The Senate

Economics
References Committee

Access of Small Business to Finance

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Senate Economics References Committee

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Summary and Recommendations

Small business is a vital element of the Australian economy, employing half the workforce. Lending to small business has slowed since the global financial crisis, and interest margins have widened. The outstanding value of smaller loans (under $500,000) has fallen in the agricultural, manufacturing and financial sectors. Surveys of small businesses show that the availability and cost of finance remains a major concern.

The slowdown in lending to small business appears to reflect a combination of demand factors such as;

- less demand for finance by small business in the wake of the global recession, as weaker sales mean that existing capacity is adequate and there is not the need to borrow for investment;
- less demand for finance by small business as reduced confidence leads to a more conservative attitude towards debt;

and supply factors such as;

- fewer small businesses being able to meet existing lending standards in the wake of the global recession;
- some tightening of lending standards by financial intermediaries. It is arguable that banks were tending towards recklessness in the preceding boom, and that some tightening of credit standards represents a prudent return to 'normal' practice, but there may also be cases where banks are over-reacting; and
- non-bank lenders having fewer funds available as securitisation and interbank lending markets dried up and/or interest rates in them became prohibitive.

Witnesses were reluctant to apportion the roles played by these various factors.

Most small businesses borrow at variable interest rates. Banks did not fully pass on the reductions in the Reserve Bank's policy rate between August 2008 and September 2009 to small business borrowers but fully passed on the subsequent increases. Over this period, banks have widened the margin between the cost of their funds and the rate they charge small businesses on loans. Some view the near-simultaneous increases in interest rates as a form of price leadership. Banks have also increased the fees they charge small business and required greater security for their loans.

These developments are reflections of competition for lending to small business having diminished. Important drivers of this include bank mergers and the difficulties faced by non-bank competitors. While some of this diminution in competition is related to the global financial crisis, and so should be temporary, the impact of structural changes such as mergers will be long-lasting.

The Committee is concerned that bank exit fees on variable-rate loans are an impediment to competition in that market.

Recommendation 1

5.29 The Committee recommends that banks abolish exit fees on variable-rate loans. If banks do not do so by the end of 2010, then guidelines or regulations, or if necessary new legislation, should be used to compel them to do so.

The Committee notes evidence suggesting that larger banks may be less interested in lending to small business than are smaller banks, which prompts further concerns about the big four banks taking over smaller rivals. The Committee is concerned that the existing provisions of the *Trade Practices Act 1974* may be insufficient to prevent further undesirable takeovers in the banking industry.

Recommendation 2

6.28 The Committee reiterates its recommendation that the Government retain the 'four pillars' policy of not allowing a merger between any of the four major banks.

Recommendation 3

6.29 The Committee recommends that a moratorium be placed on approval of any further takeovers in the banking industry for one year, unless the bank being taken over is at imminent risk of failure.

Recommendation 4

6.30 The Committee reiterates its recommendation that the *Trade Practices Act* be amended to inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

Recommendation 5

6.31 The Committee recommends that the Government request the ACCC, APRA and the Reserve Bank to provide a joint annual report to parliament on competition in the retail banking market in Australia, and the provision of finance to small business, but taking care not to increase unduly the reporting burden on financial institutions.

Some submissions called for some form of 'development bank' or 'rural bank' to be established, or Australia Post to be offered a banking licence, to fill perceived gaps in lending by the private banks, or for a body to be established to guarantee small business loans (as exists in some other countries). The Committee prefers to increase competition within the existing commercial banks.

The Committee believes that small business will be better placed to benefit from a competitive market, and place pressure on banks to make the market more competitive, if they have a stronger understanding of financial markets. It commends the Australian Securities and Investments Commission for developing a small business portal to explain concepts relating to small business credit and those banks which have also developed online tools for small businesses.

The Committee notes that some other countries have a specific code of conduct governing banks' lending to small business.

Recommendation 6

7.14 The Committee recommends that the Australian Bankers' Association meet with small business representatives to develop a code of practice for lending to small business.

The Committee notes that farmers comprise an important class of small business and have had difficulty attracting credit to tide themselves through droughts or periods of low prices.

As there is inherently more risk in subscribing venture capital than in making a secured loan, the increase in risk and risk aversion that occurs in recessions tends to lead to larger reductions in the provision of capital than in loans. The Committee, however, received far more submissions about lending to small business than about the provision of venture capital, so while it offers some comments in this area is not in a position to make recommendations.

Chapter 1

Introduction

Background

1.1 Small business is a vital element of the Australian economy, employing half the workforce. Lending to small business has slowed since the global financial crisis, and interest margins have widened. This report seeks to assess the extent to which this reflects reduced demand for finance, a reaction (possibly an over-reaction) to past lax lending standards and any lack of competition in the banking and finance industry. It suggests measures that could make the provision of finance to small business more efficient.

Conduct of the inquiry

1.2 The Senate referred the topic of small business finance to the Committee on 3 February 2010 for report by 30 June 2010. The terms of reference are:

> This inquiry will investigate the current circumstances of issues surrounding access of small businesses to finance, including:
>
> (a) the costs, terms and conditions of finance and changes to lending policies and practices affecting small businesses;
>
> (b) the importance of reasonable access to funding to support small business expansion and the sector's contribution to employment growth and economic recovery;
>
> (c) the state of competition in small business lending and the impact of the Government's banking guarantees;
>
> (d) opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion;
>
> (e) policies, practices and strategies to enhance access to small business finance that exist in other countries; and
>
> (f) any other related matters.

1.3 The Committee advertised the inquiry in a national newspaper and on its website. A large number of interested parties were also told about the inquiry and invited to make submissions.

1.4 The Committee received 52 submissions (listed in Appendix 1) which are available for viewing on the Committee's website (http://www.aph.gov.au/Senate/committee/economics_ctte/small_business_10/submissions.htm) and held public hearings in Sydney and Canberra on 12 April and 10 May 2010. (The witnesses are listed in Appendix 2.)

