural population also have a higher percentage of older individuals.

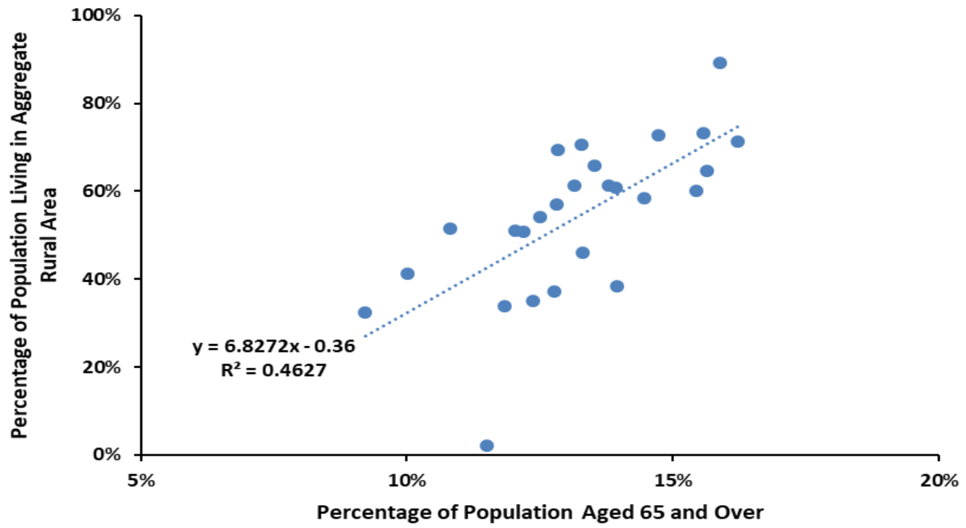
Figure 2.2: Percentage of Population Aged 65 and Over (2016)



Source: Indecon analysis of Census data

The link between rural areas and older population is also highlighted in the next figure.

Figure 2.3: Percentage of Population Aged 65 and Over Compared to Percentage of Population Living in Rural Areas (2016)



Source: Indecon analysis of Census data

A related issue is the level of internet/broadband access, as online banking can help reduce the need to use a local bank branch for certain services. The evidence indicates that over a quarter of households in some of the more rural counties do not have internet access, while many rural counties also fall significantly below the urban and national averages in relation to higher speed broadband access (see table overleaf). In the absence of other supports, poor internet and broadband access restricts the ability of these households to access online financial services, and increases the risk of financial exclusion. The National Broadband Plan (NBP) is designed to address the challenges posed by poor broadband availability in rural and other under-served locations. The overall goal of the NBP, the contract for which was signed by the Government on 19th November 2019, is to deliver a high-speed broadband service to over 540,000 premises throughout Ireland that are currently without such a service. The plan aims to bring high-speed connectivity to those living in rural areas who cannot obtain such a service from commercial operators. The importance of the NBP in the context of community banking services is that the investment in high-speed internet services will facilitate the development of online banking delivery channels and make is easier for consumers and businesses to access these services. However, while the availability of high-speed broadband services does not necessarily mean that these services will be taken up, by supporting increased potential for online delivery channels, enhanced broadband will also alter the economic feasibility of operating traditional banking and other branch networks.

Table 2.3: Households with and without Broadband/Internet Access by County			
	Percentage of Households with Any Internet Access	**Percentage of Households with Broadband Internet Access**	**Percentage of Households with No Internet Access**
Leitrim	72.6%	58.0%	27.4%
Roscommon	73.5%	59.8%	26.5%
Longford	73.8%	58.9%	26.2%
Mayo	74.5%	61.1%	25.5%
Tipperary	74.8%	60.6%	25.2%
Kerry	74.8%	61.5%	25.2%
Donegal	75.0%	62.0%	25.0%
Monaghan	75.3%	63.0%	24.7%
Offaly	75.3%	60.4%	24.7%
Cavan	76.4%	63.6%	23.6%
Wexford	77.3%	64.4%	22.7%
Sligo	77.5%	65.7%	22.5%
Limerick	77.6%	65.6%	22.4%
Clare	78.0%	64.5%	22.0%
Carlow	78.3%	66.2%	21.7%
Kilkenny	78.4%	65.4%	21.6%
Westmeath	78.4%	64.7%	21.6%
Laois	79.4%	65.4%	20.6%
Waterford	80.2%	68.6%	19.8%
Galway	80.6%	67.5%	19.4%
Louth	80.6%	70.8%	19.4%
Cork	81.3%	70.6%	18.7%
Meath	84.3%	73.4%	15.7%
Wicklow	84.6%	75.3%	15.4%
Kildare	86.8%	77.8%	13.2%
Dublin	87.8%	80.1%	12.2%
Source: Indecon analysis of CSO Census Data			

2.2 Profile of Enterprise Sector

Indecon analysis of the enterprise sector shows that there are 266,000 SMEs registered in Ireland and the number of enterprises has been growing. A significant issue regarding access to finance is that over 90% of the enterprises in Ireland are micro-enterprises.

Table 2.4: Active Enterprises by Size (Number of Employees) – 2008-2017										
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Under 10	222,030	225,328	224,994	223,582	227,210	226,018	219,888	229,472	229,534	249,690
10 - 19	11,961	10,380	9,662	9,436	9,255	9,429	9,838	10,316	10,748	11,167
20 - 49	6,659	5,638	5,166	5,002	5,056	5,151	5,375	5,686	6,166	6,546
50 - 249	3,020	2,593	2,407	2,398	2,395	2,468	2,634	2,829	3,003	3,154
All SMEs	**243,670**	**243,939**	**242,229**	**240,418**	**243,916**	**243,066**	**237,735**	**248,303**	**249,451**	**270,557**
250 and over	525	489	463	462	478	505	514	540	582	609
All persons engaged size classes	**244,195**	**244,428**	**242,692**	**240,880**	**244,394**	**243,571**	**238,249**	**248,843**	**250,033**	**271,166**
Source: Indecon presentation of CSO Business Demography data										

An analysis of the number of enterprises by county shows that 55% of SMEs are based outside of Dublin and Cork.

Table 2.5: Active Enterprises by County (2017)

	Active Enterprises	Active SMEs (Fewer than 250 persons engaged)	Percentage of Enterprises That are SMEs	Population	Active SMEs per 1,000 People
Dublin	87,828	87,463	99.6%	1,347,359	64.9
Kerry	8,846	8,837	99.9%	147,707	59.8
Leitrim	1,966	1,906	96.9%	32,044	59.5
Clare	7,068	7,056	99.8%	118,817	59.4
Wicklow	8,277	8,270	99.9%	142,425	58.1
Galway	14,565	14,543	99.8%	258,058	56.4
Mayo	7,293	7,285	99.9%	130,507	55.8
Cork	30,041	29,993	99.8%	542,868	55.2
Monaghan	3,317	3,314	99.9%	61,386	54.0
Westmeath	4,786	4,777	99.8%	88,770	53.8
Wexford	7,990	7,975	99.8%	149,722	53.3
Cavan	4,047	4,042	99.9%	76,176	53.1
Meath	10,255	10,245	99.9%	195,044	52.5
Louth	6,629	6,619	99.8%	128,884	51.4
Donegal	8,135	8,130	99.9%	159,192	51.1
Sligo	3,331	3,326	99.8%	65,535	50.8
Kildare	11,221	11,204	99.8%	222,504	50.4
Tipperary	7,968	7,956	99.8%	159,553	49.9
Limerick	9,561	9,546	99.8%	194,899	49.0
Carlow	2,880	2,738	95.1%	56,932	48.1
Roscommon	3,191	3,103	97.2%	64,544	48.1
Longford	2,022	1,950	96.4%	40,873	47.7
Waterford	5,474	5,457	99.7%	116,176	47.0
Kilkenny	4,661	4,658	99.9%	99,232	46.9
Offaly	3,442	3,438	99.9%	77,961	44.1
Laois	3,220	3,101	96.3%	84,697	36.6
Total	**268,014**	**266,932**	**99.6%**	**4,761,865**	**56.1**

Source: Indecon analysis of CSO Business Demography Data
Note: The total of 268,014 is lower than the total number of Enterprises in 2017, due to a certain number of enterprises having registered addresses outside of the Republic of Ireland.

2.3 Overview of Existing Financial Services Infrastructure

In order to meet the needs of the population and of the enterprise sector, there is an extensive branch network and a wide range of services provided by banks, credit unions, An Post and non-traditional providers. Indecon's research indicates that there are 1,912 branches operated by banks, credit unions and post offices in Ireland. Examples of the range of financial providers operating in the Irish market are presented in the next table.

Table 2.6: Illustration of Range of Financial Service Providers
Irish Banking Providers
Bank of Ireland, AIB, Permanent TSB
Foreign Banking Providers
KBC; Ulster Bank; HSBC
Credit Unions
An Post
Other – including Non-Bank Online and Other Providers
Source: Indecon

Over 63% of the branches are provided by credit unions or An Post while banks account for nearly 37% of local branches.

Table 2.7: Existing Financial Services Infrastructure – Numbers of Bank, Post Office and Credit Union Branches (2019)

	Number	Percentage of Total
Banks	702	36.7%
Credit Unions	254	13.3%
Post Offices	956	50.0%
Total	**1,912**	**100%**

Source: Central Bank of Ireland (credit unions), An Post and Indecon research on individual banks
Note: Number of Credit Unions based on figure as at end of 2018.

The following table presents data on the number of banks, post offices and credit unions in each county compared to the population of that county. As can be seen, the more rural counties (i.e., Leitrim, Donegal, Mayo, Roscommon and Monaghan) have a higher number of branches per capita although most of the largest number of branches are in Dublin and Cork. These five rural counties have among the highest levels of the number of financial service institutions per 1,000 people in the county.

Table 2.8: Existing Financial Service Institutions in Ireland Relative to Population					
	Number of Banks, Post Offices and Credit Unions	Percentage of Total	Population	Percentage of Total	Number of Institutions Per 1,000 People
Leitrim	27	1.4%	32,044	0.7%	0.84
Donegal	99	5.2%	159,192	3.3%	0.62
Mayo	79	4.1%	130,507	2.7%	0.61
Roscommon	35	1.8%	64,544	1.4%	0.54
Kerry	80	4.2%	147,707	3.1%	0.54
Longford	22	1.2%	40,873	0.9%	0.54
Monaghan	30	1.6%	61,386	1.3%	0.49
Cavan	37	1.9%	76,176	1.6%	0.49
Limerick	93	4.9%	194,899	4.1%	0.48
Tipperary	76	4.0%	159,553	3.4%	0.48
Clare	55	2.9%	118,817	2.5%	0.46
Sligo	30	1.6%	65,535	1.4%	0.46
Galway	118	6.2%	258,058	5.4%	0.46
Offaly	35	1.8%	77,961	1.6%	0.45
Cork	240	12.6%	542,868	11.4%	0.44
Westmeath	39	2.0%	88,770	1.9%	0.44
Carlow	25	1.3%	56,932	1.2%	0.44
Waterford	51	2.7%	116,176	2.4%	0.44
Wexford	62	3.2%	149,722	3.1%	0.41
Louth	52	2.7%	128,884	2.7%	0.40
Laois	31	1.6%	84,697	1.8%	0.37
Kilkenny	36	1.9%	99,232	2.1%	0.36
Wicklow	51	2.7%	142,425	3.0%	0.36
Meath	59	3.1%	195,044	4.1%	0.30
Dublin	393	20.6%	1,347,359	28.3%	0.29
Kildare	57	3.0%	222,504	4.7%	0.26
Total	**1,912**	**100%**	**4,761,865**	**100%**	**0.40**

Source: Central Bank of Ireland (credit unions), An Post, Indecon research on individual banks, and CSO Census of Population data
Note: The areas highlighted in yellow represent counties where there is less than 50% of the population living in rural areas. The blue represents areas where there is between 50.1 – 70% and green are areas where there are over 70% living in rural areas.

An analysis of the branch network per SME in each county is presented in the next table. This shows that in many rural counties there is a high number of branches per SME.

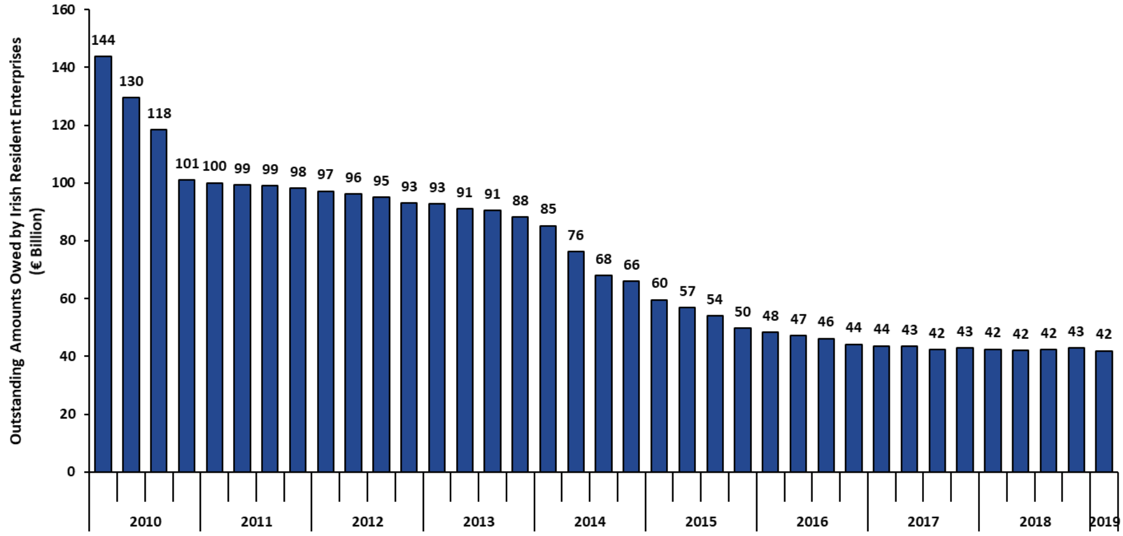
Table 2.9: Existing Financial Service Institution Branch Coverage relative to Number of Active SMEs					
	Number of Banks, Post Offices and Credit Unions	**Percentage of Total**	**Number of Active SMEs**	**Percentage of Total**	**Number of Institutions Per 1,000 SMEs**
Leitrim	27	1.4%	1,906	0.7%	14.17
Donegal	99	5.2%	8,130	3.0%	12.18
Longford	22	1.2%	1,950	0.7%	11.28
Roscommon	35	1.8%	3,103	1.2%	11.28
Mayo	79	4.1%	7,285	2.7%	10.84
Offaly	35	1.8%	3,438	1.3%	10.18
Laois	31	1.6%	3,101	1.2%	10.00
Limerick	93	4.9%	9,546	3.6%	9.74
Tipperary	76	4.0%	7,956	3.0%	9.55
Waterford	51	2.7%	5,457	2.0%	9.35
Cavan	37	1.9%	4,042	1.5%	9.15
Carlow	25	1.3%	2,738	1.0%	9.13
Kerry	80	4.2%	8,837	3.3%	9.05
Monaghan	30	1.6%	3,314	1.2%	9.05
Sligo	30	1.6%	3,326	1.2%	9.02
Westmeath	39	2.0%	4,777	1.8%	8.16
Galway	118	6.2%	14,543	5.4%	8.11
Cork	240	12.6%	29,993	11.2%	80.0
Louth	52	2.7%	6,619	2.5%	7.86
Clare	55	2.9%	7,056	2.6%	7.79
Wexford	62	3.2%	7,975	3.0%	7.77
Kilkenny	36	1.9%	4,658	1.7%	7.73
Wicklow	51	2.7%	8,270	3.1%	6.17
Meath	59	3.1%	10,245	3.8%	5.76
Kildare	57	3.0%	11,204	4.2%	5.09
Dublin	393	20.6%	87,463	32.8%	4.49
Total	**1,912**		**266,932**		**7.16**

***Source: Central Bank of Ireland (credit unions), An Post, Indecon research on individual banks, and CSO* Business Demography Statistics**
Note: The areas highlighted in yellow represent counties where there is less than 50% of the population living in rural areas. The blue represents areas where there is between 50.1 – 70% and green are areas where there are over 70% living in rural areas.

2.4 Supply of Credit in Irish Market

The overall trend in lending to Irish resident enterprises since 2010 is profiled in the following figure. As can be seen from the data, there has been a decline in the level of credit outstanding to the Irish resident enterprises since 2010. In the first quarter of 2010, Irish resident enterprises owed approximately €144 billion, compared to €42 billion in the first quarter of 2019.

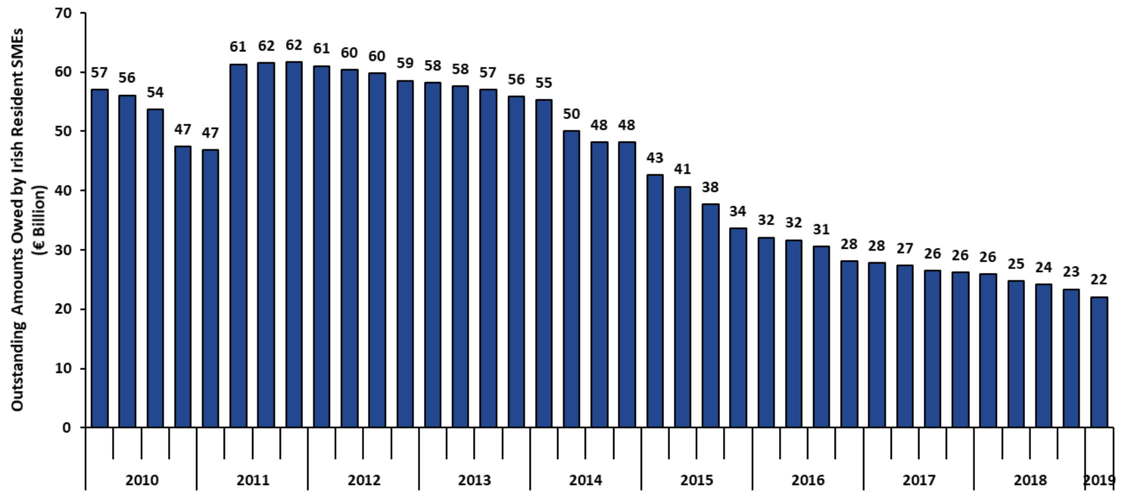
Figure 2.4: Outstanding Amounts Owed by Irish Resident Enterprises – All Enterprises (€ Billion)



Source: Central Bank of Ireland data

The outstanding amounts owed by Irish resident SMEs have also been falling in recent years, dropping by 62.7%, from €59 billion at the end of 2012 to €22 billion at the beginning at 2019.

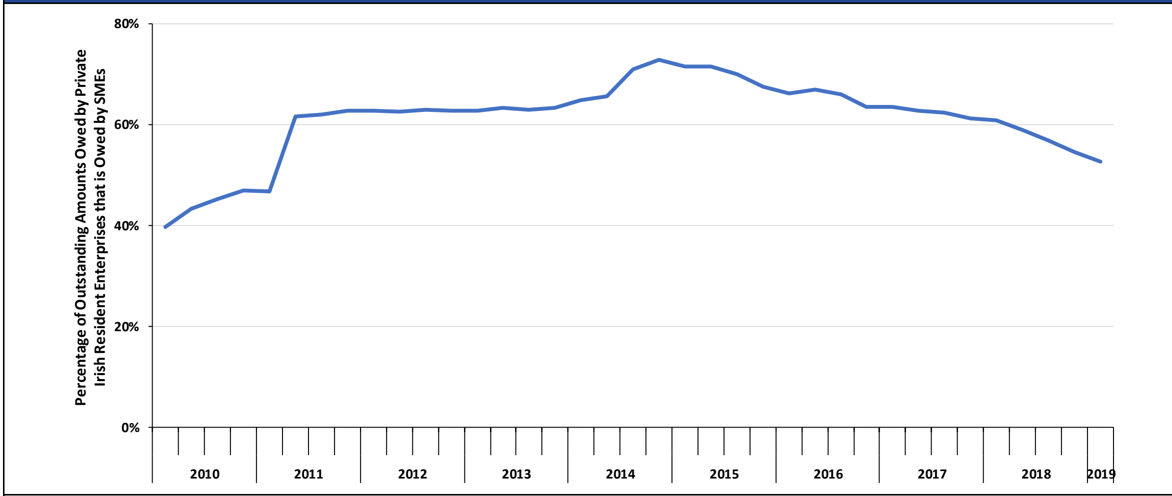
Figure 2.5: Outstanding Amounts Owed by Irish Resident Enterprises – SMEs (€ Billion)



Source: Central Bank of Ireland data

Irish SMEs accounted for just over half of the total amount outstanding owed by Irish resident enterprises in 2019.

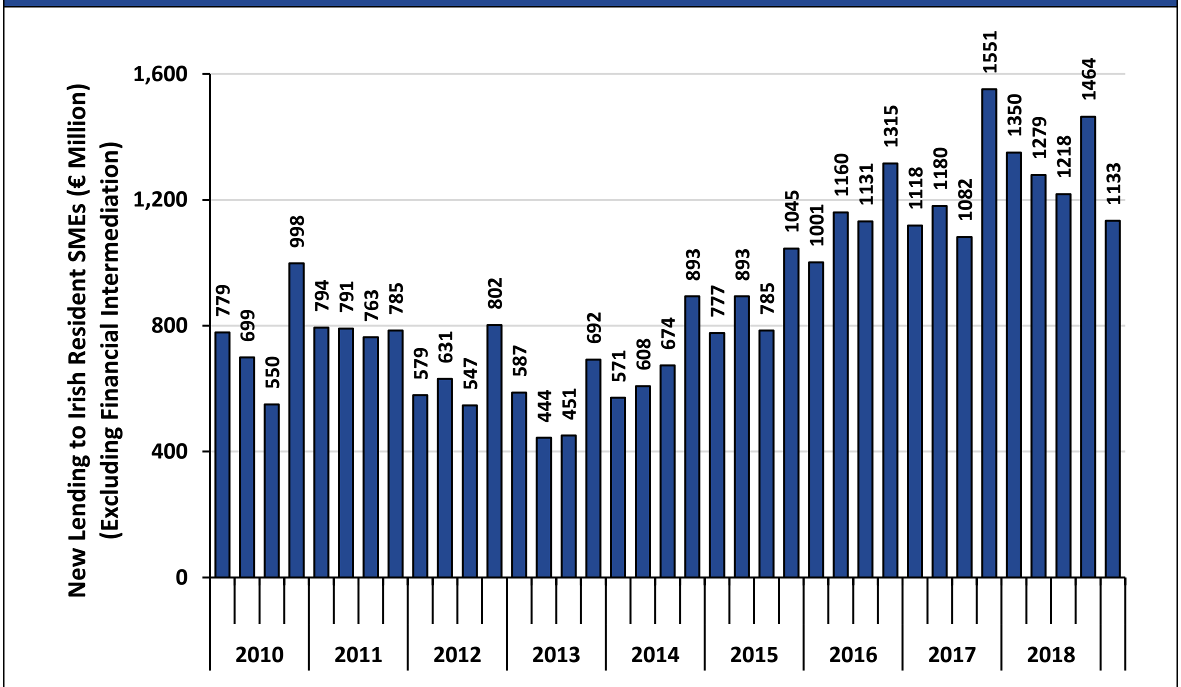
Figure 2.6: Outstanding Amounts Owed by Irish Resident SMEs as a Percentage of Total Outstanding Amounts Owed by Irish Resident Enterprises



Source: Central Bank of Ireland data

Despite the decline in the levels of outstanding lending to Irish resident SMEs, there has been significant growth in new lending. By 2018, new lending amounted to €5.3 billion, compared to €2.17 billion in 2013.