1.5 The Committee thanks all those submitters and witnesses for their contributions and participation in the inquiry process.

Structure of the report

1.6 The recent slowdown in small business finance is described in Chapter 2 and the relative role of demand and supply factors behind this slowdown are evaluated in Chapter 3. The costs and conditions applying to finance for small business are the subject of Chapter 4.

1.7 Competition in the banking and finance industry is the subject of Chapter 5. This is followed by a discussion of structural changes in the industry. Both chapters examine suggestions for improving competition within the industry. Chapter 7 examines ways of improving financial literacy.

1.8 Farmers are an important category of small business and the discussion in all chapters is relevant to them. Chapter 8 discusses some issues specific to the rural sector.

1.9 The Committee received far more submissions about lending to small business than about the provision of venture capital. A brief discussion of venture capital is included in the final chapter.

Chapter 2

Recent trends in small business finance

The role of small business in the economy

2.1 The small business sector makes a significant contribution to economic growth, accounting for 39 per cent of total value added by industry in 2007-08, and accounting for about half of employment.[1]

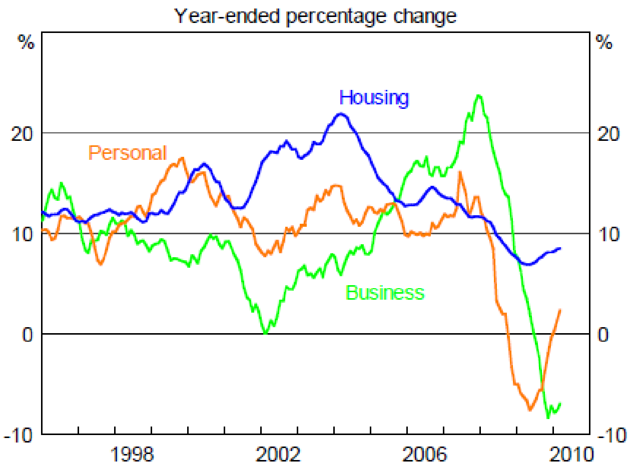
2.2 Treasury attested to the importance of small business having adequate access to finance:

> Access to finance is important in allowing small businesses to maintain their important contribution to the economy and in allowing them to grow. The availability of reasonably placed credit allows small businesses to expand their activities, fund new and innovative investments, smooth cash flows and maintain employment.[2]

The extent of the lending slowdown

2.3 The Reserve Bank publishes monthly data on credit provided by financial intermediaries, split between business, housing and other personal lending (Chart 2.1). Business credit was expanding at annual rates of around 20 per cent before the crisis, but has contracted since 2009.

Chart 2.1: Credit by sector



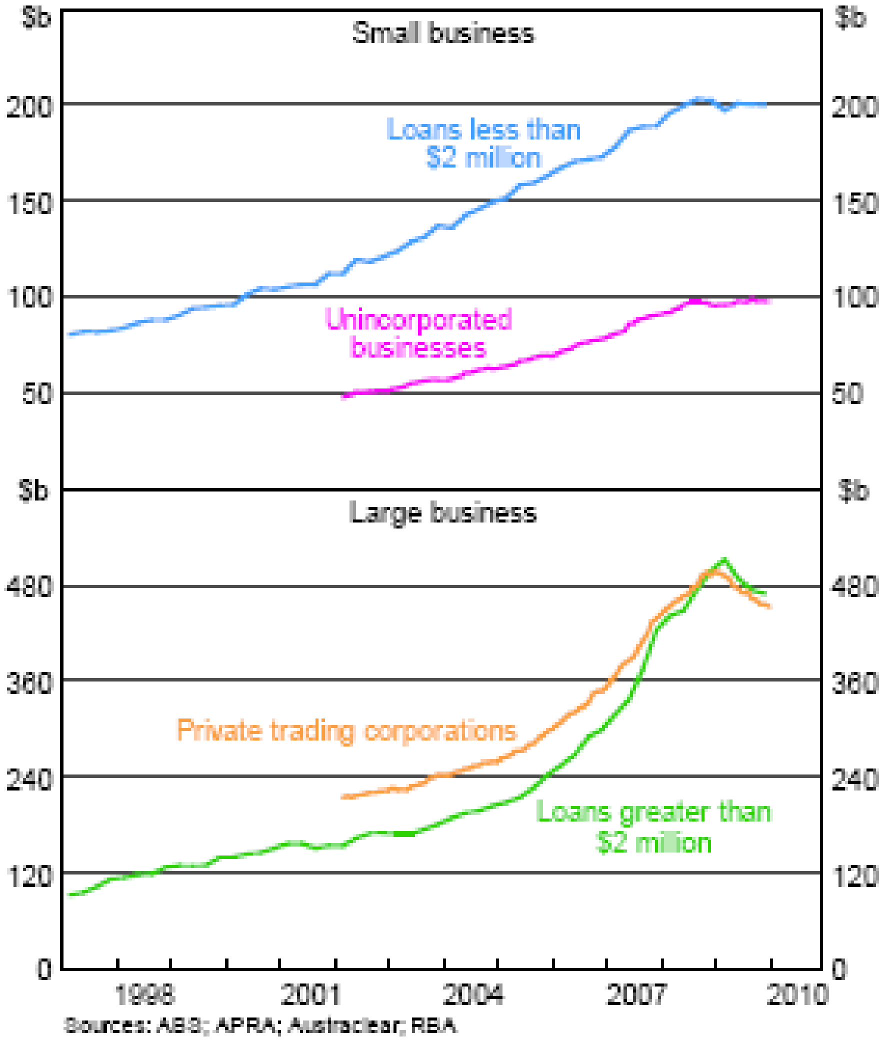
Source: Reserve Bank of Australia (www.rba.gov.au)

1 Treasury, *Submission 50*, p. 1, citing ABS data. The ABS defines a small business as one employing fewer than 20 people.