Figure 2.7: New Gross Lending to Irish SMEs (€ Million)



Source: Central Bank of Ireland data

An analysis of credit to Irish resident SMEs by sector shows that primary industries (which includes agriculture), real estate activities, wholesale/retail trade and construction accounted for 63.6% of new lending to Irish resident SMEs in the first quarter of 2019.

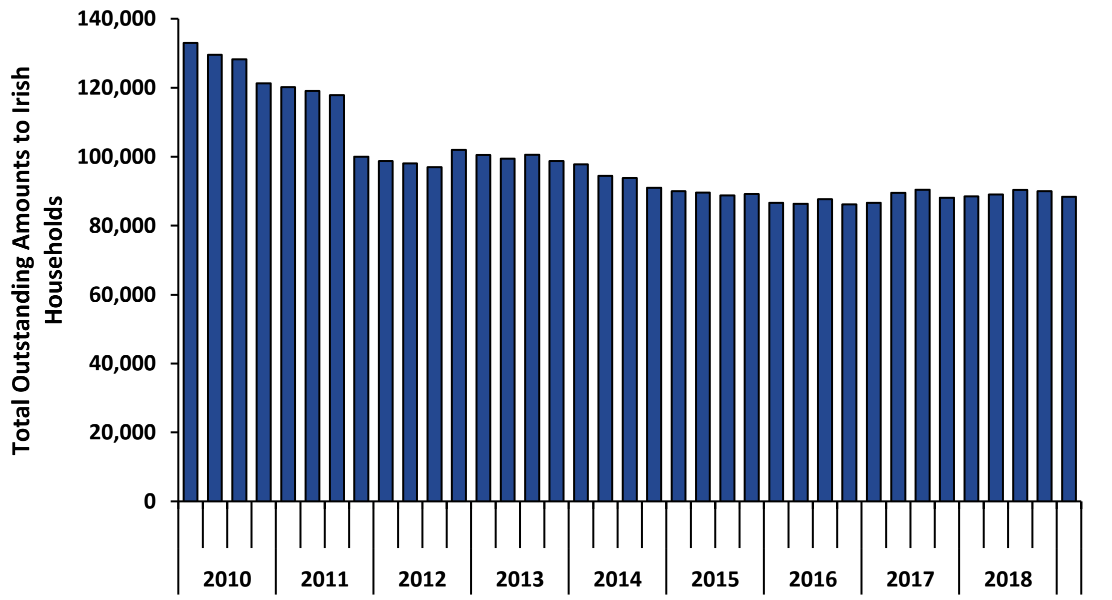
Table 2.10: Credit Advanced to Irish Resident SMEs (Q1 2019)

	Outstanding Amount (€ Million)	New Lending (€ Million)
1. Primary Industries	3,509	217
2. Manufacturing	1,164	79
3. Electricity, Gas, Steam and Air Conditioning Supply	283	3
4. Water Supply, Sewerage, Waste Management and Remediation Activities	11	..
5. Construction	472	111
6. Wholesale/Retail Trade & Repairs	3,150	188
7. Transportation and Storage	566	65
8. Hotels and Restaurants	2,243	81
9. Information and Communication	132	20
10. Financial Intermediation (Excl. Monetary Financial Institutions)	112	7
11. Real Estate Activities	7,236	210
12. Business and Administrative Services	1,113	78
13. Other Community, Social and Personal Services	1,108	41
14. Education	185	4
15. Human Health and Social Work	890	35
16. Total	**22,174**	**1,141**
16.1 Total ex. Financial Intermediation	**22,062**	**1,133**

Source: Central Bank of Ireland

It is also useful to consider the level of outstanding credit to Irish households which amounted to just under €90 billion in 2019.

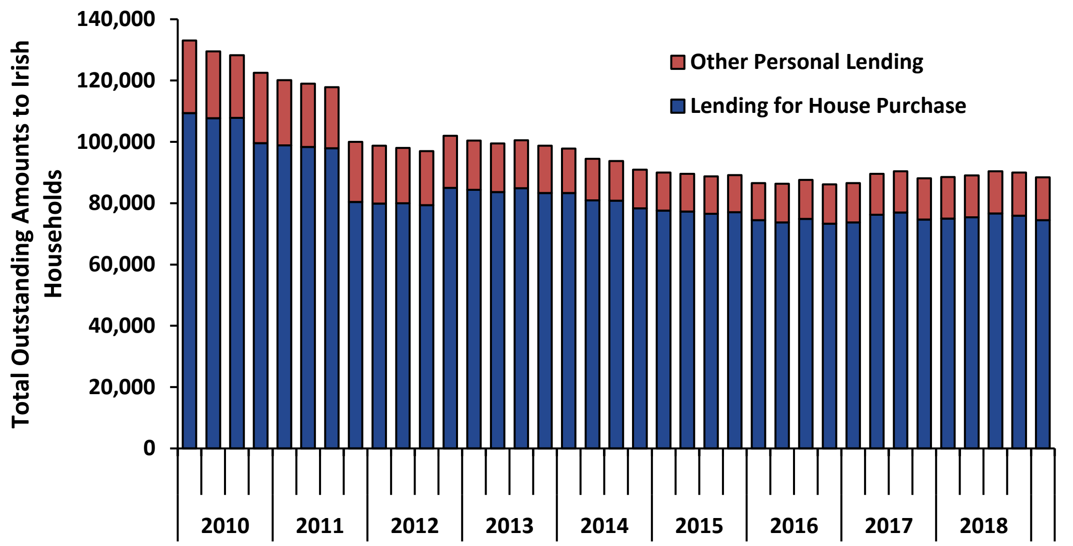
Figure 2.8: Total Outstanding Amounts Owed by Irish Households



Source: Central Bank of Ireland data

Lending for house purchases accounted for over 84% of the outstanding amount owed by Irish households in 2019 Q1.

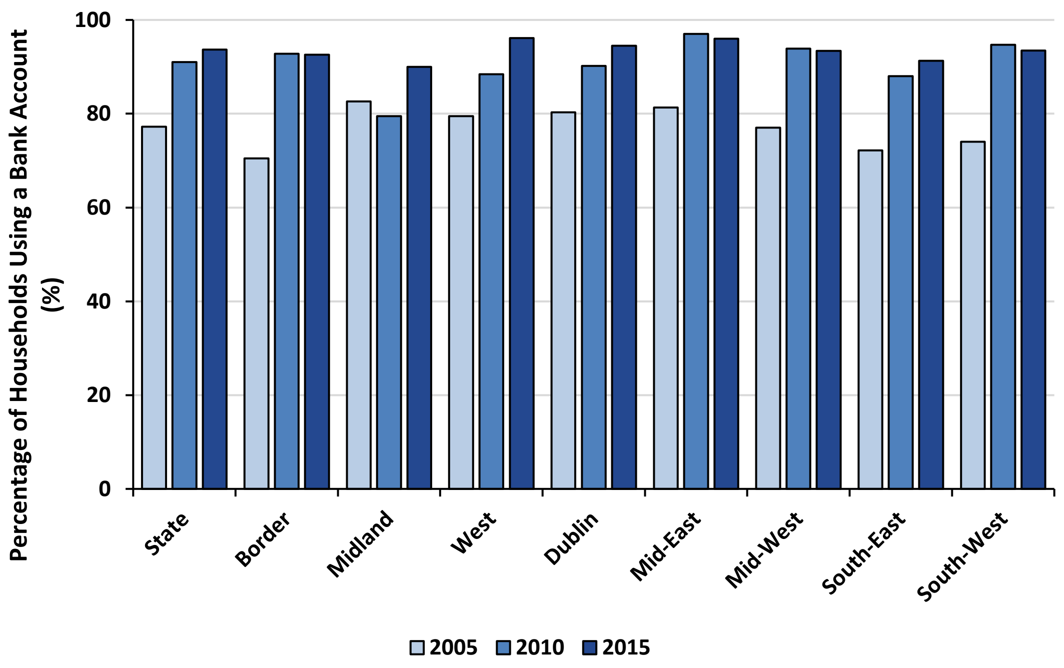
Figure 2.9: Total Outstanding Amounts Owed by Irish Households by Type of Lending



Source: Central Bank of Ireland data

In reviewing the provision of local banking and financial services in Ireland, Indecon notes that there has been a marked increase in the percentage of households using a current bank account. This has risen from 77.2% to 93.2% between 2005 and 2015.

Figure 2.10: Percentage of Households Using a Current Bank Account (2005-2015)



Source: Indecon presentation of Household Budget Survey data

2.5 Summary of Key Findings

- In assessing whether there is "market failure" in the local provision of banking and financial services in Ireland, it is useful to first examine the levels of existing provision of banking/financial services and the wider economic and demographic context in which the sector operates.
- Indecon's analysis highlights the extent of population concentration in Ireland where nearly 40% of the total population lives in Dublin and Cork. There are marked differences in the percentage of the population in each county living in rural areas. High levels of rurality and the resultant low levels of population density have implications for the number of bank branches which are commercially viable. This can impact on the ease of access for the public and for businesses.
- Indecon notes that the percentage of the population living in rural areas has declined and these areas have a higher percentage of older individuals. A related issue is the level of internet/broadband access, as online banking can help reduce the need to use a local bank branch for certain services. The evidence indicates that over a quarter of households in some of the more rural counties do not have internet access, while many rural counties also fall significantly below the urban and national averages in relation to higher speed broadband access. In the absence of other supports, poor internet and broadband access restricts the ability of these households to access online financial services, and increases the risk of financial exclusion. The National Broadband Plan (NBP) however is designed to address the challenges posed by poor broadband availability in rural and other under-served locations. The overall goal of the NBP, the contract for which was signed by the Government on 19th November 2019, is to deliver a high-speed broadband service to over 540,000 premises throughout Ireland that are currently without such a service. The plan aims to bring high-speed connectivity to those living in rural areas who cannot obtain such a service from commercial operators. The importance of the NBP in the context of community banking services is that the investment in high-speed internet services will facilitate the development of online banking delivery channels and make is easier for consumers and businesses to access these services.
- Our analysis of the enterprise sector shows that there are over 266,000 SMEs registered in Ireland and the number of enterprises has been growing. 55% of these enterprises are based outside of Dublin and Cork. Over 90% of the enterprises in Ireland are micro-enterprises with fewer than 10 employees.
- In order to meet the needs of the population and of the enterprise sector, there is an extensive branch network and a wide range of services provided by banks, credit unions, An Post and non-traditional providers. Indecon's research indicates that there are 1,912 branches operated by banks, credit unions and post offices in Ireland. Over 63% of these branches are provided by credit unions or An Post, whilst banks account for nearly 37% of local branches. While Dublin has the highest absolute number of branches of financial providers at 393, the number of branches per SME, and as a percentage of the population, is low in Dublin. The evidence also shows that there is a higher number of branches per SME and per capita in many of the counties where a significant percentage of the population lives in rural areas.

- An analysis of the provision of credit to Irish-resident enterprises indicates that the stock of credit owed by Irish resident SMEs have fallen from €59 billion at the end of 2012 to €22 billion at the beginning at 2019, a decline of 62.7% over this period. However, there has been significant growth in new lending, and by 2018 new lending to SMEs amounted to €5.3 billion, compared to €2.17 billion in 2013.

3 Role of Credit Unions as Critical Element of Community Banking

3.1 Credit Union Branch Network

A distinctive feature of the Irish local financial market is the role played by the credit union movement. Indecon believes that credit unions are critical elements of community banking. This was highlighted by the Irish League of Credit Unions, who indicated that credit unions are what Irish people consider to be by another name, i.e., community banking. In our consultation programme, CUMA, the Credit Union Managers' Association, also pointed out that the credit union movement is on the ground and in communities throughout Ireland. Indecon also notes the valuable inputs to our consultation from CUDA, the Credit Union Development Association, which pointed out the benefits of broader availability of banking services in our communities and the role which credit unions play. The following table provides details on the number of credit union branches relative to population by county.[17] Leitrim and Monaghan each have seven credit union branches and are the two highest counties in terms of credit union branches per 10,000 people.

Table 3.1: Number of Credit Unions relative to Population by County

County	Number of Credit Union Branches	Credit Union Branches per 10,000 People
Leitrim	7	2.2
Monaghan	7	1.1
Longford	4	1.0
Louth	12	0.9
Cavan	6	0.8
Limerick	15	0.8
Carlow	4	0.7
Donegal	11	0.7
Tipperary	11	0.7
Offaly	5	0.6
Roscommon	4	0.6
Waterford	7	0.6
Cork	30	0.6
Mayo	7	0.5
Meath	10	0.5
Kilkenny	5	0.5
Sligo	3	0.5
Dublin	61	0.5
Galway	11	0.4
Wicklow	6	0.4
Clare	5	0.4
Kerry	6	0.4
Laois	3	0.4
Westmeath	3	0.3
Wexford	5	0.3
Kildare	6	0.3
Total	254	0.5

Source: Central Bank of Ireland (credit unions), An Post and Indecon research

[17] It should be noted that some of credit unions may be a branch of a larger credit union, while others are individual credit union entities.

Credit unions play a very important role in addressing social as well as economic issues. An analysis by Indecon of the number of credit unions compared to the number of older individuals living alone by county demonstrates the potential role of this network in reducing financial exclusion.

Table 3.2: Existing Credit Unions in Ireland Compared to Population Over 65 Living Alone

	Number of People Aged 65 and over Living Alone	Number of Credit Unions Per 1,000 People Over 65 Living Alone
Leitrim	1,645	4.26
Monaghan	2,234	3.13
Louth	3,995	3.00
Longford	1,627	2.46
Meath	4,411	2.27
Cavan	2,755	2.18
Carlow	1,837	2.18
Limerick	6,892	2.18
Offaly	2,437	2.05
Tipperary	6,369	1.73
Donegal	6,576	1.67
Cork	18,223	1.65
Waterford	4,340	1.61
Kilkenny	3,203	1.56
Dublin	40,271	1.51
Wicklow	4,049	1.48
Roscommon	2,919	1.37
Kildare	4,561	1.32
Galway	8,434	1.30
Laois	2,373	1.26
Mayo	5,967	1.17
Clare	4,529	1.10
Westmeath	2,785	1.08
Sligo	2,809	1.07
Kerry	6,191	0.97
Wexford	5,367	0.93

Source: Various. Note: Population based on 2016 Census.

While credit unions are not currently very active in the SME market, the network of credit unions in a number of rural counties suggests this is a potential delivery mechanism for certain SME services.

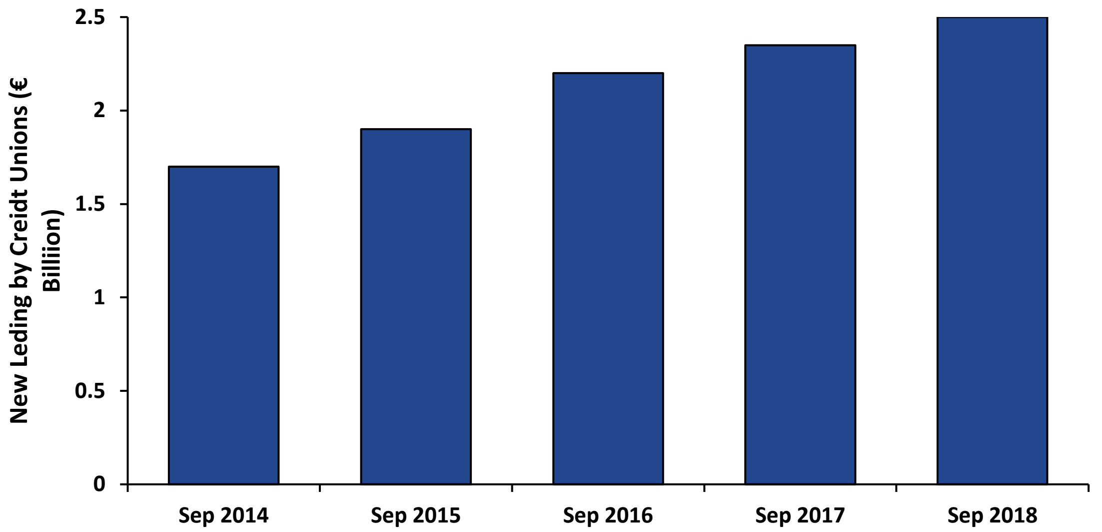
Table 3.3: Existing Credit Union Branch Coverage relative to Number of Active SMEs		
	Number of Active SMEs	**Number of Credit Unions Per 1,000 SMEs**
Leitrim	1,906	3.67
Monaghan	3,314	2.11
Longford	1,950	2.05
Louth	6,619	1.81
Limerick	9,546	1.57
Cavan	4,042	1.48
Carlow	2,738	1.46
Offaly	3,438	1.45
Tipperary	7,956	1.38
Donegal	8,130	1.35
Roscommon	3,103	1.29
Waterford	5,457	1.28
Kilkenny	4,658	1.07
Cork	29,993	1.00
Meath	10,245	0.98
Laois	3,101	0.97
Mayo	7,285	0.96
Sligo	3,326	0.90
Galway	14,543	0.76
Wicklow	8,270	0.73
Clare	7,056	0.71
Dublin	87,463	0.70
Kerry	8,837	0.68
Westmeath	4,777	0.63
Wexford	7,975	0.63
Kildare	11,204	0.54
Total	**266,932**	**0.95**

Source: Various. Note: Enterprise data based on 2017 Business Demography.

3.2 Significance of Credit Unions in Provision of Financial Services

The significance of credit unions in the Irish community banking market is reflected in the level of new lending provided by credit unions which has increased from €1.7 billion in 2014 to €2.5 billion in 2018.

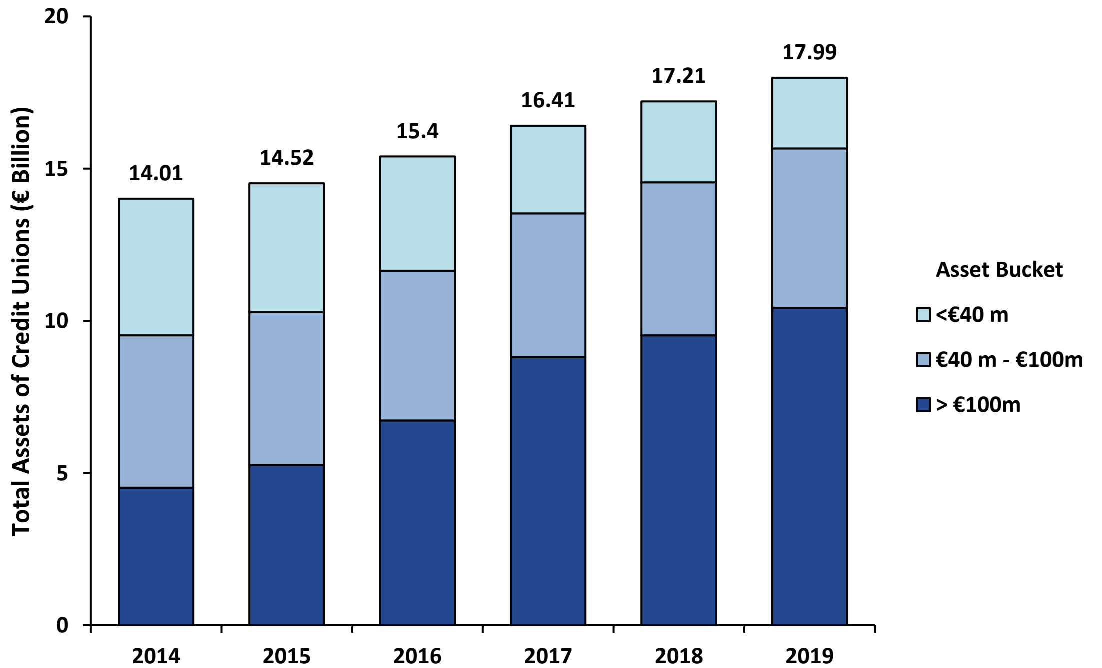
Figure 3.1: Credit Union New Lending (€ Billion) (2014-2018)



Source: Central Bank of Ireland

There has been growth in the larger credit unions, and these accounted for over 56% of the total value of assets in 2018, compared to just under a third in 2013. The increase in the scale of these credit unions offers the potential for the provision of a wider range of community banking services.

Figure 3.2: Value of Total Assets of Credit Unions by Asset Category (2014-2019)



Source: Central Bank of Ireland

The following table shows the value of outstanding credit union loans which amounted to €5 billion. Of this, a small percentage is accounted for by commercial loans. However, the level of commercial loans increased by over 80% between September 2016 and June 2019.

Table 3.4: Gross Credit Union Loans Outstanding (€ Million)

	Personal Loans	House Loans	Commercial Loans	Community Loans	Other Loans	Total
Sep-16	3,913.4	112.6	62.1	13.7	44.2	**4,146.1**
Dec-16	3,952.8	127.3	62.1	17.4	7.0	**4,166.6**
Mar-17	4,017.5	138.1	67.0	18.0	4.7	**4,245.2**
Jun-17	4,107.7	154.5	74.1	12.8	3.9	**4,353.0**
Sep-17	4,191.0	146.3	77.8	14.5	25.5	**4,455.1**
Dec-17	4,224.3	153.4	79.2	13.6	7.1	**4,477.5**
Mar-18	4,280.8	160.2	84.4	14.2	2.5	**4,542.0**
Jun-18	4,373.6	164.8	91.1	14.5	29.9	**4,673.9**
Sep-18	4,507.0	171.2	92.5	15.0	3.3	**4,789.1**
Dec-18	4,514.8	173.1	99.0	15.1	4.1	**4,806.1**
Mar-19	4,572.7	176.3	106.2	15.1	4.3	**4,874.6**
Jun-19	4,673.9	182.2	112.7	14.1	5.3	**4,988.1**

Source: Central Bank of Ireland

Indecon notes that credit unions are subject to specific regulations in relation to lending to SMEs. In their presentation to the Joint Committee on Business, Enterprise and Innovation,[18] the Credit Union Development Association outlines the impact of additional regulations with regards to lending to SMEs as follows:

> *"The regulations impacting credit unions have a disproportionate impact on credit unions due to the prudential restrictions imposed on them that far exceeds those placed on other competing financial service providers for this business. Credit Unions are restricted to lending category limits as well as loan term limits which do not apply to other lenders."*

Under the requirements of the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016, credit unions are currently required to abide by a concentration limit for commercial lending of 50% of regulatory reserves. Credit unions are also subject to loan maturity limits and large exposure limitations. Indecon understands that, as of September 2019, 90 credit unions had zero outstanding commercial loans as a percentage of regulatory reserve. A further 101 credit unions had up to 10% and an additional 37 had between 10%-25%. A total of nine had between 25% and 40%, and only four credit unions had over 40% outstanding commercial loans as a percentage of the regulatory reserves.

[18] Credit Union Development Association, presentation to joint committee on business, enterprise and innovation, January 2018

As part of a review of the lending framework for credit unions, the Central Bank issued a consultation paper, CP125, in October 2018. Following feedback received from stakeholders as part of the consultation process, the Central Bank set out draft amendments to the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 in July this year. The Central Bank received further feedback from stakeholders based on the draft amendments proposed and recently published a feedback statement and a final draft of the amendments.

One of the proposals put forward in these regulations is a combined concentration limit for house and business loans. The proposal will allow 7.5% (or 10% of assets if compliant with certain criteria) in house and business lending combined, while also containing a 5% inner limit for business lending. The definition of business lending is also changing to include business loans below €25,000, which were previously categorised as personal lending.

Under the current regulations, the concentration limit for commercial lending is 50% of regulatory reserves. However, any commercial loan issued with a value of less than €25,000 does not currently utilise this concentration limit. For loans issued greater than €25,000, there are specific underwriting and reporting requirements.

The purpose of the amended regulations is to allow the credit union sector to develop a sustainable business model to ensure the long-term viability of the sector. At present, credit unions are operating in an extremely challenging economic conditions with a fall in investment returns combined with an increase in deposits, and loan books that are not growing much faster than deposits. The new regulations, therefore, must provide the sector with sufficient capacity, flexibility, and long-term certainty. It is not clear to Indecon whether the combined limit will impact, positively or negatively, the potential for credit unions, particularly community credit unions, to invest appropriately to scale up business lending. This merits on-going consideration by the Central Bank and the CUAC.

Indecon believes that important recent developments in the credit union sector will further strengthen community banking. These include the home-loan shared services projects by ILCU and separately by CUDA, and the launching of ventures on retro-fitting homes. We also note significant new initiatives by the credit union movement to expand their services, notably Cultivate (agri-lending), Payac (current accounts), CUSOP (payments) and Metamo (the joint venture between sixteen credit unions and Fexco). Some of these developments are discussed below.

Payac was established by a group of credit unions to provide current accounts, debit cards and related services to credit union members. The company assists credit unions in obtaining regulatory approval, and in developing, implementing and providing ongoing support for payment account services. This includes setting policies, procedures, operating standards and negotiating third-party services and outsourcing arrangements. Payac formally launched a new current account service for its member credit unions in October 2019. This new product gives account-holders access to contactless payments, standing orders, direct debits, and an overdraft facility. The accounts are being made in over 30 credit unions, with 115 branches throughout the country, under the brand 'currentaccount.ie'. These accounts can be opened online or in person at a participating credit union branch, and will have access to debit cards with contactless payments, direct debits and overdraft facilities. The overdraft facilities are limited to an amount equal to monthly income, within the range of €200 - €5,000. The maintenance fee for these accounts is €4 per month, charged quarterly, whilst debit card transactions and direct debits are free.

Separately, CUSOP was established in 2013 and provides access to electronic payment systems to 167 credit unions, with another 25 credit unions scheduled to join. CUSOP is a not-for-profit body owned by the CUSOP Trust, on behalf of participating credit unions.

Cultivate is an initiative of a group of credit unions that provides short- to medium-term loan opportunities for farmers. It is a result of a collaboration between 26 credit unions based mainly in the Midlands, West and South West. The Cultivate farm loan scheme offers farmers unsecured loans of up to €50,000, which can be repaid over a period of seven years.

The Nurture Fund is an innovative programme launched in 2019 by Dundalk Credit Union in partnership with Louth County Enterprise Fund. The fund offers €25,000 in loan finance to start-up businesses and €50,000 for established businesses. The €1 million business fund aims to support the following sectors: engineering, manufacturing, energy and environment, financial services, digital technologies and tourism. In addition to their role in providing credit for small businesses and others, the credit unions were critical players in the Personal Micro Credit Loan Scheme.

The Personal Micro Credit Loan (PMC loan scheme) began as a pilot scheme supported by the Government in November 2015, to ensure that there is access to alternative finance for low income customers. The scheme was designed to provide a credible alternative to moneylenders. The initiative is included in the current Programme for a Partnership Government which states: "*Specifically we support …. The rollout and extension of the Personal Microcredit Scheme, which is providing simple microloans to members and helping to combat the use of moneylenders.*" Loans under the initiative are provided by participating credit unions and are branded as "It Makes Sense" loans. Loans range between €100 and €2,000 with a maximum APR of 12.68%. In order to qualify for an It Makes Sense Loan, an individual must:

- Either be a credit union member or join a credit union;
- Be in receipt of a social welfare payment; and
- Agree to repay the loan through the Household Budget Scheme or by standing order or direct debit if your social welfare payment is paid electronically.

To date, the scheme has been adopted by 100 credit unions, but promotion and uptake remain limited. Many of those seeking the PMC loan may have been entitled to access standard loans and this is likely to have contributed to the relatively low uptake. The PMC loan is only targeted at social welfare users which make up a relatively small percentage of licenced moneylender customers and thus should not be looked at in isolation.

A number of challenges exist with the PMC initiatives including the need for a larger number of credit unions to provide PMC loans to ensure that there is a national alternative to licenced moneylenders, and the challenge of encouraging individuals to switch from moneylenders to credit unions.

The PMC Task Force was set up on a non-Governmental basis in 2018 to address these challenges. The Task Force is chaired by the Citizens Information Board/MABS, and as the subject matter crosses over a number of areas of expertise and responsibilities, the Task Force is made up of representatives from a number of stakeholder bodies. These stakeholders include the Citizens Information Board, the Central Bank of Ireland, the Department of Employment Affairs and Social Protection, the Social Finance Foundation, a number of credit union representative bodies and the Department of Finance. Indecon believes that this Task Force has a critical role to play in developing policies to enhance the impact of the PMC initiative.

3.3 Summary of Key Findings

- A distinctive feature of the Irish local financial market is the role played by the credit union movement. Indecon believes that credit unions are critical elements of community banking. This was highlighted by the Irish League of Credit Unions, who indicated that credit unions are what Irish people consider to be by another name, i.e., community banking. In our consultation programme, CUMA, the Credit Union Managers' Association, also pointed out that the credit union movement is on the ground and in communities throughout Ireland.
- The significance of credit unions in the Irish community banking market is reflected in the level of new lending provided by credit unions which has increased from €1.7 billion in 2014 to €2.5 billion in 2018. There has been growth in the larger credit unions, and these accounted for over 56% of the total value of assets in 2018, compared to just under a third in 2013. The increase in the scale of these credit unions offers the potential for the provision of a wider range of community banking services.
- Indecon believes that important recent developments in the credit union sector will further strengthen community banking. These include the home-loan shared services projects by ILCU and separately by CUDA, and the launching of ventures on retro-fitting homes. We also note significant new initiatives by the credit union movement to expand their services, notably Cultivate (agri-lending), Payac (Current accounts), CUSOP (payments) and Metamo (the joint venture between sixteen credit unions and Fexco.)

4 Development of An Post Financial Services

4.1 An Post Branch Network

An Post has a large number of post offices and is present in every county. While there has been a decline in the number of post offices, there are currently 956 Post Offices in Ireland. The following table shows that more rural counties tend to have a higher number of post office branches per 10,000 people.

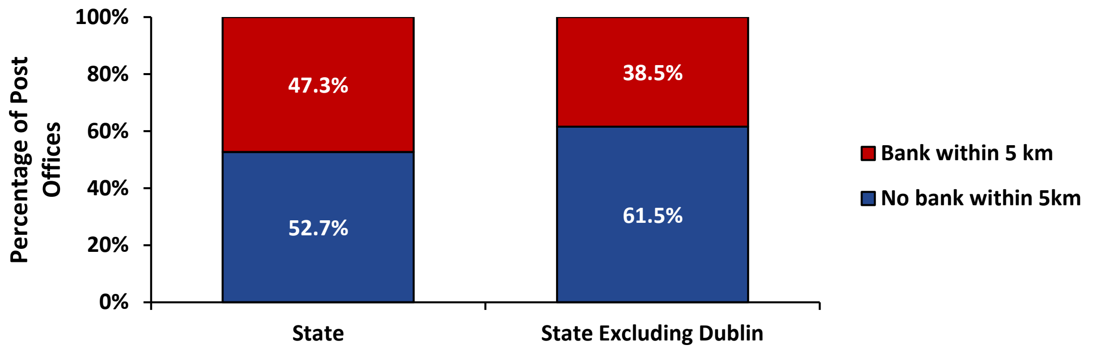
Table 4.1: Number of Post Office Branches relative to Population by County

County	Number of Post Office Branches	Post Office Branches per 10,000 People
Leitrim	13	4.1
Donegal	58	3.6
Mayo	47	3.6
Roscommon	21	3.3
Kerry	47	3.2
Clare	33	2.8
Sligo	18	2.7
Longford	11	2.7
Galway	68	2.6
Cavan	20	2.6
Wexford	38	2.5
Tipperary	40	2.5
Westmeath	21	2.4
Limerick	46	2.4
Offaly	18	2.3
Cork	124	2.3
Monaghan	14	2.3
Waterford	23	2.0
Louth	25	1.9
Carlow	11	1.9
Kilkenny	19	1.9
Laois	16	1.9
Meath	32	1.6
Wicklow	23	1.6
Kildare	25	1.1
Dublin	145	1.1
Total	**956**	**2.0**

Source: Indecon analysis of Census 2016 data and An Post data

New analysis of An Post data by Indecon confirms that there is a significant branch network of post offices in geographic areas where there is no bank branch within five kilometres.

Figure 4.1: Post Office Branches by whether Bank Branch within 5 Kilometres (2019)



Source: An Post

In a number of rural counties, there are high percentages of post offices in areas where there is no bank within five kilometres.

Table 4.2: Analysis of Proximity of Post Office and Bank Branches by County (2019)

	Number of Post Offices	Number of Post Offices Without a Bank Within 5km	Number of Post Offices with a Bank Within 5km	Percentage of Post Offices Without a Bank Within 5km
Donegal	58	45	13	77.6%
Wexford	38	28	10	73.7%
Longford	11	8	3	72.7%
Mayo	47	34	13	72.3%
Sligo	18	13	5	72.2%
Kerry	47	32	15	68.1%
Roscommon	21	14	7	66.7%
Offaly	18	12	6	66.7%
Galway	68	45	23	66.2%
Tipperary	40	26	14	65.0%
Monaghan	14	9	5	64.3%
Westmeath	21	13	8	61.9%
Limerick	46	28	18	60.9%
Cavan	20	12	8	60.0%
Clare	33	19	14	57.6%
Meath	32	18	14	56.3%
Cork	124	69	55	55.6%
Carlow	11	6	5	54.5%
Leitrim	13	7	6	53.8%
Kilkenny	19	10	9	52.6%
Laois	16	8	8	50.0%
Louth	25	12	13	48.0%
Wicklow	23	11	12	47.8%
Kildare	25	11	14	44.0%
Waterford	23	9	14	39.1%
Dublin	145	5	140	3.4%

Source: Indecon analysis of An Post data

Post offices are also important in providing services to older individuals living alone and represent a critical network to reduce the risk of financial exclusion.

Table 4.3: Existing Post Offices in Ireland Compared to Population Over 65 Living Alone

	Number of People Aged 65 and over Living Alone	Number of Post Offices Per 1,000 People Over 65 Living Alone
Donegal	6,576	8.82
Galway	8,434	8.06
Leitrim	1,645	7.90
Mayo	5,967	7.88
Kerry	6,191	7.59
Westmeath	2,785	7.54
Offaly	2,437	7.39
Clare	4,529	7.29
Cavan	2,755	7.26
Meath	4,411	7.25
Roscommon	2,919	7.19
Wexford	5,367	7.08
Cork	18,223	6.80
Longford	1,627	6.76
Laois	2,373	6.74
Limerick	6,892	6.67
Sligo	2,809	6.41
Tipperary	6,369	6.28
Monaghan	2,234	6.27
Louth	3,995	6.26
Carlow	1,837	5.99
Kilkenny	3,203	5.93
Wicklow	4,049	5.68
Kildare	4,561	5.48
Waterford	4,340	5.30
Dublin	40,271	3.60

Source: Various. Note: Population based on 2016 Census.

An Post currently provides a range of services to SMEs working with other financial institutions. The network of post offices provides a potential delivery channel to supply services to SMEs and to the wider population particularly in a number of the more rural counties (see table overleaf).

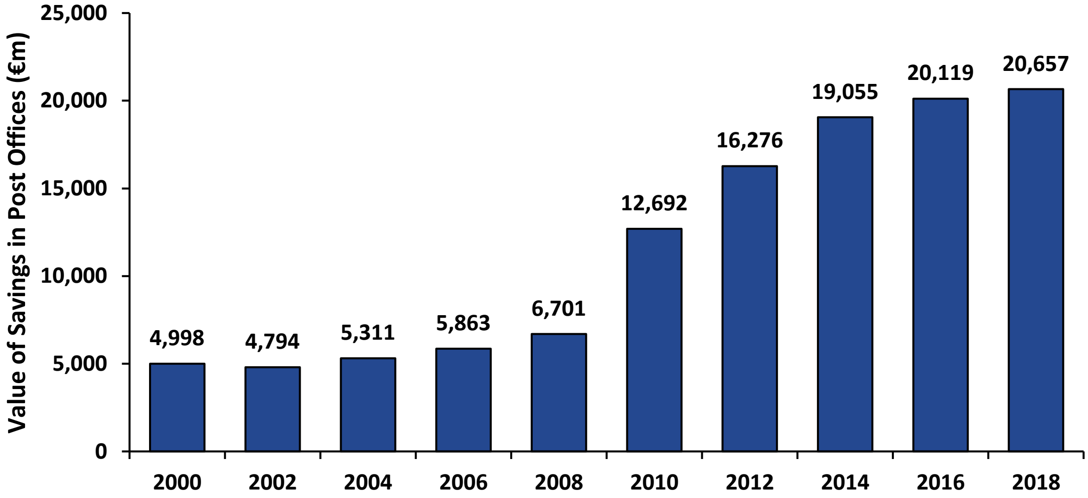
Table 4.4: Existing Post Office Branch Coverage relative to Number of Active SMEs		
	Number of Active SMEs	**Number of Post Offices Per 1,000 SMEs**
Donegal	8,130	7.13
Leitrim	1,906	6.82
Roscommon	3,103	6.77
Mayo	7,285	6.45
Longford	1,950	5.64
Sligo	3,326	5.41
Kerry	8,837	5.32
Offaly	3,438	5.24
Laois	3,101	5.16
Tipperary	7,956	5.03
Cavan	4,042	4.95
Limerick	9,546	4.82
Wexford	7,975	4.76
Clare	7,056	4.68
Galway	14,543	4.68
Westmeath	4,777	4.40
Monaghan	3,314	4.22
Waterford	5,457	4.21
Cork	29,993	4.13
Kilkenny	4,658	4.08
Carlow	2,738	4.02
Louth	6,619	3.78
Meath	10,245	3.12
Wicklow	8,270	2.78
Kildare	11,204	2.23
Dublin	87,463	1.66
Total	**266,932**	**3.58**

Source: Various. Note: Enterprise data based on 2017 Business Demography.

4.2 An Post Financial Services

An Post provides certain financial services for retail customers and SMEs. These include services in the areas of savings, lending, payment and insurance. Within the savings market, there has been a growing significance of An Post, with which the overall value of savings reached €20 billion in 2018. This reflects the role of An Post as an agent for state savings including for basic savings accounts and longer-term savings options.

Figure 4.2: Value of Savings in Post Offices (€ Million) (2000-2018)



Source: An Post

In examining the provision of financial services by An Post, Indecon notes that in collaboration with Avantcard, An Post launched a new customer lending facility in 2019. This allows customers to apply for loans of between €5,000 and €75,000, with maturities of between one and seven years. An Post Money Credit Card is also available and car loans are also provided. Significantly, the An Post Money Current Account was introduced which offers the functionality of the traditional bank current account. In terms of the SME sector, over-the-counter banking transactions are provided by An Post for customers of Irish banks and An Post provides merchant acquiring services. An Post also provides motor and home insurance policies and other insurance products. Indecon understands that An Post has ambitious plans to further expand their services as an intermediary.

4.3 Summary of Key Findings

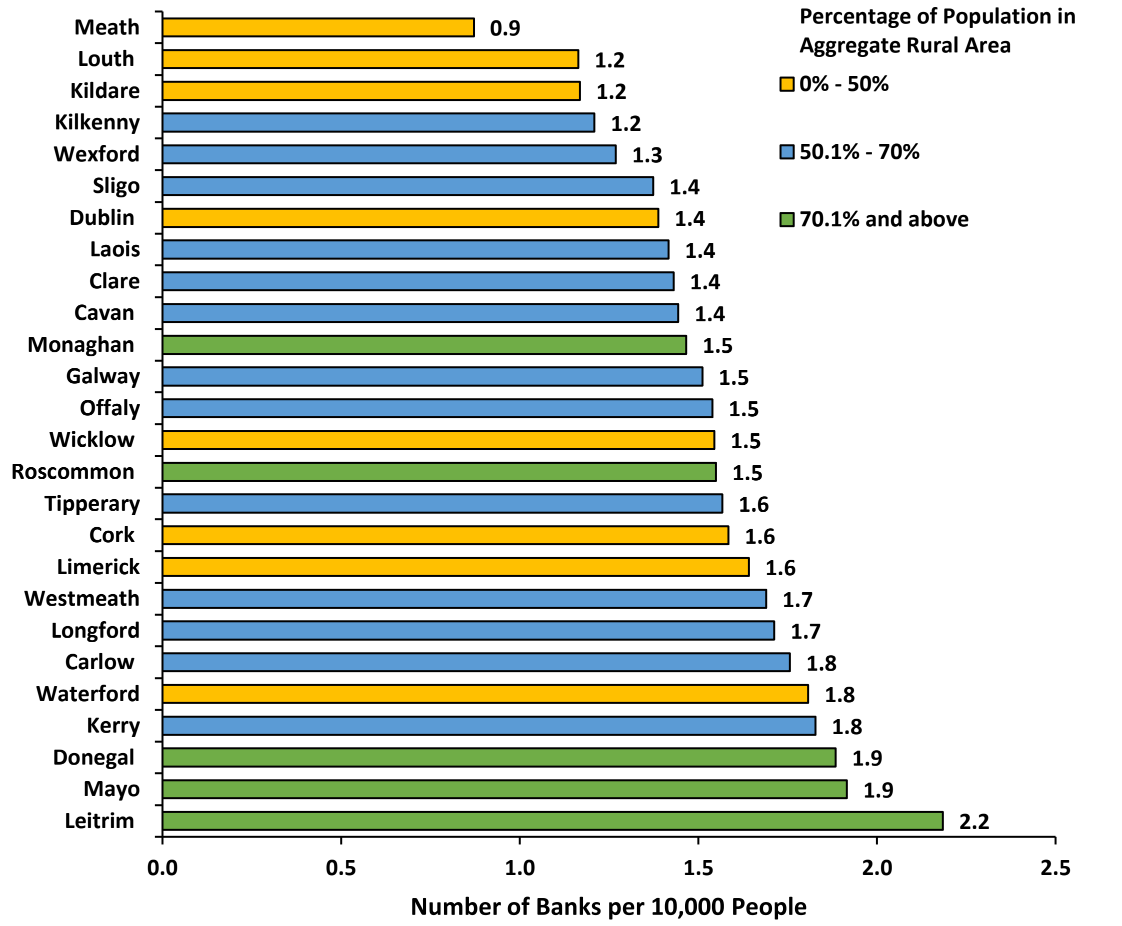
- An Post has a large number of post office branches in every county. New analysis of An Post data by Indecon has indicated that 52.7% of these post offices are in geographic areas where there is no bank branch within five kilometres. Through this network, and via other delivery channels, An Post provides a range of banking services.
- There has been a number of recent developments by An Post in the lending market. In collaboration with Avantcard, An Post launched a new customer lending facility in 2019. This allows customers to apply for loans of between €5,000 and €75,000, with maturities of between one and seven years. Recent introduction of An Post Money Current Account offers the functionality of the traditional bank current account. Indecon understands An Post has ambitious plans to further expand their services as an intermediary.

5 Analysis of Commercial Banking Providers

5.1 Commercial Bank Network

There is a large network of 702 bank branches in Ireland. Indecon research shows that some counties, including those with high levels of rural population, have a high number of bank branches per capita. Despite the overall number of branches, where the population is dispersed, local access to bank branches can be restricted and there is a challenge for the banking sector to sustain the viability of the existing branches in areas of low population. In this context, we note the recent announcement by Permanent TSB to close around a fifth of its 77-strong branch network.