2 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 2.

2.4 These commonly-cited data do not distinguish between credit provided to large companies and small businesses. APRA collects quarterly data from banks on lending to business classified by the size of the loan, which is likely to be a reasonable proxy for the size of the borrower. It shows that the cutbacks in outstanding credit have occurred in the larger loans rather than smaller loans (Chart 2.2).[3]

Chart 2.2: Bank lending to small and large businesses



Source: Reserve Bank of Australia, *Submission 2*, p. 2.

2.5 There are signs of recovery in lending to small businesses:

> … [major] banks have generally increased their lending to smaller unincorporated businesses over the past year.[4]

3 The drift from 'small' to 'large' loans apparent over the 15 years covered by the chart would be, at least partly, attributable to inflation.

4 Reserve Bank of Australia, *Financial Stability Review*, March 2010, p. 30.

Small business loans by industry and sector

2.6 The outstanding value of smaller loans (under $500,000) has fallen in the agricultural, manufacturing and financial sectors (Table 2.1)

Table 2.1: Bank loans outstanding under $500,000 at end-year

($ billion)	2007	2008	2009
Agriculture	16.1	16.0	15.4
Mining	0.9	1.1	1.1
Manufacturing	6.1	6.3	6.0
Construction	7.3	7.8	8.7
Wholesale & retail trade, transport & storage	20.8	22.7	21.1
Finance and insurance	3.8	5.6	4.2
Other	39.2	38.4	41.2
Total	94.1	98.0	97.8

Source: Secretariat based on APRA data reported in www.rba.gov.au, table D7.

2.7 Looking at new lending by purpose, the slowdown in credit provision to small business borrowers appears to be concentrated in loans for the purchase of real property (Table 2.2).

Table 2.2: Banks' new fixed business loan approvals under $500,000

($ billion)	2007	2008	2009
Construction	1.3	2.0	1.8
Purchase of real property	4.5	4.3	3.2
Wholesale finance	0.1	0.3	0.6
Purchase of plant & equipment	3.3	3.3	4.8
Refinancing	2.1	1.8	1.9
Other	9.5	8.8	9.5

Source: Secretariat based on APRA data reported on www.rba.gov.au, table D7.

2.8 The banks referred to commercial property as a particularly weak sector:

> …banks are very wary of lending to commercial property because commercial property prices have fallen, as they always do during an economic downturn. I think the banks are also remembering the early 90s

> when they got into quite a bit of trouble with being over exposed to commercial property during the recession then.[5]

2.9 Another area where lending has contracted has been in finance for international trade:

> The problem was even more dramatic for those small businesses that were seeking trade finance—those small businesses that were seeking to maintain some degree of export activity. Competition and other providers in that market dried up dramatically… the banks were in the very comfortable position of openly saying that they did not see themselves as needing to come to the table in this market, irrespective of the level of business information about the export activities that the SME was going to provide… They saw market conditions overseas as vulnerable, fluky and fluctuating.[6]

5 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 12.

6 Mr Peter Anderson, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 10 May 2010, p. 15.

Chapter 3

Causes of the slowdown in small business finance

Introduction

3.1 The previous chapter showed that, since the global financial crisis, there has been a marked slowing in the provision of credit to small businesses in Australia. Assessing whether there is a widespread or systemic 'credit crunch' applying to small business finance is quite complicated, as there are a myriad of simultaneous influences (In economic jargon, there is an identification problem, with movements both of and along the demand and supply curves.)

3.2 The slowdown in lending to small business appears to reflect a combination of demand factors such as;

- less demand for finance by small business in the wake of the global recession, as weaker sales mean that existing capacity is adequate and there is not the need to borrow for investment;

- less demand for finance by small business as reduced confidence leads to a more conservative attitude towards debt;

and supply factors such as;

- fewer small businesses being able to meet existing lending standards in the wake of the global recession;

- some tightening of lending standards by financial intermediaries. It is arguable that banks were tending towards recklessness in the preceding boom, and that some tightening of credit standards represents a prudent return to 'normal' practice, but there may also be cases where banks are over-reacting; and

- non-bank lenders having fewer funds available as securitisation and interbank lending markets dried up and/or interest rates in them became prohibitive.

3.3 Witnesses and submitters were hesitant to apportion the credit slowdown between demand and supply influences. For example, the Reserve Bank concluded:

> Lending to small businesses has been little changed over 2009, after growing steadily over prior years. The slowdown reflects both reduced demand from small businesses and a general tightening in banks' lending standards. Small businesses in most industries have been able to access

> funding throughout the financial crisis, albeit on less favourable terms than previously.[1]
>
> We think the slowdown in lending reflected both supply and demand factors. On the demand side…there was reduced demand reflecting the state of the economic cycle. On the supply side there was a general tightening in banks' lending standards. Nevertheless, as we have said in our submission, our assessment is that small businesses in most industries have been able to access funding through the financial crisis, albeit on less favourable terms than they were previously.[2]

3.4 The prudential regulator's perspective is that banks are not singling out small business for reductions in credit:

> …we do not see that the banks are treating small business differently from how they are treating other clients.[3]

3.5 They were also agnostic about the relative importance of demand and supply factors:

> …there were two elements—a demand impact and a supply impact. I do not really know which one dominated.[4]

3.6 Treasury also referred to both demand and supply factors without indicating which predominated:

> On the demand side, businesses have been deleveraging to strengthen their balance sheets and have cut back their investment plans in line with global economic weakness. On the supply side, banks have faced higher funding costs due to the global repricing of risk and have also raised their assessment of small business risk, reflecting the point in the economic cycle.[5]

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1 Reserve Bank of Australia, *Submission 2*, p. 1.