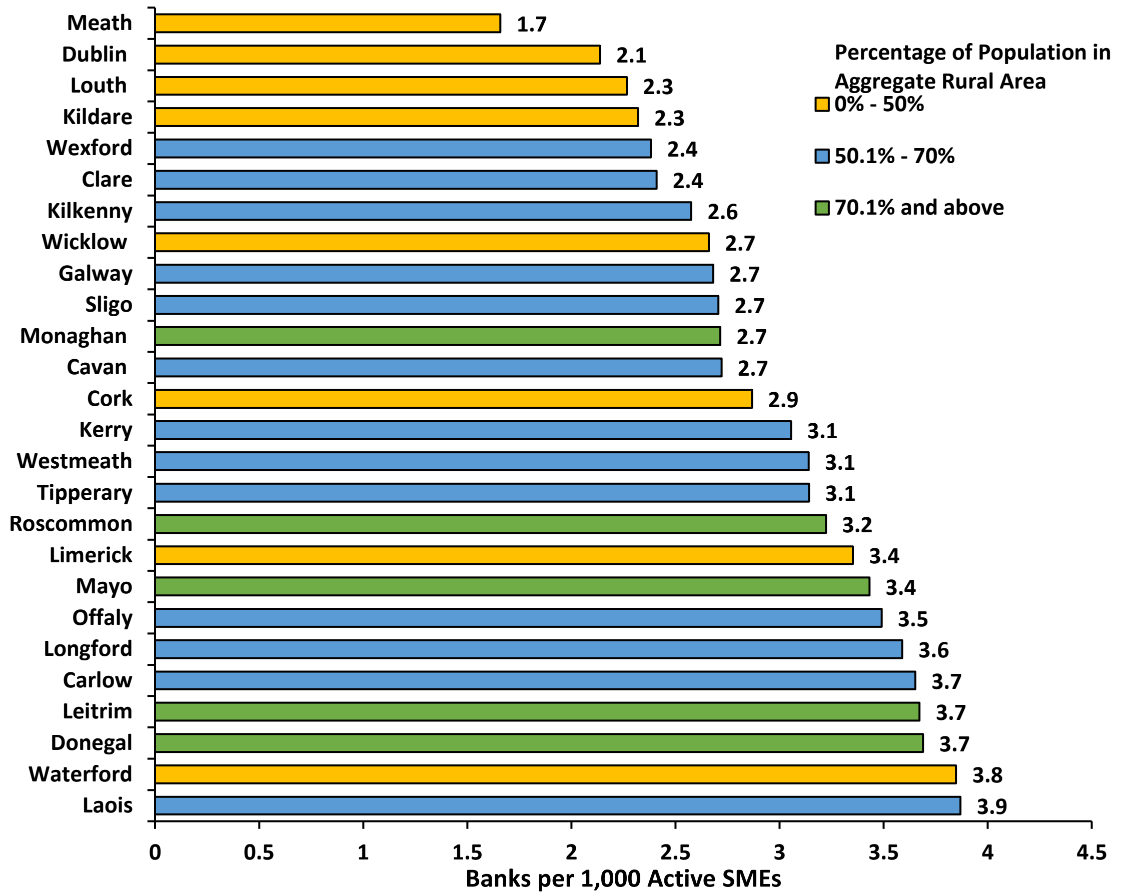
Figure 5.1: Number of Bank Branches per 10,000 Persons by County in Ireland



Source: Indecon research on individual banks and analysis of Census 2016 data

In considering supports for the SME sector, it is useful to consider the number of branches per 1,000 active SMEs. The results show that higher levels of bank branches per SME are evident in a number of counties where there is a high level of rural population.

Figure 5.2: Number of Bank Branches per 1,000 Active SMEs by County in Ireland



Source: Indecon research on individual banks and analysis of CSO Business Demography data

An important element in assessing the risk of financial exclusion is the number of bank branches compared to the population aged 65 and over who are living alone. Those in more rural areas, marked in green in the following table, have lower numbers of banks per 1,000 people aged 65 and over who are living alone.

Table 5.1: Existing Bank Branches in Ireland Compared to Population Over 65 Living Alone			
	Number of Banks	Number of People Aged 65 and over Living Alone	Number of Banks Per 1,000 People Over 65 Living Alone
Kildare	26	4,561	5.70
Carlow	10	1,837	5.44
Wicklow	22	4,049	5.43
Westmeath	15	2,785	5.39
Laois	12	2,373	5.06
Offaly	12	2,437	4.92
Waterford	21	4,340	4.84
Cork	86	18,223	4.72
Dublin	187	40,271	4.64
Limerick	32	6,892	4.64
Galway	39	8,434	4.62
Donegal	30	6,576	4.56
Kerry	27	6,191	4.36
Longford	7	1,627	4.30
Leitrim	7	1,645	4.26
Mayo	25	5,967	4.19
Monaghan	9	2,234	4.03
Cavan	11	2,755	3.99
Tipperary	25	6,369	3.93
Meath	17	4,411	3.85
Louth	15	3,995	3.75
Clare	17	4,529	3.75
Kilkenny	12	3,203	3.75
Wexford	19	5,367	3.54
Roscommon	10	2,919	3.43
Sligo	9	2,809	3.20

Source: Various. Note: Population based on 2016 Census.

5.2 Range of Services Provided

The main banks in Ireland provide an extensive range of financial services. These include both personal and commercial banking products. Personal banking services provided include: savings accounts, current accounts, consumer lending and overdraft facilities, credit cards, debit cards, mortgages, e-banking services, phone-banking services, insurance, investment and fund management. Commercial banking services offered by banks in Ireland typically include: funding and acquisition, leveraged acquisition finance, property finance, cash management, treasury services, trade finance, project finance, and transaction support.

The five main Irish retail banks are as follows:

- AIB Group;
- Bank of Ireland Group;
- Permanent TSB;
- Ulster Bank Ireland; and
- KBC Bank Ireland.

In reviewing commercial banking providers, of note is that Ireland has a concentrated banking sector. Over the last decade there has been a significant reduction in the number of retail banking groups operating in Ireland. For example, in 2007 there were 10 large lenders in the Irish mortgage market, which fell to just five by 2013.[19]

Table 5.2: Mortgage Lenders in th Irish market, 2007 and 2017

Mortgage Lenders in 2007	Mortgage Lenders in 2017
BOI (+ICS)	BOI
AIB (+Haven)	AIB (+Haven +EBS)
Ulster Bank	Ulster Bank
Irish Life and Permanent (PTSB)	KBC
KBC	PTSB
EBS	Dilosk
Irish Nationwide	Pepper
Dankse	
BOS (Irl)	
ACC/Rabobank	

Source: Competition and Consumer Protection Commission

5.3 Online and Other Financial Services Providers

In addition to the main banking groups there are a number of other, non-bank financial providers. These include providers who focus on online offerings of personal and business credit. There is a range of other equity providers and business angels including, for example, the Halo Business Angel Network. In addition, there are crowdfunding platforms which provide access to pillar to peer lending. There are also other niche providers of capital operating in the Irish market. These include Cardinal Capital Group, DunPort Capital Management, Beach Point Capital Management, and other providers.

[19] https://service.betterregulation.com/sites/default/files/2017-06-14-CCPC-Options-for-Irelands-Mortgage-Market.pdf

Role of National Broadband Plan

It is also important to highlight the role of the National Broadband Plan (NBP) in this context. The overall goal of the NBP, the contract for which was signed by the Government on 19th November 2019, is to deliver a high-speed broadband service to over 540,000 premises throughout Ireland that are currently without such a service. The plan aims to bring high-speed connectivity to those living in rural areas who cannot obtain such a service from commercial operators. The importance of the NBP in the context of community banking services is that the investment in high-speed internet services will facilitate the development of online banking delivery channels and make is easier for consumers and businesses to access these services.

5.4 Summary of Key Findings

- There is a large network of 702 bank branches in Ireland. Indecon research shows that some counties including those with high levels of rural population have a high number of bank branches per capita. Despite the overall number of branches, where the population is dispersed, local access to bank branches can be restricted and there is a challenge for the banking sector to sustain the viability of the existing branches in areas of low population. In this context, we note the recent announcement by Permanent TSB to close around a fifth of its 77-strong branch network.
- An analysis of the number of branches per 1,000 active SME show that higher levels of bank branches per SME are evident in a number of counties where there is a high level of rural population.
- The main banks in Ireland provide an extensive range of financial services. These include both personal and commercial banking products. Personal banking services provided include: savings accounts, current accounts, consumer lending and overdraft facilities, credit cards, debit cards, mortgages, e-banking services, phone-banking services, insurance, investment and fund management. Commercial banking services offered by banks in Ireland typically include: funding and acquisition, leveraged acquisition finance, property finance, cash management, treasury services, trade finance, project finance, and transaction support.
- In addition to the main banking groups there are a number of other financial providers. These include Grid Finance, Linked Finance, Flender, Fexco, Bibby and Finance Ireland. There are also online providers of personal credit including Amigo Loans and Chill Money Ireland.

6 Overview of Existing State Supports

6.1 Strategic Banking Corporation of Ireland

Extensive state supports have been put in place to address perceived areas of market failure in the Irish banking and financial services market. These include the creation of the Strategic Banking Corporation of Ireland (SBCI) in 2014. The functions of the SBCI are:

(a) to provide, and promote the provision of, additional credit in a prudent manner to enterprises or other persons in the State, in particular SMEs,

(b) to design or cause to be designed credit facilities which consistently address the financial needs of borrowers, in particular SMEs, be they related to growth, investment or operational needs,

(c) to promote competition in markets for the provision of credit to borrowers, in particular SMEs,

(d) to encourage an increase in the number of providers of finance to borrowers in the State,

(e) to encourage the entry to the market of new providers of credit,

(f) to contribute to the diversity of the types of finance available in the State,

(g) to source international funding to facilitate lending,

(h) to provide finance to projects which promote the economic development of the State,

(i) to facilitate the operation of diverse credit markets, and

(j) to carry out any functions that are ancillary, consequential or supplemental to the matters mentioned in paragraphs (a) to (i).

The SBCI operates a number of schemes on behalf of various Government Departments including the Department of Business, Enterprise and Innovation; and the Department of Agriculture, Food and the Marine, which attempt to achieve this goal, including the Brexit Loan Scheme, the Future Growth Loan Scheme, and the SME Credit Guarantee Scheme. The following table provides a listing of the schemes operated by the SBCI. Indecon also notes the important role of the SBCI in providing liquidity to non-bank on lenders.

Table 6.1: Existing SBCI Schemes	
Brexit Loan Scheme	• Amounts from €25,000 to €1.5 million • Terms ranging from 1-3 years • Can be used for future working capital requirements and must be used to fund innovation, change or adaptation of business to mitigate impact of Brexit • Maximum interest rate of 4% • Viable SMEs and Small MidCap enterprises can apply, unless in financial difficulty or in primary agriculture sector • Must meet certain Brexit-related criteria and innovation criteria
Future Growth Loan Scheme	• Loan amounts from €100,000 (€50,0000 for primary agriculture) to €3 million • Loan terms range from 8-10 years • Loans must be used for long-term investment • Cannot be used for pure real estate development, refinancing existing loan amongst other restrictions • Viable SMEs and Small MidCap enterprises can apply
SME Credit Guarantee Scheme	• Facilities of €10,000 to €1 million • Terms of up to 7 years • Designed to address barriers to lending including inadequate collateral and need for refinancing caused by exit of an SME lender
Source: SBCI	

The following table shows the number of SMEs who have drawn down SBCI loans, and the value of these loans between 2015 and 2018. €123 million was drawn down in SBCI loans in 2018, with an average loan size of €40,000.

Table 6.2: Summary of SBCI Loans (2015-2018)				
	Year to Dec 2015	**Year to Dec 2016**	**Year to Dec 2017**	**Year to Dec 2018**
SMEs in Ireland who have Drawn Down SBCI Loans	4,619	12,593	10,468	3,038
Employees in SMEs in Ireland who have Drawn Down SBCI Loans	17,000	67,150	53,389	28,436
Loans Drawn by SMEs in Ireland (€ million)	172	544	391	123
Average Loan Size (€)	37,000	43,200	37,300	40,487
Source: SBCI Annual Reports				

As the following table shows, SBCI loans have been spread across the country, with the South-West accounting for the largest share, 19.5% of loans in 2018. Meanwhile, Dublin and the Midlands had the two lowest shares, but these had increased from the previous year.

Table 6.3: SBCI Loans by Region (2015-2018)				
	Year to Dec 2015	Year to Dec 2016	Year to Dec 2017	Year to Dec 2018
South-West	19.0%	17.8%	20.3%	19.5%
Mid-West	14.0%	14.4%	16.7%	17.0%
Border	11.0%	12.3%	14.2%	12.7%
West	13.0%	13.1%	15.7%	11.8%
Mid-East	10.0%	10.1%	8.6%	11.7%
South-East	11.0%	10.8%	12.4%	10.9%
Dublin	15.0%	15.2%	8.0%	9.0%
Midlands	7.0%	6.3%	4.1%	7.4%
Source: SBCI Annual Reports				

As of August 2019, the SBCI had granted loans of €57.2 million via the Brexit Loan Scheme (€40.9m) and the Future Growth Loan Scheme (€16.3m). A county breakdown of the percentage of loans and the value of loans is presented in the following table. It shows that Dublin accounts for 23.2% of loans under these schemes and 26.6% of the value of the loans under these schemes. Each county has at least one loan across the two schemes (aside from Longford). 289 loans have been sanctioned under these schemes as of August 2019.

Table 6.4: Breaking of Brexit Loan Scheme and Future Growth Loan Scheme by County (As of August 2019)		
	Percentage of Loans	Percentage of Value of Loans
Carlow	2.8%	4.8%
Cavan	1.4%	1.1%
Clare	1.7%	1.1%
Cork	12.8%	13.7%
Donegal	8.0%	6.1%
Dublin	23.2%	26.6%
Galway	5.2%	8.7%
Kerry	0.3%	0.9%
Kildare	4.2%	3.2%
Kilkenny	1.0%	0.6%
Laois	2.1%	1.6%
Leitrim	0.7%	0.5%
Limerick	1.4%	1.0%
Longford	0%	0%
Louth	2.4%	2.8%
Mayo	4.5%	4.3%
Meath	3.8%	3.7%
Monaghan	3.5%	2.9%
Offaly	1.4%	1.3%
Roscommon	1.7%	1.7%
Sligo	2.4%	2.1%
Tipperary	3.5%	2.9%
Waterford	3.1%	1.8%
Westmeath	1.4%	1.5%
Wexford	3.1%	2.1%
Wicklow	4.5%	3.3%
Source: SBCI		

The following table shows that agriculture is the biggest individual sector in terms of SBCI funding and has been the largest in each of the last four years. Accommodation and food trade have fallen from 14% of SBCI loans in 2015 to less than 2% in 2018, whilst construction services have increased from 3% in 2015 to 13.7% in 2018.

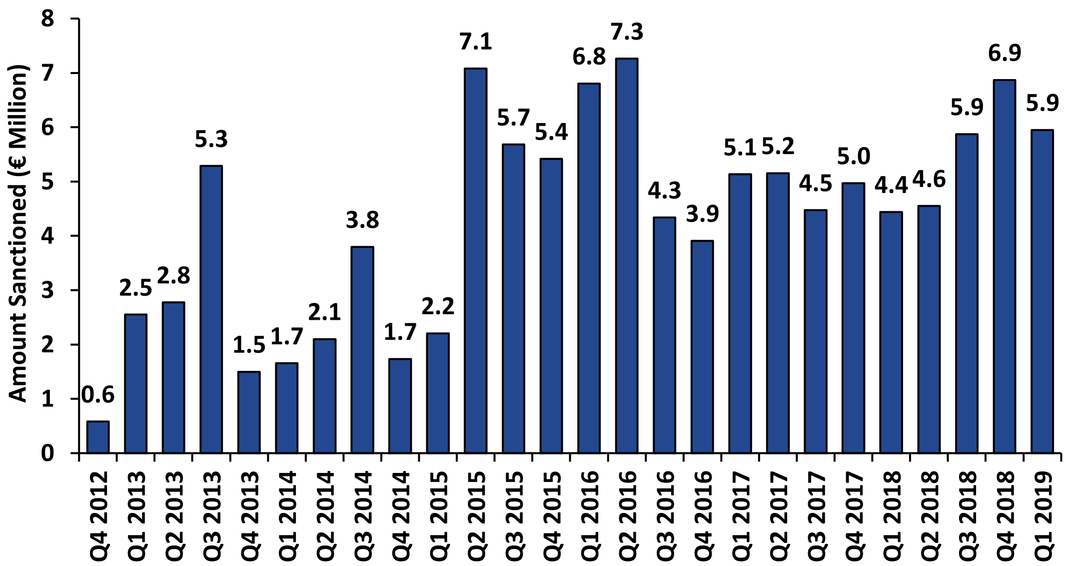
Table 6.5: SBCI Funding by Sector (2015 - 2018)

	2015	2016	2017	2018
Agriculture	26.0%	22.9%	26.1%	29.4%
Construction Services	3.0%	4.2%	9.3%	13.7%
Other	10.0%	14.5%	13.3%	11.0%
Wholesale and Retail	16.0%	18.4%	13.2%	10.9%
Admin & Support	11.0%	10.0%	10.8%	10.8%
Manufacturing Services	7.0%	7.7%	8.1%	9.4%
Transport & Storage	3.0%	4.2%	5.5%	8.7%
Professional & Scientific	4.0%	4.5%	3.4%	4.4%
Accommodation & Food Trade	14.0%	13.6%	10.3%	1.7%

Source: SBCI Annual Reports

The SME Credit Guarantee Scheme (CGS) is operated by the SBCI, on behalf of DBEI. It was designed to overcome barriers to accessing finance which include inadequate collateral or the risk level of the business market or segment. Loan facilities are available to eligible SMEs for terms of up to seven years for amounts ranging between €10,000 and €1 million. The following figure outlines the levels of CGS sanctions since the birth of the first Credit Guarantee Scheme in 2012. There has been a high level of sanctions since Q3 2018, with levels in excess of those over the previous two years.

Figure 6.1: Credit Guarantee Scheme Sanctions by Quarter (2012-2019)



Source: DBEI

Small enterprises accounted for the highest number of CGS loan facilities sanctioned, 336 small companies had loans sanctioned to total loan value of €46 million. A further 335 were micro-enterprises, accounting for over €46 million of CGS lending sanctions, at an average amount of €138,900. Small enterprises had a higher sanctioned loan value of €176,500 with medium enterprises accounting for the highest average sanction (€274,600).[20]

Table 6.6: Credit Guarantee Scheme Loans by Company Size (2012-2019 Q1)			
	CGS Facilities Granted	**CGS Lending Sanctioned (€ 000)**	**Average Amount Sanctioned (€ 000)**
Micro	335	46,538	138.9
Small	336	59,295	176.5
Medium	39	10,710	274.6
Unknown	16	2,352	147.0
Total	**726**	**118,895**	**163.8**
Source: DBEI			

The majority of CGS facilities granted by the SBCI are in the East region of Ireland, which accounted for 384 of the 726 CGS facilities granted between 2012 and 2019 Q3. These facilities had an average value of €164,000 and totalled €65 million (54.6% of the total).

Table 6.7: Credit Guarantee Scheme Loans by Company Size (2012-2019 Q1)			
	CGS Facilities Granted	**CGS Lending Sanctioned (€ 000)**	**Average CGS Lending Sanctioned (€ 000)**
East	384	65,026	169
Mid-West	93	12,546	135
South West	99	15,384	155
South East	48	8,646	180
Midlands	32	5,493	172
West	44	7,302	166
North East	16	2,502	156
North West	10	1,997	200
Total	**726**	**118,896**	**164**
Source: DBEI			

[20] Note: The Department of Business, Enterprise and Innovation has defined enterprise size on the following bases: (i) a micro enterprise is defined as an enterprise which employs fewer than 10 people and whose annual turnover and/or annual balance sheet total does not exceed €2 million; (ii) a small enterprise is defined as an enterprise which employs between 10 and 49 persons and whose annual turnover and/or annual balance sheet total does not exceed €10 million; and (iii) a medium-sized enterprise is defined as an enterprise which employs between 50 and 249 persons and whose annual turnover does not exceed €50 million or whose annual balance sheet total does not exceed €43 million. See: https://dbei.gov.ie/en/Publications/Publication-files/Q3-2019-Report-SME-Credit-Guarantee-Scheme.pdf (page 3).

6.2 Microfinance Ireland

Microfinance Ireland is a not-for-profit lender that was established in 2012 to deliver the Government's Microenterprise Loan Fund. Microfinance Ireland provides small loans of up to €25,000 to micro-enterprises which are small businesses with fewer than 10 employees and an annual turnover of less than €2 million. From its inception in October 2012 to the end of 2019 Q1, Microfinance Ireland had processed 4,664 applications for the Microenterprise Loan Fund Scheme. 44% of these applications were approved, with a value of €29.6 million. The number of applications has been growing year on year since its inception, although applications in 2019 Q1 are slightly below what they were in 2018 Q1. Despite this slightly lower number of applications processed (240 in 2019 Q1 v 253 in 2018 Q1), the value of approvals at €1.6 million was higher in the first quarter of 2019 than in 2018 (€1.3 million).

Table 6.8: Applications for Microfinance Ireland Microenterprise Loan Fund Scheme (2013-2019)

	2013	2014	2015	2016	2017	2018	2019 Q1	Total
Applications Processed	348	483	743	902	927	1,021	240	4,664
Approved	139	274	357	397	400	384	114	2,065
Approved Rates	40%	57%	48%	44%	43%	38%	47%	44%
Approved (€'000)	2,159	4,159	5,378	5,392	5,503	5,361	1,623	29,575
Average Approval (€)	15,532	15,179	15,064	13,582	13,758	13,961	14,237	14,322

Source: DBEI - Microfinance Ireland Progress Report
Note: figures for 2013 include the launch period from October to December 2012.

The following table shows that just over half of approvals have been for companies with only one employee (1,053 out of 2,065) since the inception of the Microenterprise Loan Fund Scheme. Business with two or three employees were the next largest cohort in terms of number of approvals, accounting for just under a third of the total.