2 Dr Guy Debelle, Assistant Governor, Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 18.

3 Mr Keith Chapman, Australian Prudential Regulation Authority, *Committee Hansard*, 12 April 2010, p. 57.

4 Mr Graham Johnson, Australian Prudential Regulation Authority, *Committee Hansard*, 12 April 2010, p. 57.

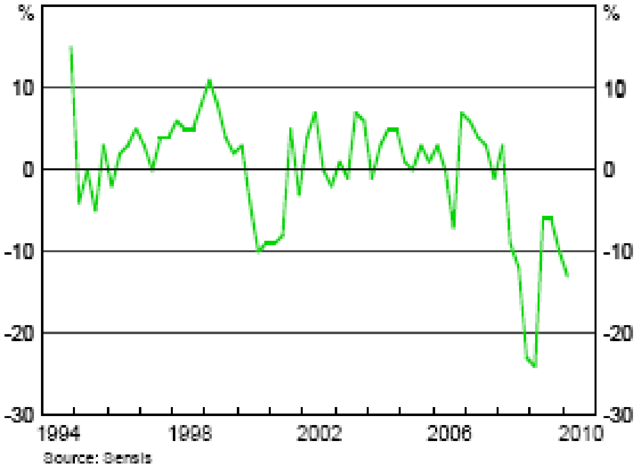
5 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 2.

Demand for credit by small business

3.7 On the demand side, the Reserve Bank note that small business has scaled back investment plans (Chart 3.1).

Chart 3.1: Small business investment expectations

Net balance: deviation from long-run average



Source: Reserve Bank of Australia, *Submission 2*, p. 3.

3.8 Similarly, APRA noted:

> …the smaller end had a fall-off in their approach to the banks and other lenders for loans.[6]

3.9 The banks referred to a reduction in demand for credit:

> …we saw demand, particularly in the September quarter of 2008, start to contract quite markedly. It is pretty fair to say that since that time credit demand in this area has been flat…[7]

> Since the beginning of the global economic crisis, overall lending to business has been subdued both at ANZ and other lenders. This primarily reflects a fall in loan application numbers due to reduced demand for credit in uncertain times and to a lesser extent a tightening in credit criteria.[8]

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6 Mr Graham Johnson, Australian Prudential Regulation Authority, *Committee Hansard*, 12 April 2010, p. 57.

7 Mr James Tate, Chief Product Officer, Westpac Banking Corporation, *Committee Hansard*, 12 April 2010, p. 69.

8 ANZ Bank, *Submission 40*, p. 3.

Supply of credit to small business

3.10 On the supply side, APRA observe:

> On the supply side, after something like the global financial crisis, the increase in arrears rates and non-performing loans, the authorised deposit-taking institutions and other lenders actually tightened up their lending terms, as would be expected after something like the global financial crisis. The ADIs did things like reducing the maximum loan they would give to particular classes of borrower, they lowered maximum loan to valuation ratios, had higher interest coverage ratios—those sorts of things—to tighten up their terms, with more stringent covenants, and hence there was a drop-off in the available supply.[9]

3.11 Similarly,the Reserve Bank note:

> Small business borrowers have faced lower loan-to-valuation ratios, stricter collateral requirements and higher interest coverage ratios.[10]

3.12 This conclusion is supported by CPA Australia. A survey of their members concluded:

> The banks are still lending but mostly where the loan is fully secured by a tangible asset and personal guarantees (and in some cases, also key man insurance). Where there is an existing loan, banks are requiring additional security. In summary, members stated that lenders were no longer prepared to provide finance on 'soft' security such as cash flow or goodwill (unsecured finance) - which had been available pre-GFC.[11]

3.13 This reflects the increase in non-performing business loans in recent years. As the bankers put it:

> Banks were right to look at business, in particular small business which is inherently more risky, as a source of potential increases in bad debts. The number of business loans that are 90-days plus in arrears or over three months outstanding has increased significantly over that time, which underlines the fact that the banks were right to see this as being a riskier area of lending.[12]

3.14 The bankers contrasted the risks in business lending compared with home lending:

> That figure is seven times higher than what home lending is, so to compare it with home lending, which is a relatively safe and secure form of lending,

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9 Mr Graham Johnson, Australian Prudential Regulation Authority, *Committee Hansard*, 12 April 2010, p. 57.

10 Reserve Bank of Australia, *Submission 2*, p. 3.

11 CPA Australia, *Submission 46*, p. 5.

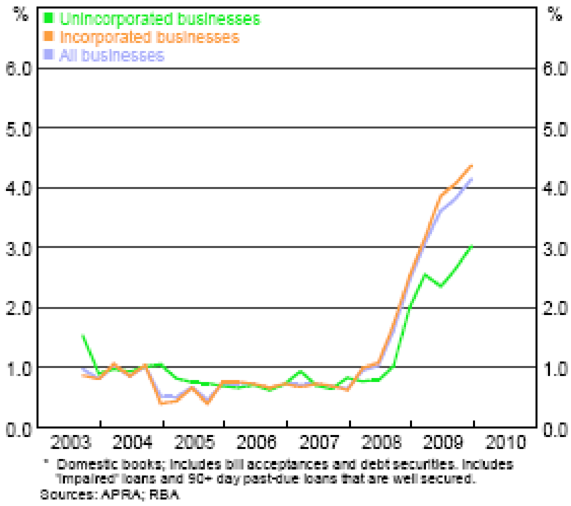
12 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 2.

> business lending is less safe and banks have been right during the economic times to make sure that they are lending appropriately.[13]

3.15 While Chart 3.2 suggests the increase in non-performing business loans may have been smaller for small business than for larger firms, it has been significant for both.

Chart 3.2: Banks' non-performing business assets

Share of outstanding lending



Source: Reserve Bank of Australia, *Submission 2*, p. 5.

3.16 Chart 3.2 refers to the aggregate of all banks. The Commonwealth Bank told the Committee that:

> Pre, post and during the GFC we have not seen any significant change in the credit quality of our book, nor the rate of arrears and the number of people that we pass on a monthly basis to what we call our credit services—businesses that are struggling go across to that unit first off—has not changed at all over the last two years.[14]

3.17 The National Australia Bank reported fewer bad debts among small than larger businesses:

> Senator XENOPHON—In your submission you said that the $13 billion in bad and doubtful debt that the bank reported in 2009 was largely from its

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13 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 3.

14 Mr Brewis-Weston, Commonwealth Bank of Australia, *Committee Hansard*, 12 April 2010, p. 105.

business lending activities. How much of that was related to small businesses…?

Mr Healy—The bulk of that would be mid sized and larger businesses, rather than small businesses…Small businesses were helped last year by the government stimulus, which helped many segments of the small-business market. Whilst I do not have the exact figures, the majority of that would have been geared more towards mid sized and larger companies.[15]

3.18 One view is that the tightening in the supply of credit is an appropriate return to more prudent behaviour after excesses of the recent boom:

> Prior to the GFC the spreads on lending were probably the lowest they had been for the statistics that had been collected. There had been 15 years of economic good times, and non-performing loans were at historical lows. I think there was a movement towards lending perhaps without the risk based pricing that should have really been there just prior to the GFC hitting, and then there was some correction after that.[16]
>
> …one of the factors about the global financial crisis is that people reacquainted themselves with the discipline around ensuring that lending was properly priced for risk.[17]

3.19 Other submitters assert that the banks have over-reacted and excessively restricted access to small business finance.[18] There is concern that some good small businesses are being denied funding:

> Senator BUSHBY—…are there small businesses out there that are quite capable of meeting loan repayments and who maybe even have a demonstrated history of being able to meet loan repayments but who are now finding themselves unable to secure finance either to continue or to expand on the basis of decisions that banks have made to raise the bar in terms of lending criteria?
>
> Dr Burn—We fear that that is the case. We do not have any direct evidence about that.[19]

3.20 On the other hand, Westpac's interpretation is as follows:

> …our approximate one per cent decline in business lending in that year was in line with system lending. Analysis of this data highlights that much of this decline was demand-driven and symptomatic of cyclical economic

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15 Mr Joseph Healy, Group Executive, Business Banking, National Australia Bank, *Proof Committee Hansard*, 10 May 2010, p. 26.

16 Mr Graham Johnson, Australian Prudential Regulation Authority, *Committee Hansard*, 12 April 2010, p. 58.

17 Mr Healy, National Australia Bank, *Proof Committee Hansard*, 10 May 2010, p. 25.

18 Mr Suryan Chandrasegaran, *Submission 3*, p. 1.

19 Dr Peter Burn, Director of Public Policy, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 54.

conditions. In Westpac's view, the decline in lending is a result of a combination of factors; business customers prudently paying down debt, thereby reducing their gearing, and an increase in applications falling short of underwriting standards. The latter is supported by an increase in credit bureau default rates for customers applying for credit. This implies a higher proportion of SME customers applying for credit have a greater risk of defaulting on their debt… Westpac's rate of overriding adverse credit bureau decisions has remained steady in order to support more SME borrowers and overall approval rates have remained high at above 85%...during the past 18 months, Westpac has made no major changes to key SME credit policies relating to debt service cover, interest cover, Loan-to-Value-Ratios (excluding commercial property) or other credit policies…[20]

3.21 The Australian Bankers' Association emphasised that:

> …banks need small business to be doing well for banks themselves to be doing well.[21]

3.22 They did concede, however, there had been some tightening of supply of credit, referring to:

> …changes that banks have reasonably and prudently made in their approach to lending through the course of the global financial crisis…banks have taken a more stringent approach to lending. There is no doubt about that. [22]

3.23 The Australian Bankers' Association argued though that reported instances of undue tightening of credit were rare not typical:

> There will always be businesses, for some reason or another, that are finding it difficult to get credit, or to get credit on the terms that they previously had or the terms that they want. Where opportunities are provided for small business to come forward with specific examples these examples exist, but they tend to be a small number. The government's own clearing house, Hotline for Small Business, has attracted less than 100 calls in the time that it has been set up since March last year, just over 12 months…we need to be careful to extrapolate that to suggest that there are some system-wide issues.[23]

3.24 The reduction in supply of credit is more dramatic from non-ADI lenders. As the bankers put it:

> …there were businesses prior to the financial crisis that were only able to raise money because money was dirt cheap and because there were a lot of

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20 Westpac, *Submission 31*, p. 2.

21 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 1.

22 Mr Münchenberg, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, pp 1-2.

23 Mr Münchenberg, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 4.

> people out there who were providing money on very limited risk analysis. When those elements have been removed then obviously there is going to be a tightening.[24]

3.25 The banks referred to having:

> …picked up a lot of customers from lenders who are no longer operating because of changes in credit markets.[25]

The impact of Basel capital requirements

3.26 Bank supervisors from around the world, meeting at the Bank for International Settlements in Basel, have agreed on rules governing capital requirements for banks which APRA implement in Australia. Some witnesses believe that these rules could discourage lending to small businesses as more capital is required to be held against small business loans than for home loans:

> Several commentators have pointed to Basel II regulatory capital requirements as a factor leading to higher costs for small business and a skewing away from business lending as under Basel II banks have to provide a higher level of capital reserves for business loans.[26]

> Prima facie, Basel II makes it more attractive for a bank to lend to the household sector than to small business. In fact, we have the perverse situation where it is more attractive to lend for a weekend holiday home than to a small business…there is more capital involved in supporting small business lending as distinct from household lending, and that creates a bias.[27]

3.27 APRA responded:

> It is feasible in certain circumstances that some loans could have quite significantly higher capital requirements and it would look, to somebody looking at the underlying security of that loan, as if they were the same. I will take small business as an example, and one that is secured against a residential mortgage as opposed to an owner occupier buying their house. The risk profile is quite different, as I am sure some of the submissions have indicated. The underlying default rates and arrears rates on owner occupied homes and investor lending is a lot lower than it is for small and medium sized enterprise loans that are secured against the residential mortgage. They have a far higher likelihood of what they call 'probability of default rates' and 'loss given default' than do the normal residential mortgages. Basel II, as a whole, is intended to be risk based, so it actually ensures that the capital that is being held is commensurate with the risk of the loan, and that is whether it is a low-doc mortgage loan, an owner