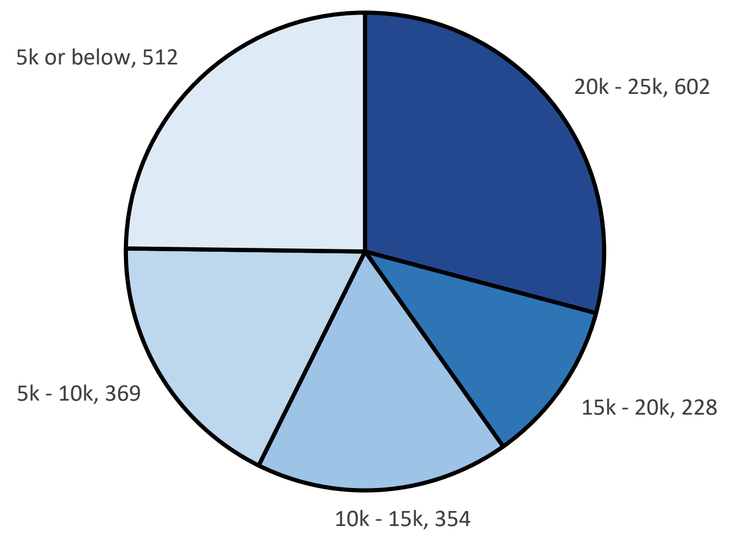
Table 6.9: Microfinance Ireland – Application Approvals for Microenterprise Loan Fund Scheme by Size of Enterprise (2013-2019)

Number of Employees	2013	2014	2015	2016	2017	2018	2019 Q1	Total
1	60	141	187	235	195	183	52	1,053
2 to 3	56	86	97	91	134	143	42	649
4 to 5	16	22	33	45	37	31	9	193
6 to 9	10	25	40	26	34	27	8	170
10	0	0	0	0	0	0	0	0
Total	**142**	**274**	**357**	**397**	**400**	**384**	**111**	**2,065**

Source: DBEI - Microfinance Ireland Progress Report
Note: figures for 2013 include the launch period from October to December 2012.

Approximately one quarter of approvals to the scheme were for €5,000 or below, whilst more than a quarter were at the higher end of the value spectrum from €20,000 to €25,000.

Figure 6.2: Microfinance Ireland – Microfinance Loan Fund Scheme Approvals by Size



Source: DBEI - Microfinance Ireland Progress Report

As discussed previously the Eastern region has the highest number of applications, but as seen in the following table, Dublin has one of the lowest approval rates. Counties in the West of Ireland, such as Sligo, Mayo, Leitrim, Clare, Roscommon and Galway had amongst the highest approval rates.

Table 6.10: Microfinance Ireland – Geographical Spread of Loan Approval Rates (based on Geographical Analysis of Approvals between October 2012 and March 2019)

County	Application Received	Application Approved	Approval Rate
Wexford	183	104	56.8%
Sligo	98	55	56.1%
Mayo	123	69	56.1%
Leitrim	62	34	54.8%
Clare	137	67	48.9%
Roscommon	86	41	47.7%
Galway	235	111	47.2%
Tipperary	211	97	46.0%
Kilkenny	68	31	45.6%
Donegal	122	54	44.3%
Kildare	174	77	44.3%
Waterford	197	87	44.2%
Limerick	210	92	43.8%
Cork	376	163	43.4%
Offaly	90	39	43.3%
Carlow	74	32	43.2%
Westmeath	126	54	42.9%
Longford	95	40	42.1%
Cavan	131	55	42.0%
Kerry	136	56	41.2%
Laois	102	42	41.2%
Dublin	1,072	437	40.8%
Wicklow	162	66	40.7%
Monaghan	73	28	38.4%
Meath	249	91	36.5%
Louth	132	43	32.6%
Total	**4,725**	**2,065**	**43.7%**

Source: DBEI - Microfinance Ireland Progress Report

6.3 Enterprise Ireland and Local Enterprise Office Supports

Enterprise Ireland has a range of supports for companies at different stages of their development. Those with ideas for start-ups may qualify for supports from the Enterprise Ireland Start-Up Team, the New Frontiers Entrepreneur Development Programme and from Local Enterprise Offices. High Potential Start-Up (HPSU) Funding is available to those with the potential to develop a product or service for international sale, and with the potential for the creation of 10 jobs and €1 million in sales within its first three years. These types of companies are able to apply for the following supports:

- HPSU Feasibility Grants
- Innovation Vouchers
- New Frontiers Entrepreneur Development Programme
- Competitive Start Fund (CSF)
- Innovative HPSU Fund
- Market Discovery Fund
- Mentor Grant
- Excel at Export Selling workshops

More established SMEs can also apply for a range of supports including the Be Prepared Grant, Strategic Marketing Review Grant, Research, Development and Innovation (RD&I) Fund and the Capital Investment Initiative (CII) Fund.

The following table outlines Enterprise Ireland's expenditure towards financially supporting industry in terms of company development. Marketing and knowledge transfer support, and fixed asset support were the two largest individual items of expenditure for Enterprise Ireland, accounting for almost €37 million of the €60.9 million they spend in 2018 in the area of company development.

Table 6.11: Enterprise Ireland Financial Support to Industry (Company Development) - 2015-2018

	2015	2016	2017	2018
Employment	14,876	13,886	13,039	11,796
Beef and Sheep Meat Investment Fund	3,270	820	2,466	670
Fixed Asset Support	17,450	15,893	16,893	17,395
Technology Infrastructure	74	874	489	440
Marketing and Knowledge Transfer Support	13,805	13,525	16,933	19,318
Feasibility	3,248	3,057	2,320	1,882
Management Development and Training	6,914	7,238	7,458	7,199
Consultancy Grants	973	1,014	801	950
Community Enterprise Centres	640	289	705	68
Community Enterprise Initiative	-	371	393	151
Regional Enterprise Development Fund	-	-	63	1,059
Total	**61,250**	**56,967**	**61,560**	**60,928**

Source: Enterprise Ireland Annual Reports

Enterprise Ireland also provided financial supports to industry via third parties such as Business Innovation Centres, the Design and Crafts Council of Ireland and Local Enterprise Offices. Enterprise Ireland had expenditures of over €43 million in 2018, with the vast majority of this giving support to industry via Local Enterprise Offices (LEOs).

Table 6.12: Enterprise Ireland Financial Support to Industry (Third Parties) - 2015-2018

	2015	2016	2017	2018
Business Innovation Centres	2,211	2,200	2,200	2,200
Design and Crafts Council of Ireland	7,753	3,019	2,919	3,224
Local Enterprise Offices	31,576	32,470	37,729	37,834
Total	**41,540**	**37,689**	**42,848**	**43,258**

Source: Enterprise Ireland Annual Reports

Local Enterprises Offices offer a range of supports are discussed below. These include:

- Feasibility study grants. These grants are aimed at assisting the company to research market demand for a product or service. They are available to those eligible for expenditure in the areas of market research, innovation, research etc, with the maximum grant equal to €15,000.
- Technical assistance for micro exporters (TAME). TAME is aimed at enabling clients to develop new market opportunities. TAME part-funds participation at trade fairs, international trade networking events, development of export related websites and a number of other activities. The grant covers 50% of eligible costs up to a maximum of €2,500 in a calendar year.
- Priming grants which are available to micro-enterprises within the first 18 months of starting up. They are limited to companies/sole traders/partnerships operating in the LEO's geographic area and must fulfil a number of criteria in relation to their sector and fit with the Enterprise Ireland portfolio. The maximum grant is €150,000 although the grant payable is the lesser of €150,000 or 50% of the investment.
- Business expansion grants. These grants have the same limit as the priming grants but are limited to micro-enterprises who have existed for over 18 months. The grant is designed to assist them in the growth phase of their business cycle after their start-up phase.
- Microfinance loans. Local Enterprise Offices work closely with Microfinance Ireland, with enterprises able to apply for a Microfinance Ireland loan through their Local Enterprise Office. Approved customers would be provided a mentor from the Local Enterprise Office mentor panel to help the business develop.

  The following table shows that the number of projects supported, amount of assistance supported and the average amount approved have all increased year on year since 2015. The financial assistance approved by LEOs in 2018 was €18.2 million, at an average of €14,456 per project.

Table 6.13: LEO Supports (2015-2018)			
	Business Projects	**Direct Financial Assistance Approved (€m)**	**Average Amount Approved (€)**
2015	984	10.0	10,163
2016	1,040	11.4	10,962
2017	1,131	16.0	14,147
2018	1,259	18.2	14,456
Source: DBEI/LEO reports			

6.4 Credit Review Office

The Credit Review Office was established in 2010 by the Government in order to provide a review process for SMEs and other enterprises who had been refused credit by banks participating in the NAMA scheme. Banks currently covered by the Credit Review Office are Allied Irish Bank, Bank of Ireland, PTSB and Ulster Bank.

The Credit Review Office outlines its objectives in its *Statement of Strategy for the Credit Review Office* as follows:[21]

- *Continue to support viable SMEs and Farms to access credit.*
- *Provide excellent service to our clients.*
- *Improve the Credit Review Office website.*
- *Implement Social Media Channels to improve accessibility and information on the Credit Review Office.*
- *Provide specific guidance to SMEs and Farms on emerging market challenges, such as self-financing projects and re-financing loans which have been sold-on to Investment Funds.*
- *Continue to provide market feedback and general banking assistance to the Minister and Officials in the Department of Finance.*

While the Credit Review Office does not have statutory powers to overturn decisions on lending made by banks, it can make recommendations to the banks. In over 90% of cases supported by the Credit Review Office, the banks have accepted their opinion and complied with these recommendations.

The Credit Review Office received 958 formal applications between 2010 and 2018. 658 of these cases have reached final conclusion and the Credit Review Office has found in favour of the appeals of the borrowers in 372 of the cases, as shown in the following table.

[21] Credit Review Office. *Statement of Strategy for the Credit Review Office.* Available at: https://www.creditreview.ie/wp-content/uploads/2018/05/Statement-of-Strategy-for-the-Credit-Review-Office.pdf

Table 6.14: Breakdown of Completed Cases with Credit Review Office Opinion		
	Number of Cases	**Percentage of Cases**
Bank upheld	286	43.5%
Borrower upheld	372	56.5%
Total cases completed and opinions	**658**	
Source: CRO		

The 372 cases in which the Credit Review Office have upheld appeals by borrowers have led to credit of €52.9 million being made available to the borrowers. The Credit Review Office estimates that this has helped to protect/create 3,694 jobs.

Table 6.15: Breakdown of Value of Completed Cases with Credit Review Office Opinion		
	Value of Cases (€ m)	**Percentage of Value of Cases**
Bank Upheld	53.3	50.2%
Borrower upheld	52.9	49.8%
Total cases completed and opinions	**106.2**	
Source: CRO		

6.5 Summary of Key Findings

- Extensive state supports have been put in place to address areas of market failure in the Irish banking and financial services market. These include supports provided by organisations such as the Strategic Banking Corporation of Ireland, Microfinance Ireland, the Local Enterprise Offices and Enterprise Ireland. Outside the supports reviewed in this report there have also been other important initiatives including the Ireland Strategic Investment Fund and other Government measures. There have also been measures introduced to reduce the risk of financial exclusion.
- The SBCI operates a number of schemes including the Brexit Loan Scheme, the Future Growth Loan Scheme, and the SME Credit Guarantee Scheme. €123 million was drawn down in SBCI loans in 2018, with an average loan size of €40,000. Analysis by Indecon of SBCI data indicates that most of SBCI lending is allocated to enterprises in regional areas outside of Dublin. The SME Credit Guarantee Scheme (CGS) is operated by the SBCI, on behalf of DBEI. Loan facilities are available to eligible SMEs for terms of up to seven years for amounts ranging between €10,000 and €1 million. €5.9 million was sanctioned via the CGS in 2019 Q1.
- Microfinance Ireland is a not-for-profit lender that was established in 2012 and provides small loans of up to €25,000 to micro-enterprises which are small businesses with fewer than 10 employees and annual turnover of less than €2 million. From its inception in October 2012 to the end of 2019 Q1 Microfinance Ireland had processed 4,664 applications for the Microenterprise Loan Fund Scheme. 44% of these applications were approved, with a value of €29.6 million.

- Local Enterprises Offices offer a range of supports, including advice, feasibility study grants, technical assistance for micro exporters (TAME), priming grants, business expansion grants and microfinance loans. The financial assistance approved by LEOs in 2018 amounted to €18.2 million, at an average of €14,456.
- Enterprise Ireland offers supports for companies at different stages of their development. These include Enterprise Ireland Start-Up supports and other initiatives. Enterprise Ireland also operates significant seed and venture capital support for the internationally traded indigenous sector.
- The Credit Review Office was established in 2010 by the Government in order to provide a review process for SMEs and other enterprises who had been refused credit by banks participating in the NAMA scheme. The Credit Review Office received 958 formal applications between 2010 and 2018. 658 of these cases have reached final conclusion and the Credit Review Office has found in favour of the appeals of the borrowers in 372 of the cases, leading to credit of €52.9 million being made available to the borrowers.

7 Assessment of Potential Market Failure in Financing of SMEs

7.1 Potential Causes of Market Failure

It is important to consider whether any unmet credit demand by enterprises in Ireland is due to market failure and/or other reasons, for example, project unviability. An unwillingness of financial institutions to lend because of project unviability is a feature of any functioning market and would not represent market failure or merit public policy interventions. The European Commission has defined market failure as follows: "The concept of market failure refers to non-functioning aspects of the market which result in an inefficient allocation of resources and entail the underproduction or overproduction of certain goods and services."[22] Market failure can arise due to a lack of competition or undercapitalisation of banks, or due to the presence of information asymmetries. Absence of competition can result in higher interest rates, which may discourage viable investments. Undercapitalisation of banks can result in a risk-averse approach to financing of potentially viable projects.[23]

Market failure arising from asymmetric information between the borrower and the lender means that lenders' ability to price risk is impaired, and some SMEs and micro-enterprises may be discouraged from applying for loans because of a lack of awareness of the availability of credit. International research by Nguyen (2014) suggests that local branches can help overcome information asymmetries.[24]

Market failures in finance can also arise due to positive externalities not taken into account by the lender. For example, financing of viable enterprises to enable increased investment can result in positive spill-overs to the economy.

In considering the level of competition in the banking market, the data shows that there is a restricted number of competitors who account for a high level of market share. The Herfindahl–Hirschman Index in key parts of the market including mortgages suggests the Irish banking sector is currently heavily concentrated in the three largest lenders. The most recent figures from the Central Bank of Ireland show that the three largest lenders accounted for 90.3% of new lending in Q4 2018. Consumer inertia and information gaps may also act as a barrier to competitive pressures. For example, the evidence shows that in the second half of 2018 only 0.03% of current account customers changed provider.

One additional area of potential market gap concerns those in society who face financial exclusion. During our stakeholder consultation the Citizens Information Board indicated that there is a segment of the population who continue to be excluded from financial services and products. This is likely to reflect wider societal and economic issues. Individuals may also be financially excluded due to lack of access to the internet and as noted earlier, many households do not have such access.

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[22] European Commission and European Investment Bank, Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period. April 2014. Op. Cit.See: https://www.fi-compass.eu/sites/default/files/publications/manual_vol-I_ex-ante-assessment-general-metholology.pdf

[23] Indecon's analysis of core Tier 1 capital ratios in Irish banking indicates that Irish banks have higher levels of capital than other EU countries (19.3% compared to 16.2% in EU). This should in theory enable the banks to be open to considering all viable lending opportunities, however, the banks also have to keep high levels of solvency to absorb any losses associated with legacy non-performing loans.

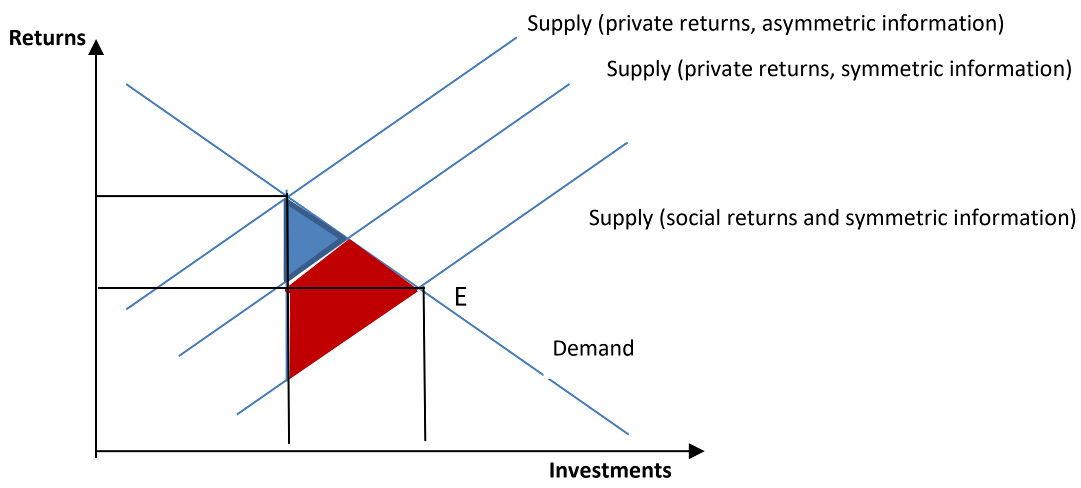
[24] Nguyen (2014), Op. Cit.

This point was also made to Indecon in our consultations by the Irish Congress of Trade Unions, who noted that it should not be assumed that internet banking is a viable alternative for many people.

The ICTU also noted that there are many low-income groups, elderly persons or people suffering from social exclusion who have no regular access to the internet. The National Disability Authority has also indicated that social inclusion and community participation in financial services is an important issue for people with disabilities where travelling to other locations may not be a feasible option.

The next figure presents a graphical depiction of the effects of market failures on credit supply. The economic inefficiency arising from the presence of such market failure can result in a lower amount of credit provided or higher interest rate. This *inter alia* refers to projects where more credit or where a lower interest rate would apply if the lender could accurately assess and monitor the credit risk of the borrower (symmetric information), or if the lender could be rewarded for the social benefit generated by the enterprise/project funded (positive externality). Similar issues apply if the level of competition between providers is restricted resulting in higher interest rates. The economic deadweight loss for society is represented in the figure as the blue-shaded area. The additional loss to society due to externalities is denoted by the red-shaded area in the figure. The level of supply of credit is also influenced by the capital requirements in the banking sector.

Figure 7.1: Economic Efficiency and Market Failure in Finance

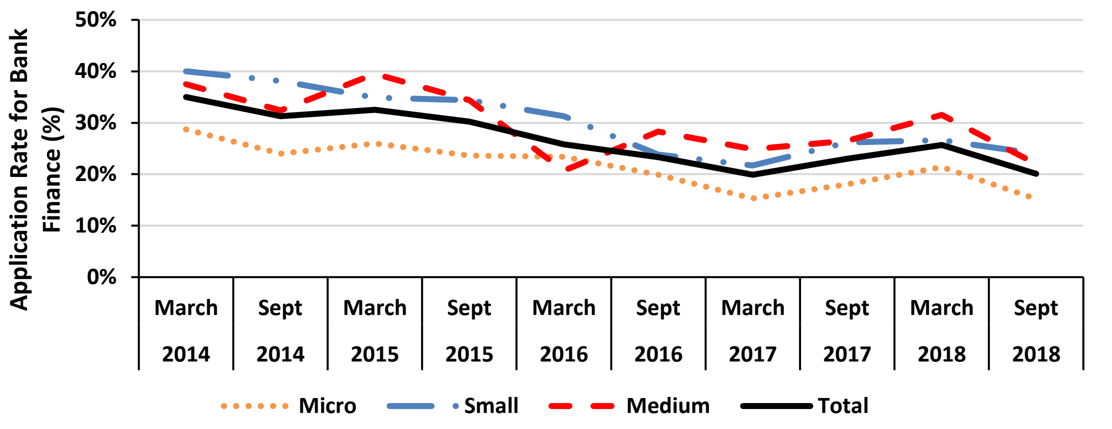


Source: Indecon

7.2 Analysis of Enterprise Demand for Credit

In examining whether there is market failure in the financing of SMEs, it is useful to first analyse the level of enterprise demand for credit. The data shows that there has been a decline in the application rates for bank finance by SMEs in the Irish market. Application rates for bank finance were 35% in March 2014 and declined to 20% across all SMEs in September 2018.

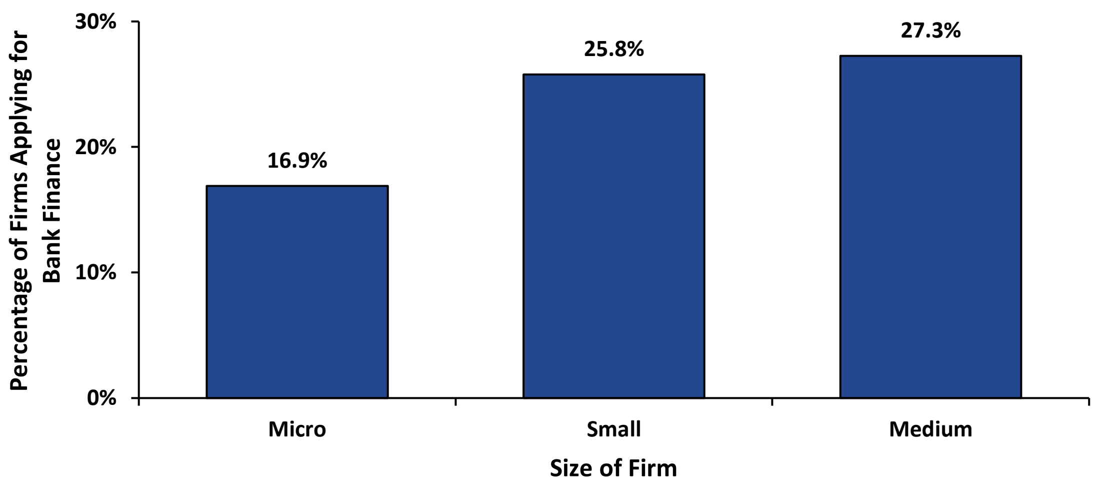
Figure 7.2: Application Rates for Bank Finance



Source: Central Bank of Ireland data – SME Market Report

In reviewing enterprise demand for credit, of interest is that micro-enterprises have consistently lower application rates than the other types of SMEs. On average, between 2016 and 2018, only 16.9% of micro-enterprises applied for bank finance, compared to over 25% for small and medium-sized enterprises.

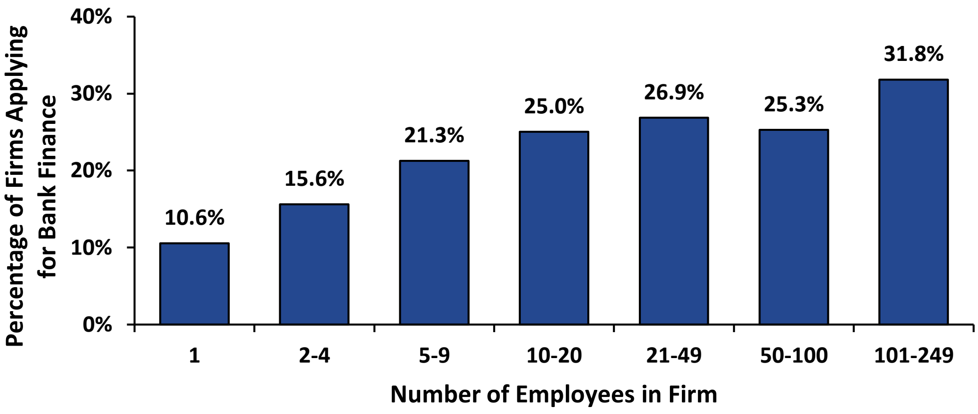
Figure 7.3: SME Application Rates for Bank Finance by Size of Firm



Source: Indecon analysis of SME Credit Demand Surveys (2016-2018)

The lower levels of applications by firm size is reflected in the variance in application rates by the number of employees.