24 Mr Münchenberg, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 11.

25 Mr Münchenberg, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 1.

26 NARGA, *Submission 29*, p. 4.

27 Mr Healy, National Australia Bank, *Proof Committee Hansard*, 10 May 2010, p. 23.

> occupier through to a large corporate loan that is unsecured; it differentiates the security and basically has capital according to the underlying risk profile. By itself it is attempting to be a better way of ensuring proper capital is held for the risk faced. That may mean that you do have differences according to sector because of the nature of the business, the risks in the business, the nature of the security and that sort of thing…There are two forms of the capital regime. One is what we call standardised, which is for basically the non-model users, the smaller authorised deposit-taking institutions and banks have not got approval to use an APRA model. We basically specify what risk weights you use. For example, if you have an SME or a corporate loan that is unsecured it would be 100 per cent risk weight—$8 capital per $100 of loan. The larger banks have their own models, which we have accredited over a lengthy process for them to get their Basel II accreditation. Those models use historical data to determine the probability of default and loss given default, on all the various portfolios and generates a capital outcome commensurate with the risk. We have to approve that. We monitor it closely. We compare those banks with their peers. Yes, it will give potentially differential rates for the model users as opposed to the standardised users, but that reflects the fact that the more complicated models are supposed to be better at predicting the underlying risk.[28]

3.28 Since the global financial crisis there have been proposals for further increases in capital requirements. Quantitiative impact studies are currently underway to develop these proposals.[29]

Non-bank lenders

3.29 Small business was hurt by the impact on non-bank lenders of the global financial crisis:

> Incidentally, many small businesses had relied upon non-bank financial institutions, regional banks and foreign banks for access to credit. With the onslaught of the crisis, that segment of the banking system shrank significantly and reduced capacity. They made it clear to some small businesses that, when there facilities were due for renewal, they would be instructing them to seek other forms of borrowing.[30]

3.30 The reduced role of non-bank lenders is discussed further in Chapter 5.

Business liasion by official agencies

3.31 The Reserve Bank's own interreactions with small business led them to conclude:

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28 Mr Graham Johnson, APRA, *Committee Hansard*, 12 April 2010, pp 58-59.

29 APRA, *Committee Hansard*, 12 April 2010, pp 66-67.

30 Mr Healy, National Australia Bank, *Proof Committee Hansard*, 10 May 2010, p. 25.

…liaison by the Reserve Bank, including through its Small Business Panel, suggest that small businesses in most industries have had tighter but still reasonable access to funds throughout the financial crisis, with property companies being a notable exception.[31]

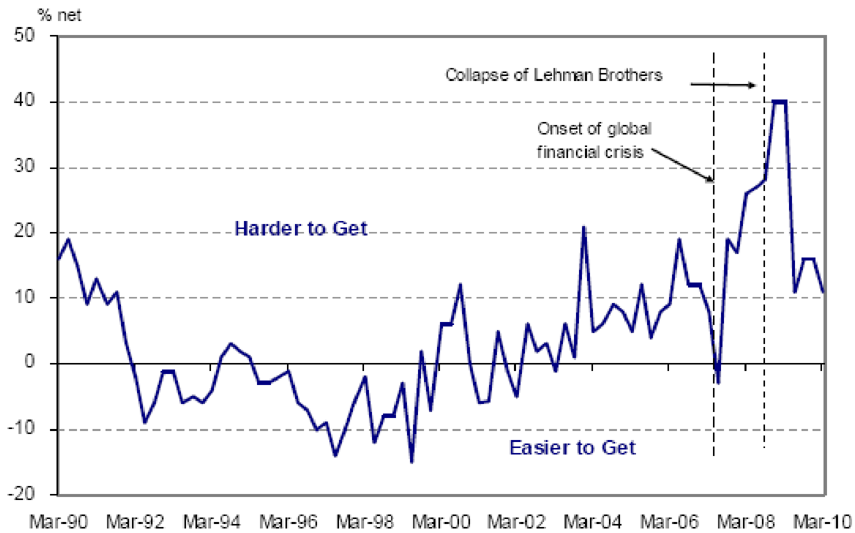
3.32 Treasury also talk to small business as part of their business liaison programme. They summarised recent discussions as:

Smaller to medium-sized firms appeared generally able to access bank credit, but could be deferring expenditure and continuing their deleveraging until economic and financial conditions become more favorable.[32]

Business surveys

3.33 Another indication comes from surveys of businesses. The long-running Westpac-ACCI Survey – admittedly a survey of businesses in general rather than specifically small business – indicates that while financial conditions are at 'tighter than average levels', they are much improved from early 2009 (Chart 3.3) and only 5 per cent of firms nominated finance as the factor most limiting expansion.[33]

Chart 3.3: ACCI survey – availability of finance



Source: ACCI, *Submission 32*, p. 17.

3.34 A specific ACCI survey found that a quarter of businesses reported that changes in bank lending criteria had led them to revise down capital expenditure plans.[34] Another ACCI survey asks companies what are the main constraints on their

31 Reserve Bank of Australia, *Submission 2*, p. 3.

32 Treasury, 'Key themes from Treasury's business liaison program', *Economic Roundup*, issue 4, 2009, p. 53.

33 *Westpac-ACCI Survey of Industrial Trends*, March quarter 2010; ACCI, *Submission 32*, p. 17.