Figure 7.4: SME Application Rates for Bank Finance by Size of Firm



Source: Indecon analysis of SME Credit Demand Survey (2016-2018)

Many rural counties have high numbers of micro-enterprises and these businesses have limited banking relationships. Irish Rural Link highlighted this issue in the consultation process. If micro-enterprises do not apply for credit, this could impact on overall investment levels in the economy. It is useful to examine the level of application for credit on a county-by-county basis. For statistical reasons, Indecon grouped counties together in order to ensure each grouping had a sufficient number of SMEs in the credit demand survey. Waterford and Wexford had the highest percentages of SMEs applying for bank finance, whilst Cork, Kerry and Dublin had the lowest.

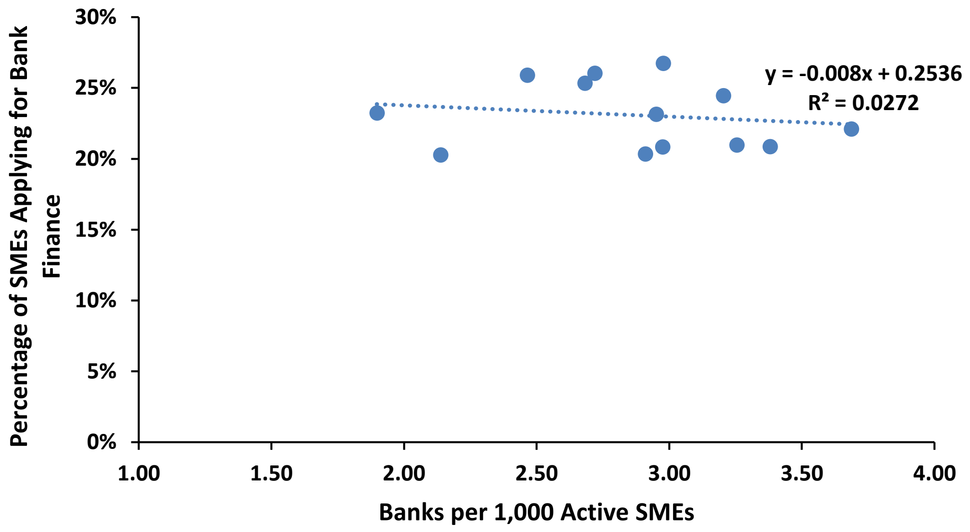
Table 7.1: Applications for Bank Finance by County

	Number of SMEs	Number of SMEs who Applied for Bank Finance	Percentage of SMEs who Applied for Bank Finance
Waterford and Wexford	288	77	26.7%
Cavan and Monaghan	146	38	26.0%
Kildare and Wicklow	305	79	25.9%
Galway	229	58	25.3%
Mayo and Sligo	184	45	24.5%
Louth and Meath	310	72	23.2%
Clare and Limerick	294	68	23.1%
Donegal and Leitrim	190	42	22.1%
Longford, Roscommon and Westmeath	167	35	21.0%
Laois, Offaly and Tipperary	283	59	20.8%
Carlow and Kilkenny	168	35	20.8%
Cork and Kerry	738	150	20.3%
Dublin	1,264	256	20.3%
State	**4,566**	**1,014**	**22.2%**

Source: Indecon analysis of SME Credit Demand Survey (2016-2018)

Indecon analysed the correlation between SME bank finance rates and the number of banks per 1,000 active SMEs in the county grouping. The results suggest almost no correlation between the two variables, as outlined in the following figure.

Figure 7.5: Correlation Between SME Bank Finance Application Rates and Banks per 1,000 SMEs in the Region



Source: Indecon analysis of SME Credit Demand Survey (2016-2018)

In informing our analysis, it is important to examine the characteristics of enterprises who applied for credit. The following table shows that firms which made a loss in the previous six months were slightly more likely to apply for bank finance. However, enterprises who had recorded a turnover increase were also more likely to apply for bank finance. Interestingly, application rates were much higher for those SMEs who had missed at least one repayment in the previous six months.

Table 7.2: SME Application Rates for Bank Finance in Six Months (2016 – 2018)

	Did Not Apply	Applied
Made Profit in Previous 6 Months	77.7%	22.3%
Broke Even in Previous 6 Months	78.9%	21.1%
Made Loss in Previous 6 Months	72.9%	27.1%
Turnover Increased in Previous 6 Months	74.5%	25.5%
Turnover Decreased in Previous 6 Months	79.0%	21.0%
Turnover Remained the Same in Previous 6 Months	81.3%	18.7%
Have not missed any repayments in last 6 months	78.3%	21.7%
Have missed at least one repayment in last 6 months	58.3%	41.7%
Don't Know	88.5%	11.5%

Source: Indecon analysis of SME Credit Demand Survey (2016-2018)

In understanding the reasons why enterprises did not apply for finance, Indecon notes that the majority of SMEs did not apply for finance because it was not needed.

Table 7.3: SMEs who did Not Apply for Credit as it was Not Required

	Dublin	Leinster	Munster	Conn/Ulster
Didn't need it	76%	77%	79%	76%
Existing finance in place	4%	3%	2%	5%
Prefer not to borrow	3%	5%	3%	4%
Use personal funds	1%	1%	1%	1%
Raise finance from grants	0%	1%	0%	0%
Raise finance from investors/VC	1%	-	0%	-

Source: Indecon analysis of Department of Finance SME Credit Demand Survey (2016-2018)

In examining whether access to credit is needed to expand investment, it is interesting to note the conclusion of the recent important ESRI research on exploring investment patterns for SMEs.[25] This research found that "*just under 80 per cent of Irish firms indicate they are satisfied with the level of investment they undertook or the capacity they currently have if they didn't invest*." The ESRI research also found that 63% of those who did not invest stated that they had adequate capacity, with a further 15% indicating that they had insufficient internal funds. However, for a small percentage of firms the reason for not investing was that they did not have access to external finance, equating to just over 11% of those who felt that they did not have adequate capacity.[26]

Table 7.4: Firms Perceptions of Their Investing Behaviour

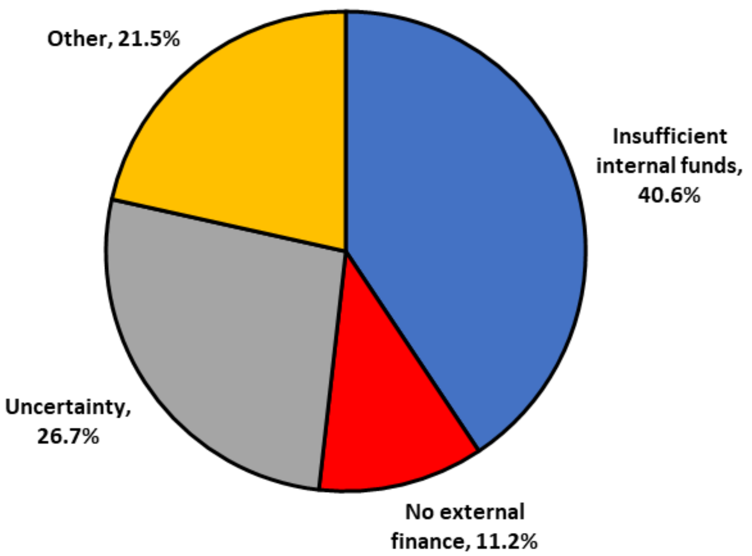
Size of Firm	Adequate Capacity	Invested Adequately	Invested Less than they would have liked	Not Adequate Capacity	Capital Gap
Micro	39.2%	38.3%	7.6%	15.0%	**22.6%**
Small/Medium	29.3%	50.4%	10.6%	9.7%	**20.3%**
All firms	33.4%	46.4%	9.4%	11.9%	**21.2%**

Source: Gargan E., Lawless, M. Martinzx-Cillero, M., O'Toole, C., Exploring SME Investment Patterns in Ireland: New Survey Evidence (2018) Economic and Social Research Institute et al 2018.

[25] Gargan, E., Lawless, M., Martinez-Cillero, M., O'Toole, C., Exploring SME Investment Patterns in Ireland: New Survey Evidence.

[26] Ibid

Figure 7.6: Reasons For Not Investing Amongst Those Without Adequate Capital Capacity



Source: Gargan et al 2018.

For a percentage of firms who did not apply for credit, there were other project viability reasons which explains why credit applications were not made as outlined in the table below. Where enterprises are of the view that it is not the right time to invest or have concerns about the inability of repaying lending, not applying for credit is the correct decision.

Table 7.5: Viability-related Reasons for Not Applying for Credit

	Dublin	Leinster	Munster	Conn/Ulster
Inability to repay/meet requirements	-	0%	0%	1%
Not right time in economic climate	1%	0%	0%	1%
Going out of business	0%	0%	-	1%
Possible rejection	1%	1%	1%	1%
Turned down before	1%	0%	0%	1%
Existing debt too high	0%	1%	0%	1%

Source: Indecon analysis of Department of Finance SME Credit Demand Survey (2016-2018)

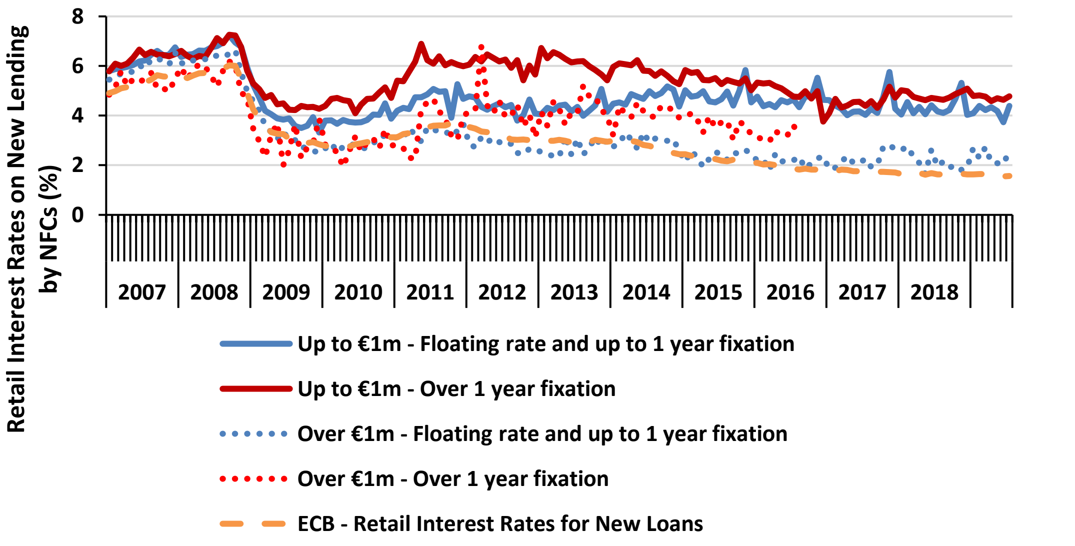
While most firms did not apply for credit because it was not needed or because of viability concerns, the evidence in Table 7.7 shows that for a minority of firms, factors such as: credit being too expensive; a belief that banks are not lending; a lack of trust in banks; or the application process being perceived as too difficult may be constraining some SMEs from applying for loans and increasing their levels of investment.

Table 7.6: Cost of Credit and Informaiton Asymmetries Reasons for Not Applying for Credit				
	Dublin	**Leinster**	**Munster**	**Conn/Ulster**
Too expensive to borrow	1%	1%	1%	0%
Belief that banks not lending	0%	1%	1%	1%
Application process too difficult	0%	1%	1%	1%
Don't trust the banks	1%	1%	1%	1%
Too many terms and conditions	0%	1%	1%	1%
Banks take too long to make decision	0%	-	1%	0%
Source: Indecon analysis of Department of Finance SME Credit Demand Survey (2016-2018)				

As evident from the data above for a small number of micro-firms who did not apply for credit, the reason may be the level of interest rates. While the SME survey suggests that 1% of SMEs did not apply because it was too expensive, other data sources suggest that interest rates may be a more significant issue for Irish SMEs. For example, the ECB's Survey on the Access to Finance of Enterprises (SAFE) asks those firms who indicate that they will seek external financing in the next 2-3 years what is the most important limiting factor in obtaining this financing (Question 22). In the 2018 iteration of this surrey, 24.1% of Irish respondents cited 'High interest rates or price' as the key limiting factor in obtaining financing.

Indecon notes that the cost of credit in Ireland is higher than in other countries. It is also notable that retail interest rates for new business loans of up to €1m were over 4%, which was much higher than the interest rate for new business loans of over €1m. High costs of lending are likely to be particularly relevant to micro-firms where the evidence shows that the firm face higher interest rates and have much lower application rates for bank finance.

Figure 7.7: Retail Interest Rates for New SME Lending by Non Financial Corporations by Size of Loan



Source: Central Bank of Ireland and ECB data

In addition to cases where there is clearly no market failure, Indecon has examined the number of SMEs who are likely discouraged from applying for credit due to the perceived cost of credit being too high, information asymmetry issues and other related reasons. The following table presents estimates for the number of SMEs subject to this discouragement on a county-by-county basis. For the purposes of this analysis, we define as discouraged firms who did not apply for finance due to one of the following reasons:

- Belief that it too expensive to borrow;
- Belief that the banks are not lending;
- Don't trust the banks;
- Application process too difficult; or
- Banks take too long to make a decision.

The following table illustrates the findings from the SME Credit Demand Survey from applying for credit in terms of the proportion of respondents in each county who indicate that they were discouraged, as per the above definition.

Table 7.7: Proportion of SMEs Discouraged from Applying for Credit due to the Cost of Credit, Information Asymmetries and Related Issues

County	% of SMEs	County	% of SMEs
Carlow	5%	Longford	0%
Cavan	5%	Louth	1%
Clare	1%	Mayo	6%
Cork	2%	Meath	4%
Donegal	1%	Monaghan	0%
Dublin	3%	Offaly	2%
Galway	8%	Roscommon	11%
Kerry	9%	Sligo	2%
Kildare	2%	Tipperary	3%
Kilkenny	12%	Waterford	3%
Laois	5%	Westmeath	3%
Leitrim	3%	Wexford	5%
Limerick	3%	Wicklow	2%

Source: Indecon analysis of SME Credit Demand Survey

Applying the findings of this survey to the population of Irish SMEs suggests there may be around 9,715 SMEs who are discouraged from borrowing due to the cost of credit or information asymmetries and related issues.

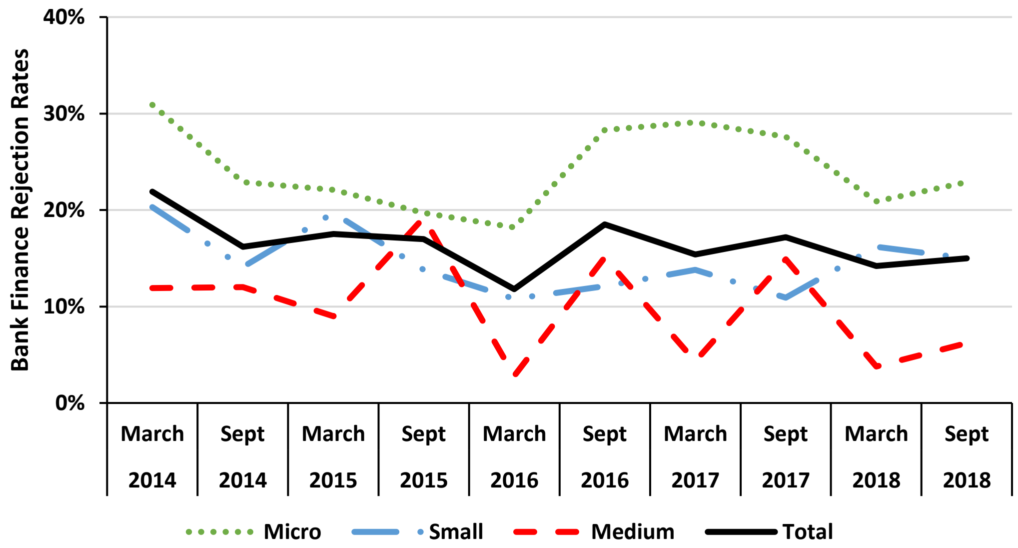
Table 7.8: Estimated number of SMEs Discouraged from Applying for Credit due to the Cost of Credit, Information Asymmetries and Related Issues			
County	**No. SMEs**	**County**	**No. SMEs**
Carlow	149	Longford	-
Cavan	187	Louth	66
Clare	79	Mayo	410
Cork	526	Meath	372
Donegal	68	Monaghan	-
Dublin	3,056	Offaly	69
Galway	1,107	Roscommon	365
Kerry	817	Sligo	67
Kildare	190	Tipperary	241
Kilkenny	567	Waterford	182
Laois	153	Westmeath	141
Leitrim	68	Wexford	396
Limerick	281	Wicklow	159
Source: Indecon analysis			

7.3 Analysis of Bank Rejection of Credit Applications

As well as considering the levels of discouraged borrowers, it is important to examine the evidence on bank rejection rates for credit applications by SMEs. During the stakeholder consultation it was suggested that the banks in providing credit are focusing on what they perceive to be lower risk lending. This is not surprising as risk is appropriately a key criterion for any lending institution and this is likely to be given even more emphasis as the major banks attempt to reduce legacy high levels of non-performing loans.

Some level of rejection of credit application is appropriate as funding unviable projects would reduce economic efficiency and also lead to higher interest costs for other firms arising from loan defaults. Indecon notes that bank finance rejection rates fell from 22% to 15% for SMEs between 2014 and 2018. Micro-enterprises however, had higher rejection rates in each period.

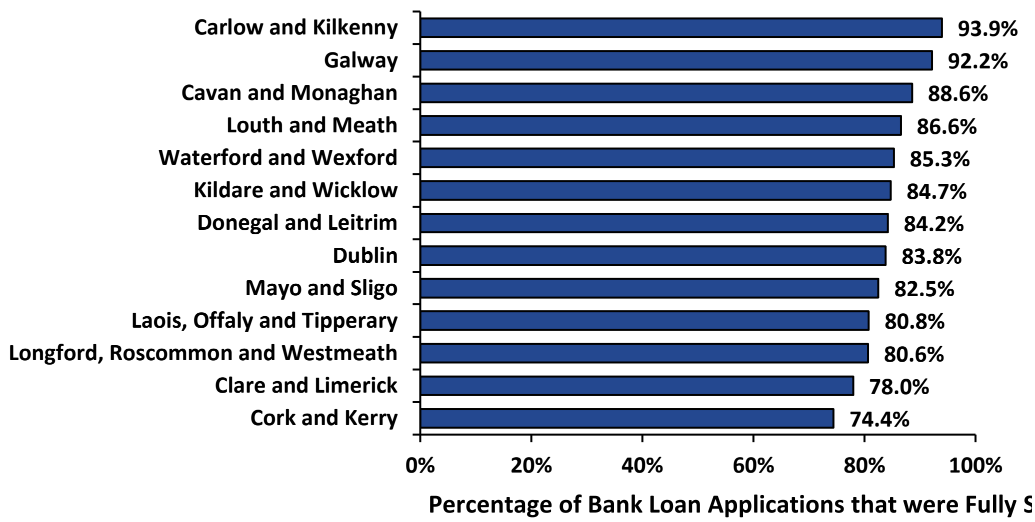
Figure 7.8: Bank Finance Rejection Rates



Source: Central Bank of Ireland data – SME Market Report

Evidence on approval of applications for bank finance by county shows that Carlow and Kilkenny had the largest percentage of bank finance loans being successful, followed by Galway. Cork and Kerry had the lowest success rates.

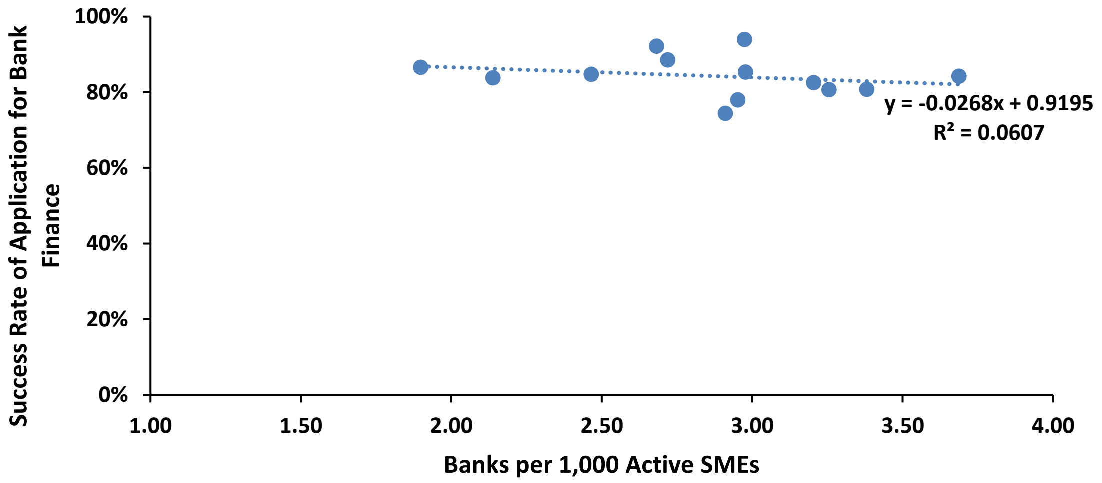
Figure 7.9: SME Application Success Rates for Bank Finance by County of Firm



Source: Indecon analysis of SME Credit Demand Surveys (2016-2018)

The following figure shows that there is almost no correlation between SME bank application success rates and the number of banks per 1,000 active SMEs in the county grouping.

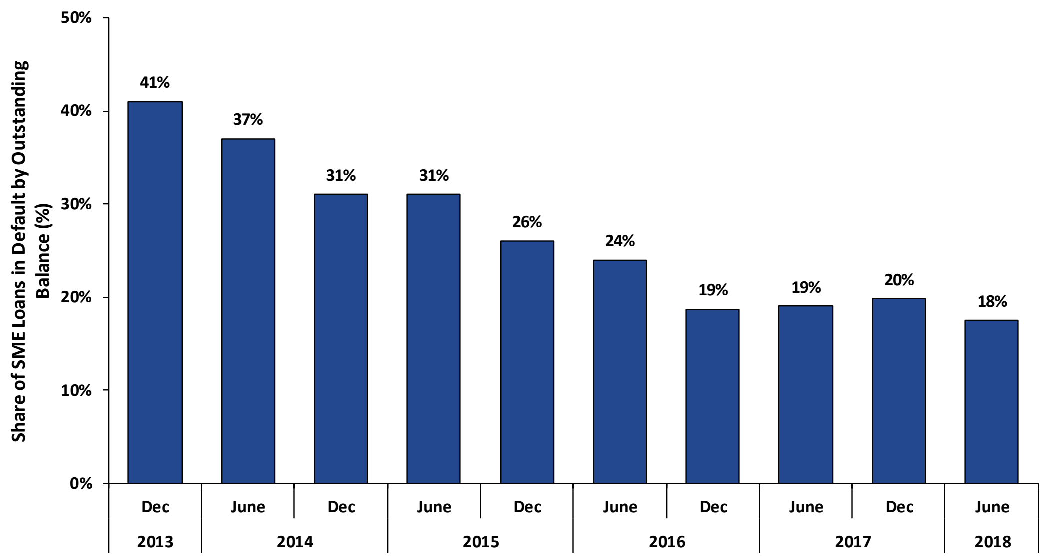
Figure 7.10: Correlation Between SME Bank Finance Application Success Rate and Banks per 1,000 SMEs in the Region



Source: Indecon analysis of SME Credit Demand Survey (2016-2018)

The decline in loan rejection rates is likely to reflect improvements in the economy and the reduction in loan default rates among SMEs.

Figure 7.11: SME Loan Default Rate by Outstanding Balance



Source: Central Bank of Ireland data – SME Market Report

An analysis of the characteristics of SMEs by success rates of applications shows that firms that made a profit had a success rate of almost 88%, compared to 68.8% for those who had made a loss. Those whose turnover had increased in the previous six months were also more likely to be successful in their application. Not surprisingly amongst those who had not missed any repayments, 85.2% were fully successful with their application, compared to 52.9% of those who had missed at least one repayment in the previous six months.

Table 7.9: SME Application Success Rates for Bank Finance by Whether Firm Made a Profit in Previous Six Months

	Unsuccessful	Partially Successful	Fully Successful
Made Profit in Previous 6 Months	10.8%	1.4%	87.8%
Broke Even in Previous 6 Months	22.9%	1.2%	75.9%
Made Loss in Previous 6 Months	28.0%	3.2%	68.8%
Turnover Increased in Previous 6 Months	13.1%	1.6%	85.3%
Turnover Decreased in Previous 6 Months	28.0%	1.7%	70.3%
Turnover Remained the Same in Previous 6 Months	13.8%	1.7%	84.5%
Have not missed any repayments in last 6 months	13.3%	1.5%	85.2%
Have missed at least one repayment in last 6 months	45.1%	2.0%	52.9%
Don't Know	28.6%	14.3%	57.1%

Source: Indecon analysis of SME Credit Demand Survey (2016-2018)

Table 7.10 breaks down the value of bank loan applications by whether or not they were successful by size of loan. Much higher levels of rejection were evident in applications for smaller loans. This may, in part, be related to the levels of financial information provided to banks as part of loan applications and could reflect issue of financial literacy among micro-firms. However, the evidence on business characteristics also suggests that other factors may be relevant and it is important to attempt to control for such variables using more formalised econometric modelling.

Table 7.10: Breakdown of Value of Bank Loan Applications (€m) (2016-2018 SME Credit Demand Surveys)

Value of Loan	Fully Successful	Over 70% of Loan Approved	Less than 70% of Loan Approved/ Respondents Didn't Know	Unsuccessful	Total	Percentage of Total That Was Unsuccessful/ Received Less than 70% of Value
€10,000 and below	0.32	0.00	0.02	0.07	**0.41**	20.9%
€10,001 - €25,000	2.08	0.00	0.00	0.44	**2.52**	17.4%
€25,001 - €50,000	4.55	0.03	0.00	1.13	**5.71**	19.8%
€50,001 - €100,000	6.62	0.00	0.20	0.91	**7.73**	14.3%
€100,001 - €200,000	12.05	0.00	0.00	1.62	**13.66**	11.8%
€200,001 +	85.42	8.50	1.20	5.20	**100.32**	6.4%
Total	**111.05**	**8.53**	**1.42**	**9.36**	**130.35**	**8.3%**

Source: Indecon analysis of SME Credit Demand Survey
Note: The total (€130.35m) differs from that in the previous table due to differing numbers of respondents for each question in the SME Credit Demand Survey.

7.4 Econometric Analysis to Inform Assessment of Presence of any Market Failure

Indecon has undertaken rigorous econometric analysis to attempt to identify the reasons behind companies applying for bank finance, and to understand the determinants of success in applying for finance. Indecon used a probit model to estimate the probability that a firm will apply for bank finance, and whether a firm that applied for finance will be successful in their application. The following table contains a list of the variables included in Indecon's modelling.

Table 7.11: Variables included in Modelling
Application for bank finance in past six months (1 = Yes, 0 = No)
Fully successful in application for bank finance (1 = Yes, 0 = No)
Number of Employees in Firm
Main Sector of Operation of Firm
Year in Which Firm Responded to Survey (2016/2017/2018)
Number of banks per 1,000 SMEs in the county in which the firm is registered
Whether the firm made a profit in the previous six months
Whether the firm's turnover had changed in the previous six months
Whether the firm had missed a loan repayment in the previous six months
Number of business management practices (as measured by the SME Credit Demand Survey)
Source: Indecon

Indecon's modelling controls for the size of the firm, using the number of employees as a proxy for its size, and the sector of the firm as application and success rates vary by sector. Additionally, Indecon controls for the year in which the enterprise responded. This is necessary due to the nature of the pooled cross section approach undertaken by Indecon. Changing economic conditions in recent years may affect the level at which SMEs apply for finance, and we also control for this factor. In the base model for application these are the only variables included. The following equation sets out the baseline application model:

$$Baseline\ Application\ Model:$$

$$\Pr(Application) = \alpha + \beta_1 Number\ of\ Employees + \beta_i Sector_i + \beta_j Year_j + \beta_2 Banks\ per\ 1{,}000\ SMEs + \varepsilon$$

In Indecon's full application model we included a number of business performance measures, as discussed by Gerlach-Kristen et al (2015).[27]

[27] Gerlach-Kristen, P., O'Connell, B. and O'Toole, C., 2015. Do Credit Constraints Affect SME Investment and Employment? *The Economic and Social Review*. Vol, 46, No. 1, Spring, 2015, pp. 51-86.

These measures attempt to capture business management practices and business performance, by including measures of profit and turnover in the past six months, whether the firm missed any loan repayments in the past six months and the number of business management practices that the SME Credit Demand survey captures that are used in the firm. The authors state that these "*factors help capture the productive capacity of the firm, the scale of its operation, its risk profile and the profitability of its operations and investment opportunities*."

$$Full\ Application\ Model:$$

$$\Pr(Application) = \alpha + \beta_1 Number\ of\ Employees + \beta_i Sector_i + \beta_j Year_j + \beta_2 Banks\ per\ 1{,}000\ SMEs + \beta_i Business\ Performance\ Measures_i + \varepsilon$$

Indecon's baseline success model contained the same explanatory variables as the application model but using success as the left-hand side variable. It was possible for firms to have been partially successful in their bank finance attempt but these cases made up approximately 2% of applications and firms could have varying degrees of success with some receiving 90% of the loan and other 50% of the loan for example. Indecon have therefore based their model on whether the firm was fully successful in their application. Thus, we have assigned a value of 1 if a firm was fully successful and 0 if they were unsuccessful or partially successful.

$$Baseline\ Success\ Model:$$

$$\Pr\ (Success) = \alpha + \beta_1 Number\ of\ Employees + \beta_i Sector_i + \beta_j Year_j + \beta_2 Banks\ per\ 1{,}000\ SMEs + \varepsilon$$

As in the case of the application model Indecon's full success model includes measures of business performance to investigate how these affect the probability of success.

$$Full\ Success\ Model:$$

$$\Pr\ (Success) = \alpha + \beta_1 Number\ of\ Employees + \beta_i Sector_i + \beta_j Year_j + \beta_2 Banks\ per\ 1{,}000\ SMEs + \beta_i Business\ Performance\ Measures_i + \varepsilon$$

As Table 7.12 shows, a statistically significant variable in the baseline application model was the level of employment in the organisation, once sector, number of banks per 1,000 of the county in which the SME was located and the year were taken into account. A company with a higher level of employment is more likely to apply for bank finance. This is in line with the previous cross-tabulation analysis conducted by Indecon. Indecon then added additional variables in the Full Application Model (column 2 in the following table). Firms that made a loss in the last six months had a statistically significant increased likelihood of applying for bank finance compared to those who made a profit. Firms who had experienced decreased turnover or no change in turnover were less likely to apply for bank finance, whilst those who had missed at least one bank repayment were more likely to apply for bank finance. The more business management practices the firm undertook the more likely they were to apply for bank finance. It is important to note that business performance and practices are clear drivers of applications, whilst the measure of the rurality of the population in the county in which the enterprise is located is not statistically significant, suggesting there is no clear issue in terms of the rurality of counties impacting on application rates.

In terms of Indecon's models on bank finance application success rates, there are similar findings to the models for application rates, with business performance a clear driver as to whether a firm would be successful in their application. Firms with more employees were more likely to be approved, which is in keeping with Indecon's crosstabs presented previously which highlighted that micro-enterprises were less likely to be successful in their applications. Firms who broke even (8.5%) or made a loss (14.4%) in the last six months were less likely than firms who had made a profit to be successful in their application. A clear driver of success rates was whether the firm had missed a repayment in the previous six months with those who had missed a repayment associated with a 22% drop in the likelihood of success.

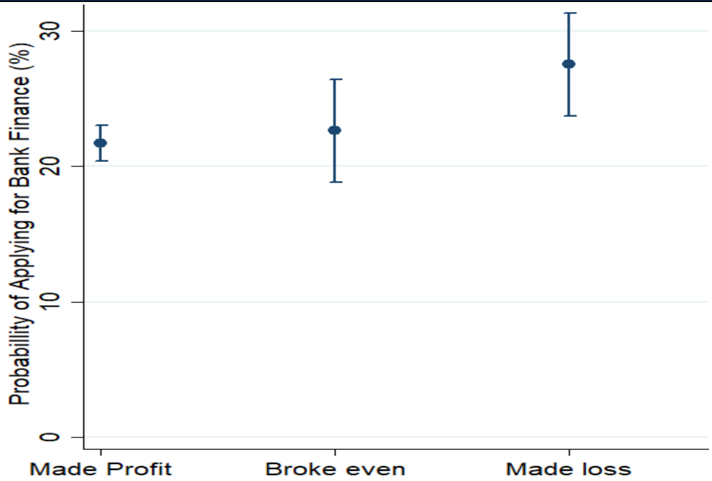
Table 7.12: Econometric Analysis of Market Failure in SME Credit Market

VARIABLES	(1) Baseline Application Model	(2) Full Application Model	(3) Baseline Success Model	(4) Full Success Model
Log(employees)	0.0394***	0.0308***	0.0405***	0.0382***
	(0.00335)	(0.00446)	(0.0100)	(0.00945)
bankspe1000smes	-0.000628	-0.000396	-0.0210*	-0.0148
	(0.0110)	(0.0114)	(0.0121)	(0.0125)
Year = 2017	-0.00200	-0.0106	0.0198	0.0218
	(0.0164)	(0.0154)	(0.0244)	(0.0248)
Year = 2018	-0.0180	-0.0307	0.0422	0.0643**
	(0.0193)	(0.0188)	(0.0314)	(0.0278)
Profit in last six months = 2, Broke even in last six months		0.00921		-0.0839***
		(0.0168)		(0.0303)
Profit in last six months = 3, Made a loss in last six months		0.0582***		-0.147***
		(0.0211)		(0.0558)
Profit in last six months = 4, Refused		-0.0867		
		(0.0586)		
Profit in last six months = 5, Not sure		-0.0407		-0.190**
		(0.0327)		(0.0782)
Turnover in last 6 months = 2, Turnover decreased in last six months		-0.0605***		-0.0479
		(0.0197)		(0.0330)
Turnover in last 6 months = 3, Turnover remained the same in last six months		-0.0559***		0.0227
		(0.0113)		(0.0179)
missedrep = 1, Have missed at least one repayment in last six months		0.219***		-0.217***
		(0.0366)		(0.0702)
missedrep = 2, Don't know		-0.0961**		-0.207*
		(0.0394)		(0.125)
Number of Bus Man Practices = 1		0.0418**		0.0489
		(0.0210)		(0.0712)
Number of Bus Man Practices = 2		0.0478**		0.00743
		(0.0243)		(0.0712)
Number of Bus Man Practices = 3		0.0957***		-0.00660
		(0.0217)		(0.0759)
Observations	4,558	4,558	919	917

Source: Indecon analysis of SME Credit Demand Survey and Business Demography

The findings presented above demonstrate that firm performance is a key predictor of application and success for bank finance loans. The following figures demonstrate the changing probabilities of applying for bank finance and the success of that application by the profit performance of the business in the previous six months.

Figure 7.12: Probability of Applying for Bank Finance by Profit Performance of Firm



Source: Indecon analysis of SME Credit Demand Survey and Business Demography

There is a clear difference in the success of those who made a profit and those who made a loss. The following figure shows that the probability of success exceeds 85% when the firm made a profit but close to 70% when the firm made a loss, all else held equal.

Figure 7.13: Probability of Success in Application for Bank Finance by Profit Performance of Firm

Source: Indecon analysis of SME Credit Demand Survey and Business Demography

Indecon conducted a number of sensitivities to the above analysis. This included using the revenue of a firm instead of the number of employees as a proxy for the size of the firm. This did not have any meaningful impact on the results of the modelling. Both in the case of the application and the success models, the rurality of the county remained statistically insignificant, whilst business performance measures did have an impact. Further modelling was conducted which included the number of years the firm was in operation and this was found to not have a statistically significant impact on either the probability of application or success of the application.

Indecon also ran the application and success models using different measures of population density (population per square kilometre and number of post offices without a bank within five kilometres in the county the firm is registered) instead of the number of banks per 1,000 SMEs. For the first of these alternative measures, population per square kilometre, Indecon found that whilst this coefficient was not statistically significant at the 5% level, there was significance at the 10% level, with the small negative coefficient indicating that there may be a slight negative relationship between population density and the probability of applying. However, the coefficient was statistically insignificant in the success model, suggesting that population density does not impact on the probability of success.

Table 7.13: Econometric Analysis of Market Failure in SME Credit Market (Sensitivities)

	Sensitivity 1		Sensitivity 2	
VARIABLES	Application Model - Pop per square KM	Success Model - Pop per square KM	Application Model - Number of Post Offices Without Bank Within 5KM	Success Model - Number of Post Offices Without Bank Within 5KM
Log(employment)	0.0309***	0.0385***	0.0308***	0.0382***
	(0.00445)	(0.00907)	(0.00448)	(0.00954)
Year = 2017	-0.00986	0.0218	-0.0105	0.0192
	(0.0155)	(0.0250)	(0.0154)	(0.0259)
Year = 2018	-0.0306	0.0649**	-0.0306	0.0634**
	(0.0187)	(0.0274)	(0.0188)	(0.0281)
Profit in last six months = 2, Broke even	0.00903	-0.0837***	0.00927	-0.0834***
in last six months	(0.0168)	(0.0301)	(0.0168)	(0.0305)
Profit in last six months = 3, Made a loss	0.0591***	-0.145***	0.0586***	-0.148***
in last six months	(0.0212)	(0.0560)	(0.0214)	(0.0568)
Profit in last six months = 4, Refused	-0.0853		-0.0862	
	(0.0588)		(0.0587)	
Profit in last six months = 5, Not sure	-0.0400	-0.194**	-0.0404	-0.203**
	(0.0325)	(0.0800)	(0.0326)	(0.0841)
Turnover in last 6 months = 2, Turnover	-0.0607***	-0.0493	-0.0606***	-0.0483
decreased in last six months	(0.0200)	(0.0326)	(0.0198)	(0.0328)
Turnover in last 6 months = 3, Turnover	-0.0562***	0.0225	-0.0561***	0.0236
remained the same in last six months	(0.0118)	(0.0183)	(0.0115)	(0.0182)
missedrep = 1, Have missed at least one	0.217***	-0.223***	0.219***	-0.218***
repayment in last six months	(0.0368)	(0.0705)	(0.0366)	(0.0673)
missedrep = 2, Don't know	-0.0950**	-0.205*	-0.0960**	-0.206*
	(0.0392)	(0.124)	(0.0395)	(0.123)
Number of Bus Man Practices = 1	0.0419**	0.0461	0.0416**	0.0487
	(0.0205)	(0.0704)	(0.0210)	(0.0714)
Number of Bus Man Practices = 2	0.0491**	0.00515	0.0478**	0.00757
	(0.0232)	(0.0704)	(0.0242)	(0.0719)
Number of Bus Man Practices = 3	0.0975***	-0.00799	0.0958***	-0.00733
	(0.0210)	(0.0748)	(0.0215)	(0.0768)
Log(Population per sq KM)	-0.00601*	-7.48e-05		
	(0.00325)	(0.00500)		
Number of POs without bank within 5			9.93e-05	-0.000639
KM			(0.000215)	(0.000509)
Observations	4,558	917	4,558	917

Source: Indecon analysis of SME Credit Demand Survey and Business Demography

7.5 Summary of Key Findings

- In assessing gaps between supply and demand for finance, it is important to consider if unmet credit demand is due to market failure and/or other reasons, for example, project unviability. An unwillingness of SMEs to apply for credit or the refusal of financial institutions to lend because of project unviability is a feature of a functioning market and would not merit public policy interventions or constitute a market failure. *"The concept of market failure refers to non-functioning aspects of the market which result in an inefficient allocation of resources and entail the underproduction or overproduction of certain goods and services."*[28]
- Market failure can, however, occur because of restricted levels of competition in a market or because of asymmetric information between the borrower and the lender. When information is asymmetric, lenders' ability to price risk is impaired and some SMEs and micro-enterprises may be discouraged from applying for loans. International research by Nguyen (2014) suggests that local branches can help overcome information asymmetries and bank closures can impact on small business lending.[29]
- Market failures in finance can also arise due to positive externalities not taken into account by the lender. Financing viable enterprises can result in positive spill-overs to the economy. In particular, promoting investment in Irish start-up and other SMEs has the benefit of enhancing the development of rural areas and stimulating growth and innovation in indigenous sectors. For these reasons the state has introduced a wide range of supports for micro-enterprises and SMEs as outlined above.
- Economic inefficiency arising from the presence of market failure can result in a lower amount of credit provided or higher interest rates. This refers to projects where more loans would be provided or where a lower interest rate[30] would apply if the lenders could accurately assess and monitor the credit risk of the borrower (symmetric information), or if the lender could be rewarded for the social benefit generated by the enterprise/project funded (positive externality). This also includes cases where viable micro-firms are discouraged from applying for loans due to information gaps. This could arise because of a lack of information on the willingness of banks to lend or a distrust of banks or perceived difficulties with application processes. A similar issue applies if the level of competition between providers is restricted resulting in higher interest rates.
- To help inform a judgement on whether there is "market failure" in the provision of banking and financial services for the enterprise sector, Indecon has undertaken a detailed analysis of lending patterns at sectoral and geographic levels. Despite the overall levels of new lending there has been a decline in the application rates for bank finance by the SME sector. Application rates for bank finance were 35% in March 2014 and declined to 20% by September 2018. Micro-enterprises have consistently lower application rates than the other types of SMEs. The key issue is what are the reasons for this decline in demand for credit. The evidence examined by Indecon shows that the main reason why SMEs did not apply for

[28] European Commission and European Investment Bank, Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period. April 2014. See: https://www.fi-compass.eu/sites/default/files/publications/manual_vol-I_ex-ante-assessment-general-metholology.pdf

[29] See: 2014 Hoai-Luu Nguyen https://economics.mit.edu.files/10143

[30] Indecon's analysis shows that interest rates on SME lending are higher in Ireland than in some other EU countries.

finance is because they did not need the credit. However, for a small percentage of SMEs the reasons for not applying are: perceptions that credit is too expensive; lack of trust in the banks; a belief that banks are not lending; belief that the application process is too difficult; or that banks take too long to make decisions. While these represent only a very small percentage of firms who did not apply for credit, when applied to the totality of enterprises in the economy this suggests that approximately 9,715 SMEs may have been discouraged from applying for lending because of these reasons. Some of these firms even if they applied for credit, may not have been accepted for valid reasons but we note that bank finance rejection rates fell from 22% to 15% for SMEs between 2014 and 2018.

- While overall application or rejection rates are of interest, it is important to empirically estimate the key determinants impacting on credit supply and demand. Indecon has undertaken rigorous new econometric modelling to identify the reasons behind companies applying for bank finance controlling for other factors, and the determinants of success in loan applications. Indecon used a probit model to estimate the probability that a firm will apply for bank finance, and whether a firm that applied for finance will be successful in their application. Indecon controls for the size of the firm, using the number of employees as a proxy for its size, and the sector of the firm as application and success rates vary by sector. In Indecon's application model we also included a number of business performance measures. The results show that a statistically significant variable in the baseline application model is the size of firms. Companies with higher level of employments are more likely to apply for bank finance.
- Rural areas have a high weighting of micro-enterprises and these businesses have limited banking relationships. Irish Rural Link highlighted this issue in the consultation process. If micro-enterprises do not apply for credit, this could impact on overall investment levels in the economy. Indecon's analysis of the available evidence, however, suggests that for most enterprises a lack of internal funds rather than access to credit is the main constraint but for some firms access to credit is a barrier. This is consistent with the recent important ESRI research on exploring investment patterns for SMEs.[31] The ESRI paper suggests a capital gap exists for one in five enterprises. For 11.2% of these firms, the ESRI research indicates access to external finance was seen as a barrier.
- During the stakeholder consultation it was suggested that the banks in providing credit are focusing on what they perceive to be lower risk lending. This is not surprising as risk is appropriately a key criterion for any lending institution and this is likely to be given even more emphasis as the major banks attempt to reduce legacy high levels of non-performing loans. The econometric modelling undertaken by Indecon is consistent with this as it highlights the significance of firm size and business performance in influencing the level of credit provided. Lower risk and higher performing firms are also likely to have invested in a range of skills and business management processes. Indecon's new econometric evidence shows that the more business management practices the firm undertook the more likely they were to apply for and to secure bank finance. This is particularly relevant as a SFA paper indicated that only 46% of firms surveyed said they had good or expert knowledge of financial literacy.[32] Enhancing skills and knowledge within SMEs to improve business

[31] Gargan, E., Lawless, M., Martinez-Cillero, M., O'Toole, C., Exploring SME Investment Patterns in Ireland: New Survey Evidence.