34 ACCI, *Submission 32*, p. 16.

investment. Taxes, regulations, labour costs and insufficient demand are all judged more important than credit-related factors.[35]

3.35 Sensis' March 2010 survey of small business found that:

> …20 per cent of businesses reported it was currently relatively easy to access finance; compared to 35 per cent reporting they felt it was relatively difficult, and the remainder feeling that current lending conditions were fairly normal.[36]

3.36 The Deloitte survey of chief financial officers in late 2009 found that 80 per cent them regarded credit as costly but they were evenly divided on its availability.[37] A survey by the Chamber of Commerce and Industry of Western Australia found that a quarter of small business respondents rated borrowing costs among the top three issues affecting them.[38] A Telstra-sponsored survey of small business found that 6 per cent regarded the availability of finance as their major concern while 38 per cent regarded its cost as their major concern.[39] A survey of real estate agencies found that three-quarters felt that access to finance was more difficult than before the global financial crisis and four-fifths believe lending conditions are stricter.[40] Another survey found that 'over 77 percent of retailers are concerned or very concerned about current difficulty in accessing finance'.[41] A survey of residential builders found that 75 per cent faced greater difficulty obtaining finance than was the case before the global financial crisis.[42]

3.37 The Australian Industry Group told the Committee that around a quarter of respondents (both large and small firms) to a recent survey it conducted identified the availability of credit as a negative influence.[43] For small businesses, this was slightly lower than the proportion in 2009.

3.38 A survey of such surveys by the Reserve Bank suggested to them that:

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35 *ACCI Survey of Investor Confidence*, January 2010. The credit-related factors are 'charges by lending institutions' (ranked 7th most important), 'insufficient retained earnings' which arguably implies inadequate external financing (9th) and 'level of interest rates' (10th).

36 Sensis, *Submission 25*, p. 2. The finance industry found it particularly difficult.

37 Australian Industry Group, *Submission 14*, p. 5.

38 WA Small Enterprise Network, *Submission 18*, p. 3.

39 Australian Industry Group, *Submission 14*, p. 6.

40 Real Estate Institute of Australia, *Submission 37*, p. 5.

41 Australian Retailers' Association, *Submission 45*, p. 9.

42 Mr Wolfe, Chief Executive, Housing Industry Association, *Proof Committee Hansard*, 10 May 2010, p. 43.

43 Dr Peter Burn, Director of Public Policy, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 43.

> Small business surveys provide mixed evidence on the availability of finance. Some business surveys, such as the PwC/East & Partners Business Barometer and the ACCI Small Business Survey, suggest that over the past year the availability and cost of intermediated debt has been a constraint on small businesses. However, others, such as the Sensis Business Index and the NAB SME Survey suggest that the cost and availability of debt financing is a concern for relatively few small businesses, with issues such as lack of sales, future cash flow and the economic climate being more important.[44]

Comments by business organisations

3.39 The cost and availability of finance was described by the general council of ACCI as:

> …the most significant day-to-day issue facing Australia's businesses.[45]

3.40 Similarly, the Council of Small Business of Australia described the cost of credit as:

> …the No. 1 issue for small businesses in Australia.[46]

3.41 Turning to individual sectors, the Housing Industry Association opined that:

> The lack of access to finance for residential development is restraining the supply of new housing across Australia… banks are rationing credit to small residential developers, placing an enormous pressure on their cash flow, while at the same time banks are extending a 'normal' stream of credit to households in the form of mortgages.[47]

3.42 Three-quarters of their members reported greater difficulty in attracting finance than before the global financial crisis.[48]

3.43 Similarly, when the Real Estate Institute of Australia surveyed their members:

> …three-quarters of respondents felt that access to finance was more difficult than it was before the global financial crisis. This was despite the

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44 Reserve Bank of Australia, *Submission 2*, p. 3.

45 Mr Peter Anderson, Chief Executive, ACCI, *Proof Committee Hansard*, 10 May 2010, p. 9. The general council comprises the presidents and chief executives of the major chambers of commerce from every state and territory, together with 26 industry associations.

46 Ms Jaye Radisich, Chief Executive Officer, Council of Small Business of Australia, *Proof Committee Hansard*, 10 May 2010, p. 73.

47 Housing Industry Association, *Submission 7*, p. 1. See also their chief executive's evidence, *Proof Committee Hansard*, 10 May 2010.

48 Housing Industry Association, *Submission 7*, p. 13. The submission includes more detailed results from the member survey.

> fact that two-thirds of respondents felt that their financial position was either the same or better than it was 12 months earlier.[49]

Obtaining better information

3.44 The Australian Securities and Investments Commission has a suggestion that may improve information on this topic:

> Currently, Australia does not have a dedicated senior loan officer survey to determine the supply and demand conditions prevailing in the small and medium-sized enterprise (SME) lending market. Such lending surveys currently exist in a number of countries including the United States of America (US), the United Kingdom, Europe and Japan, and have been useful in researching the lending demand and supply dynamics for both SMEs and large firms. For example, the US Federal Reserve issues the 'Senior Loan Officer Opinion Survey on Bank Lending Practices'.[50]

Demographic factors

3.45 The retirement of the baby boomer generation may generate an increase in demand for small business finance. Dr Seet and Dr Graves from the University of Adelaide submitted that:

> …it is anticipated that around 60% of family business owners plan to retire by 2016. Although the majority of family firms intend to pass the business onto the next generation, it is predicted that half will be unable to do so due to a lack of available and / or suitable successors. As a consequence, many family owners will have little option but to sell or close down the business. The scale of this problem suggests that not all family business owners can look forward to traditional exit options such as trade sales, and therefore alternative succession strategies, such as the involvement of PE [private equity], need to be considered. The successful ownership transition of family firms (e.g. to next generation, management buy-out or sale) is critical to the Australian economy as it is estimated that a successful transfer conserves, on average, five jobs, whereas a start-up generates on average two jobs.[51]

3.46 The authors warn, however, that private equity is reluctant to invest in small business and small business is distrustful or ignorant of private equity investors. This makes the role of lenders in facilitating the transfers of small business all the more important.

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49 Mr Jock Kreitals, Manager, Policy, Real Estate Institute of Australia, *Proof Committee Hansard*, 10 May 2010, p. 42.