[32] Financial Literacy among Irish Micro, small and medium-sized businesses SFA 2019. Report prepared with project partners TU Dublin, Microfinance Ireland, SBCI and Skillnet Ireland.

performance is therefore likely to be an appropriate policy intervention and one which will impact on access to credit. The results of Indecon's econometric modelling also suggest that the rurality of the population in the county in which the enterprise is located is not in itself statistically significant when other factors are controlled for. Indecon, however, notes the econometric modelling is restricted to using county level data on rurality and it would be useful to have data to model the distance to the nearest bank branch before coming to definitive conclusions on the importance or otherwise of bank branches. Our results may also reflect the higher levels of bank branches per SME in many rural counties.

- Indecon's analysis of the evidence indicates that while the overall availability of credit to the enterprise sector in Ireland has significantly improved, and while most firms do not apply for credit because it is not needed, there are information asymmetries and other factors which are likely to have contributed to the low levels of credit applications particularly from smaller enterprises.

- One additional area of market gap concerns those in society who face financial exclusion. During our stakeholder consultation the Citizens Information Board indicated that there is a segment of the population who continue to be excluded from financial services and products. This is likely to reflect wider societal and economic issues. Individuals may also be financially excluded due to lack of access to the internet and as noted earlier, many households do not have such access. This point was also made to Indecon in our consultations by the Irish Congress of Trade Unions who noted that it should not be assumed that internet banking is a viable alternative for many people. Congress indicated that there are many low-income groups, elderly persons or people suffering from social exclusion who have no regular access to the internet. The National Disability Authority has also indicated that social inclusion and community participation in financial services is an important issue for people with disabilities where travelling to other locations may not be a feasible option.

8 Overall Conclusions and Recommendations

8.1 Conclusions

A summary of Indecon's conclusions from our detailed evaluation of the concept of community banking in Ireland is presented in Table 8.1.

Table 8.1: Key Conclusions from Evaluation of Concept of Community Banking in Ireland
1. There is extensive provision of banking services by credit unions, An Post, as well as by commercial banking providers in the Irish market.
2. There are some areas of market failure in the local provision of financial services.
3. There is a wide range of existing supports funded by the Irish Exchequer to assist SMEs and micro-enterprises.
4. There is not a compelling economic case for the establishment of a new state-owned public banking network.
5. There is a range of ways in which targeted measures could assist the provision of local banking services in a cost-effective manner.

1. There is extensive provision of banking services by credit unions, An Post, as well as by commercial banking providers in the Irish market.

Our analysis has demonstrated the important role played in the provision of local banking and financial services in Ireland by a range of non-banking organisations including the credit unions and An Post. Indecon's analysis indicates that in addition to the community banking role played by the credit unions and An Post, the main commercial banks have a large footprint of branches. There is also evidence of new entrants to the SME market including non-traditional providers. Indecon's analysis suggests there is currently wide availability of many core banking services. However, Indecon notes the high levels of concentration in the banking sector and the fact that credit is more expensive than in other counties.

2. There are some areas of market failure in the local provision of financial services.

Indecon's examination of the evidence suggests that despite the extent of the branch network and the provision of services, there are some areas of market failure. Information asymmetries exist which are restricting the level of both credit demand and supply. The evidence also shows that a small percentage of enterprises are discouraged from borrowing due to a range of factors such as perceptions that banks are not lending or due to the level of interest rates or issues concerning application processes. There are also market gaps for those at risk of financial exclusion.

3. There is a wide range of existing supports funded by the Irish Exchequer to assist SMEs and micro-enterprises.

Indecon's analysis has highlighted the wide range of existing supports which are funded by the Irish Exchequer to assist SMEs and micro-enterprises. These include supports provided by The Strategic Banking Corporation of Ireland (SBCI) and Microfinance Ireland as well as supports provided by Enterprise Ireland and Local Enterprise Offices. Other initiatives include the establishment of the Credit Review Office and the Credit Guarantee Schemes. In addition, measures have been taken to help enhance financial inclusion including by MABS, credit unions and other organisations.

4. There is not a compelling economic case for the establishment of a new state-owned public banking network.

Indecon's analysis indicates that the absence of a physical branch network in rural areas is not the key factor determining access to credit. Indecon accepts that Irish customers still value face-to-face relationships and the branch network will continue to play an important role in Irish banking. Local branches can help overcome information asymmetries. However, our analysis supports the conclusions of the previous investigation by the Department of Finance and the Department of Rural and Community Development, that there is not a compelling case for significant investment by the State into a new local public banking network. We would have concerns over the ability of such a new state-owned entrant to provide effective competition and the Exchequer costs and risks involved would not be justified by our analysis of the causes and extent of market failure.

5. There is a range of ways in which targeted measures could assist the provision of local banking services in a cost-effective manner.

Indecon believes there are measures which could be taken to enhance the provision of local banking services in Ireland. These as outlined in our recommendations include measures to leverage the existing banking network and state infrastructure as well as encouraging new entrants. There are also actions which could be taken by the commercial banks to enhance service provision and reduce information asymmetries. There is also a need for ongoing measures to reduce financial exclusion of vulnerable individuals, but this will require wider action outside of the remit of a community banking response. A key role that the credit union sector plays in driving and promoting social inclusion. This was also a point made during the consultation process by the Citizens Information Board.

8.2 Recommendations

Indecon has, in line with our terms of reference, presented recommendations to further strengthen community banking provision in Ireland. It is hoped that these recommendations and the analysis in this report will assist in inputting to evidence based policy in this important area. In forming our independent recommendations, Indecon is very conscious of the need to maximise the use of scarce public expenditure and recognise the constraints faced by the Exchequer. We are also cognisant that despite the extent of financial service provision, there are some areas of market failures and there is merit in enhancing the provision of banking services to local communities. The recommended measures represent targeted initiatives to strengthen community banking in the most cost-effective way.

Our recommendations were informed by an examination of potential delivery mechanisms including:

- Leveraging the existing financial services system in Ireland;
- Leveraging existing state infrastructure/supports;
- Facilitating new market entrants; and
- Online / Fintech-based approaches.

The existing financial services sector in Ireland includes commercial banks as well as credit unions, An Post, and other providers. Indecon believes there is scope for the delivery of an expanding range of local financial services via the existing networks. Of particular importance is the recent initiatives taken by the credit union movement as well as the plans by An Post to expand the services provided. There is also an ongoing role for the main banking groups to help overcome information asymmetries and to ensure that viable micro-firms and SMEs are facilitated to secure credit.

One of the noteworthy features of the Irish financial market is the extent to which state supports have been implemented to address areas of market failure, promote access to finance and to reduce the risk of financial exclusion. This existing infrastructure could be leveraged to enhance access to finance. Some adjustments to the existing state supports could be made to further the provision of local banking services. Using the existing programme infrastructure would represent a cost-effective way of enhancing access to finance.

New entrants to the Irish banking market would help directly address any areas of market failure. This could assist in improving access to credit and would enhance competition. There would be resultant benefits in service provision and in the reduction of the cost of lending in the Irish market.

There is also potential for online or other Fintech initiatives to further expand banking services to local communities. Online or Fintech offerings have an advantage in terms of lower costs. Such online offerings could entail offering decentralised platforms for enhanced financial services provision to communities. Facilitating individuals to access such services would, however, be important and options for face-to-face interactions will also be needed for some parts of the market.

Indecon's recommendations are summarised in Table 8.2 and are elaborated upon in the subsequent paragraphs.

Table 8.2: Recommendations re Community Banking Services in Ireland

LEVERAGING ROLE OF STATE SUPPORTS FOR SMEs INFRASTRUCTURE TO ADDRESS MARKET GAPS:

1. **Continue to target rural enterprise support in future counter-guarantee loan schemes.**
2. **Expand Microfinance Ireland's mandate to provide enterprise loans of up to €50,000.**
3. **Promotion by Local Enterprise Offices of Micro Enterprise Loan Fund.**
4. **Set ambitious targets for regional impact of any revised Brexit loan scheme.**
5. **Consider new initiatives to support expansion of SME lending by newer platforms.**

REDUCING FINANCIAL EXCLUSIONS AND MANAGING OF EXISTING INFORMATION BY CREDIT UNIONS, AN POST AND LOCAL AUTHORITIES:

6. **Expansion of Personal Micro Credit Scheme by member-owned credit unions.**
7. **Facilitation of new providers to enhance access to credit in communities.**
8. **Development of initiatives by local authorities as part of digital strategies to assist individuals to apply online for banking services.**

ENHANCING COMPETITION:

9. **Support the Credit Union Market to deliver Expanded Range of Community Banking Services.**
10. **An Post to explore and discuss with its parent Government Department, NewEra, and, where appropriate, the Department of Finance, the possibility of investing in partner financial organisations, where such investment is commercially viable and where it would enhance competition in lending market.**
11. **Extend Exemption for New Community Banking Entrants from Notification of Charges for 5 Years.**

REDUCING INFORMATION ASYMMETRIES AND BUILDING SKILLS:

12. **Development of Technology Based Lending Tool Kit by Enterprise Ireland and Local Enterprise Offices.**
13. **Advisory supports by Local Enterprise Offices to include assistance with preparation of lending applications.**
14. **Skillnet Ireland to offer analysis of lending requirements as a component in their Management Development Programmes.**

ENHANCED RESPONSIBILITY FOR COMMERCIAL BANKS:

15. **Commercial Banks should consider the establishment of an increased number of Community Banking Hubs or provide alternative methods of banking services delivery in areas where branch closures may have hindered access to banks.**

Source: Indecon

LEVERAGING ROLE OF STATE SUPPORTS FOR SMES INFRASTRUCTURE TO ADDRESS MARKET GAPS

1. Continue to target rural enterprise support in future counter-guarantee loan schemes.

The SBCI Future Growth Loan Scheme was designed to address a market gap in the provision of longer-term lending for SMEs. This has been successfully introduced and there has been extensive utilisation of this by enterprises outside of Dublin and the major cities. Similar schemes should be introduced going forward in order to enhance local banking provision, and Indecon recommends that targeting rural enterprise should be a priority for SBCI, and in future counter-guarantee loan schemes. This should be supported by the setting of ambitious targets for rural areas. Having a strong rural enterprise focus would increase awareness of the availability of lending for the sector.

2. Expand Microfinance Ireland's mandate to provide enterprise loans of up to €50,000.

Indecon notes that Budget 2020 included a provision in the context of a no deal Brexit to permit Microfinance Ireland to expand its mandate from a maximum loan size of €25,000 to up to €50,000. This is consistent with our judgement that there are some market gaps in the provision of loans for micro-enterprises. The average loan size for micro-enterprises as per the Department of Finance's September 2018 report was €140,571. Indecon believes that the expansion of Microfinance Ireland's mandate will help address gaps in this segment of the lending market.

3. Promotion by Local Enterprise Offices of Micro Enterprise Loan Fund.

Microfinance Ireland (MFI) was established in 2012 to provide small loans (€2,000 - €25,000) for business purposes, to start-up, newly established or growing micro-enterprises employing fewer than 10 people and with turnover of less than €2 million per annum. Since its establishment to the end of 2018, MFI has approved 1,699 loans totalling €28 million. During our consultation programme we understand that it has been estimated that this has helped to create or sustain 4,808 jobs and that 79% of these loans have gone to recipients outside of Dublin. To reflect the risks, the loans are priced at 7.8%. However, if the applications are referred through the LEOS, a lower rate of 6.8% applies. Indecon recommends that promotion by Local Enterprise Offices of MFI loan funds is intensified as it is important that all viable micro-enterprises in local communities are aware of this funding provision.

4. Set ambitious targets for regional impact of any revised Brexit loan scheme.

As part of any revised Brexit loan scheme there is merit in setting ambitious targets for its regional impact. This would assist in meeting market gaps by SMEs in local communities in securing lending for viable projects. The focus on regional impacts would be aligned with the case for supporting regional development.[33]

[33] In its detailed review of the economic appraisal model used by the enterprise development agencies, Indecon proposed differential weighting of regional enterprise investment decisions. See 'Indecon Review of the Enterprise Agencies' Economic Appraisal Model in Ireland' – report prepared for Irish Government/Department of Business, Enterprise and Innovation, 2018 (https://dbei.gov.ie/en/Publications/Publication-files/Review-of-the-Enterprise-Agencies-Economic-Appraisal-Model.pdf).

5. Consider New Initiatives to Support Expansion of SME Lending in New Platforms.

The three main commercial banks have a very high share of the non-property/unsecured direct SME lending market. In addition, many of the incentives provided by the State to support access to finance are channelled through the pillar banks. While the main banks are an important route to market, the level of take-up would be enhanced by the provision of lending by non-traditional lenders. Providing tailored supports to assist the new type of lenders would enhance competition in the Irish banking market. Non-traditional online and other lending players have a different source of liquidity and risk capital from the main banks and this impacts on their pricing. Indecon believes that the impact of these players on community banking particularly in SMEs lending could be enhanced by the provision of a funding platform which would benefit from SBCI first loss risk sharing approach and that this should be considered. A condition of providing any such facility should be that it reflected by way of a loan price discount so that SMEs benefit. Indecon understands that SBCI has access to unused COSME Counter Guarantee Capacity from the EIF as well as from its own capital and this could potentially be introduced without any exchequer support. However, providing a limited amount of exchequer support to form a loss reserve and or to facilitate set-up costs would increase the roll out of this initiative.

Reducing Financial Exclusions and Managing Existing Information by Credit Unions, An Post and Local Authorities

6. Expansion of Personal Micro Credit Scheme by member-owned credit unions.

The Personal Micro Credit Scheme provides for small scale loans by credit unions to borrowers who have difficulty in accessing low cost credit. Loans under the scheme known as 'It Makes Sense' loans range in value from €100 to €2,000 and have a maximum interest rate of 12% in line with credit union legislation. This scheme directly addresses a market gap referred to in our conclusions for people who would otherwise be financially excluded. The Programme for a Partnership Government supports the rollout and extension of the Personal Micro Credit Scheme and Indecon's analysis would support this action. Indecon understands that as of April 2019, good progress has been made with 110 credit unions at 264 locations representing almost 50% of credit unions. Greater participation in the scheme is, however, recommended. Indecon also notes the ongoing work of the Personal Microcredit Task Force, which was established by the Social Finance Foundation and includes representatives from the Department of Employment Affairs and Social Protection, the Department of Finance, the Central Bank as well as the credit union development and management associations. Among the work of the task force is the examination of potential solutions to address the challenges involved in the further roll-out of the Personal Micro Credit Scheme.

7. Facilitation of new providers to enhance access to credit in communities.

Indecon believes there may be potential for An Post or other community-based providers to increase access to credit. This could build on An Post's recently introduced services in partnership with AvantCard which offers personal loans and credit cards through the network of local post offices. Indecon would be supportive of An Post or other new providers taking on a greater role in community banking in such areas.

8. Development of new initiatives by local authorities as part of digital strategies to assist individuals to apply online for banking services.

Local authorities are developing digital strategies which include actions to assist local communities. As part of these strategies Indecon recommends the development of new initiatives to assist individuals to apply online for banking services. These could be developed in conjunction with the national library network and with local community organisations. During our consultation process, the point was raised that there is a cohort of the population among which, for a number of reasons, use of online channels is regarded as problematic. Assistance to individuals to apply online for banking services would help reduce financial exclusion.

ENHANCING COMPETITION

9. Support the Credit Union movement to Deliver Expanded Range of Community Banking Services.

It was suggested during our consultations that there is a need for "substantive recognition of the role of the credit unions" in meeting emerging market gaps. Indecon is fully supportive of this and believes that it is essential that ongoing policy decisions and regulations are framed in a manner which ensures no discrimination against credit unions in their plans to develop a wider range of community banking services where they have the capabilities and financial strengths to do so. Policy should therefore support the credit union movement to deliver new community banking services. This will require collaboration between Credit Unions and measures to encourage the adoption of new services where feasible. In addition to their traditional role in savings and personal lending the introduction of current accounts and targeting lending in the house loan and SME markets would enable the credit unions to provide all the main areas of community banking. This will require investment in technology and skills and Indecon notes that there has been recent progress in these areas. The full potential of the credit unions will also require an appropriate regulatory and policy context. Indecon believes that the CUAC Report Implementation Group on how the credit union movement could deliver more services to their communities provides a useful roadmap in this area. Indecon notes that the Central Bank has recently revised the lending regulations for credit unions. Ensuring that regulation supports the long-term sustainability of credit unions is appropriately the independent prudential function of the Central Bank. The priority is to ensure the ongoing viability of the sector. How to achieve this while providing incentives for investment in the structures required to develop commercial lending is an important issue for consideration by the Central Bank and the sector.

10. An Post to explore and discuss with its parent Government Department, NewEra, and, where appropriate, the Department of Finance, the possibility of investing in partner financial organisations, where such investment is commercially viable and where it would enhance competition in lending market

An Post is a provider of certain financial services to retail and SME customers. An Post has in excess of 500 post offices in locations where there are no banks within 5 kms and is an important part of the local community banking infrastructure. An Post has an ambitious growth strategy for its An Post Money business. We understand that this is likely to require An Post to partner with other organisations to provide lending propositions in mortgages, unsecured SME lending and technological capability. This may be facilitated if An Post co-invests from its own resources in equity in partner financial organisations. Indecon believes that this could enhance community banking in Ireland and should be supported. Indecon would, however, recommend that such investment should only be made where it is commercially viable and where it would enhance competition in the lending market for SMEs and micro-enterprises.

11. Extend Exemption for New Community Banking Entrants from Notification of Charges for 5 Years.

The Central Bank (Supervision and Enforcement) Act 2013 provided that relevant new credit institutions establishing business in the state after 1 August 2013 are not subject to Section 149(1) and are not required to notify the Central Bank of charges imposed for their services for a period of three years after the credit institution commences business in the State. In order to facilitate any new community banking organisation who may wish to establish in Ireland, and taking account of the need to facilitate the commercial viability of any new entrants and also to minimise administrative burden, we recommend that consideration is given to extending the exemption for any new community banking entrants from Section 149(1) for a five-year period. Indecon accepts that this is not a major barrier but any initiatives which could, at the margin, facilitate new entrants should be encouraged.

Reducing Information Asymmetries and Building Skills

12. Development of Technology Based Lending Tool Kit by Enterprise Ireland and Local Enterprise Offices.

Increasingly technology can assist in the evaluation of credit risk and in the preparation of credit applications. The background is the requirement on lenders to evaluate risks for new SME lending applications. This is important as supporting non-viable projects would simply increase loan defaults and would not be consistent with increasing economic efficiency. An issue, however, raised in the consultations was that for micro-enterprises and some SMEs preparing applications for banking lending is challenging. This can arise from the lack of specialised skills in SME. Some of these constraints could be eased by the use of technology which could assist SMEs to prepare cash flow projections based on existing financial information. Indecon recommends that consideration is given to the merits of developing a technology-based lending kit is to assist SMEs in local communities to apply for business loans.

13. Advisory supports by Local Enterprise Offices to include assistance with preparation of lending applications.

There is a case for Local Enterprise Offices to assist smaller firms with the preparation of lending applications. Small businesses in the past have been helped by local bank managers with this task. Indecon recognises that some Local Enterprise Offices currently undertake this role as part of their wider supports. In addition, InterTradeIreland, reflecting this market gap, organises workshops on preparing lending applications and this could reduce the number of discouraged borrowers to apply for credit for viable projects. Indecon recommends wider supports in this area.

14. Skillnet Ireland to offer analysis of lending requirements as a component in their Management Development Programmes.

The new econometric evidence completed by Indecon for this project has demonstrated that a number of factors are statistically significant in influencing the demand for credit by firms in Ireland. These include whether firms keep regular management accounts, whether they have an existing business plan and whether they estimate requirements for cash flow for the coming months. All these factors are essential in preparing effective lending applications. They are also likely to give SME confidence that they can afford lending costs and to make informed decisions. Indecon recommends that Skillnet Ireland offer support for training including the analysis of lending as a composition in their Management Development Programmes. There may also be merit in Skillnet Ireland supporting targeted discreet skill development for SME management in this area.

Enhanced Responsibility for Commercial Banks

15. Commercial Banks should consider the establishment of an increased number of Community Banking Hubs or provide alternative models of banking services delivery in areas where branch closures may have hindered access to banks.

While there is a tendency to assume that any market gaps should be addressed by Government action, Indecon believes that there is also a need for an appropriate response by the existing major commercial banks. This should ensure at least a minimum level of service to local communities, whereby credible options for face-to-face interaction with banks' lending personnel are made available. Indecon recognises that the banks have developed options other than traditional branches which include workbenches, event facilities, mobile banks and partner spaces with other organisations as well as more mobile customer advisors. An extension of these into a wider network of community banking hubs or other initiatives could open up additional opportunities for the banks and also address the market gaps which exist as a result of some micro-enterprises and SMEs not having close proximity to a major lender in the market. In this context Indecon understands that the main banking groups allocate relationship managers to SMEs based on a range of criteria including levels of existing or potential business exposures and that the criteria varies between banks. These relationship managers can help expedite the process concerning lending decisions and other bank services to enterprises and can encourage viable lending proposals. We also recognise that there are business advisers in branches where individuals can discuss lending or other requirements and various other channels in which enterprise can meet banks to discuss their requirements. Indecon believes there may be a way in which local provision can be enhanced by the banks by giving a greater weight to the allocation of relationship managers or regional business advisers where bank branches are not readily accessible. This could involve increasing investment in providing convenient voice, digital and other booking systems for business advisors to explain lending criteria and offering an increased number of site visits for SMEs and micro-enterprises in regional areas. Most of the banks have mobile colleagues who are willing to travel to meet customer needs throughout the country. Pro-active offers to meet SMEs and micro-enterprises based in regional areas to explain how to apply for bank services and to understand their business should be rolled out on a regional basis.