50 Australian Securities and Investments Commission, *Submission 17*, p. 6.

51 Dr Pi-Shen Seet and Dr Chris Graves, *Submission 48*, p. 2.

The outlook

3.47 Treasury were confident that lending to small business would pick up in due course:

> Going forward, it is anticipated that conditions will improve as the economy recovers and global funding markets re-establish themselves. Investment is expected to recover, risk margins are likely to fall and some lenders that have been forced to scale back their activities as a result of the crisis will be in a position to re-enter the market.[52]

52 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 2.

Chapter 4

Costs and conditions of small business finance

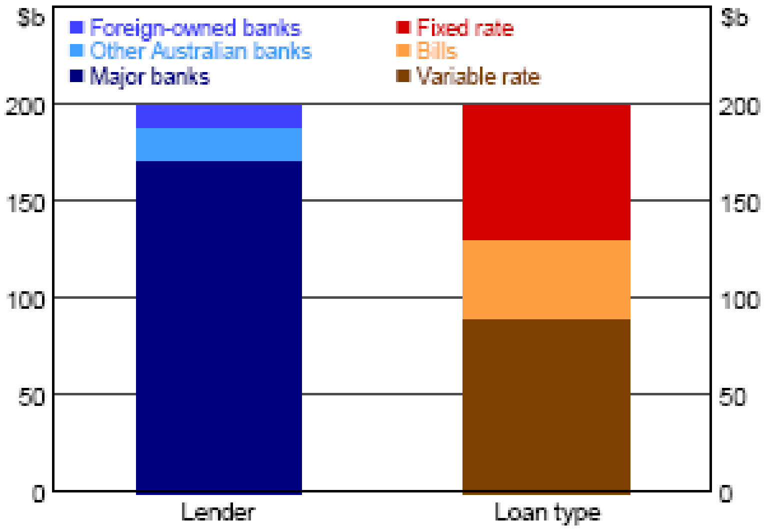
Interest rates

4.1 The Reserve Bank observes that most small business loans are at variable interest rates (Chart 4.1):

> About two-thirds of lending to small businesses is through commercial bills and other loans with variable interest rates. The remaining third of lending is at fixed rates; the interest rates on these loans are generally fixed for between one and five years.[1]

Chart 4.1: Composition of banks' outstanding small business lending

Loans of less than $2 million; December 2009

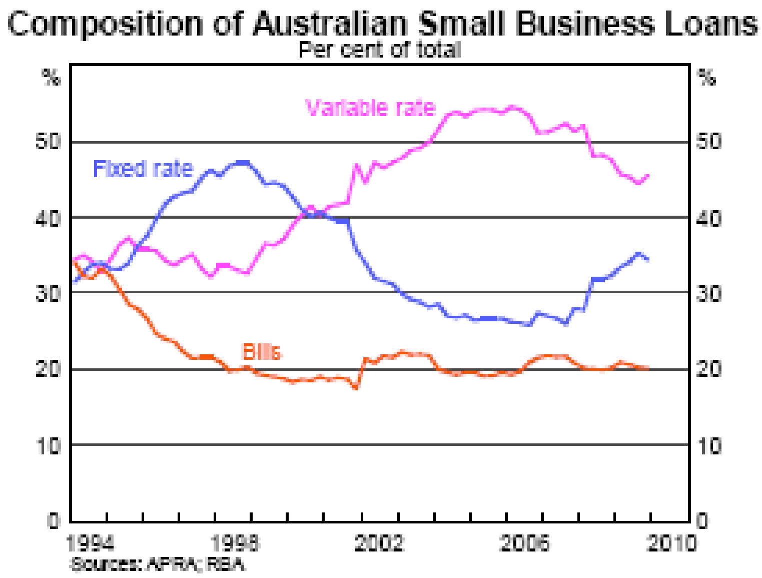


Source: Reserve Bank of Australia, *Submission 2*, p. 2.

4.2 As interest rates have been relatively low, more small businesses have been taking out fixed rate loans (Chart 4.2).

1 Reserve Bank of Australia, *Submission 2*, p. 2.

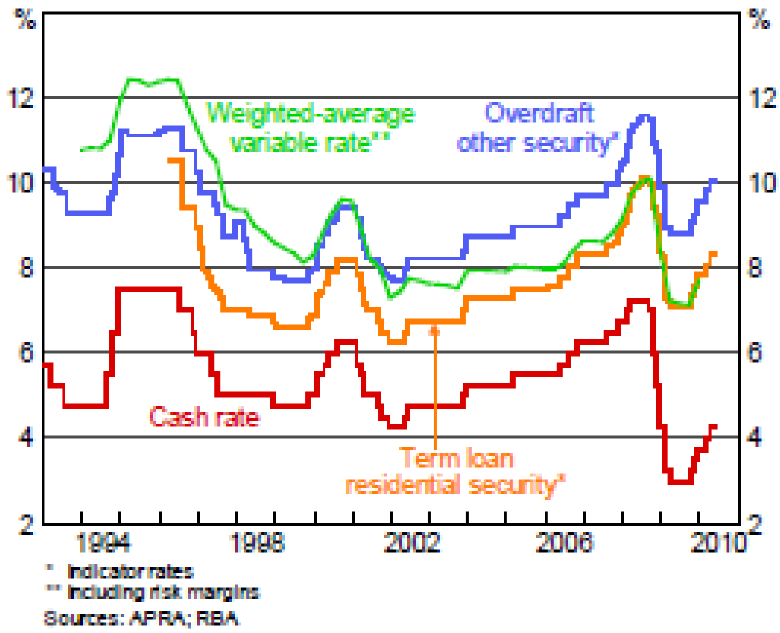
Chart 4.2



Source: Reserve Bank of Australia (www.rba.gov.au)

4.3 The interest rates charged by banks on small business loans are compared with those on other interest rates in Chart 4.3.

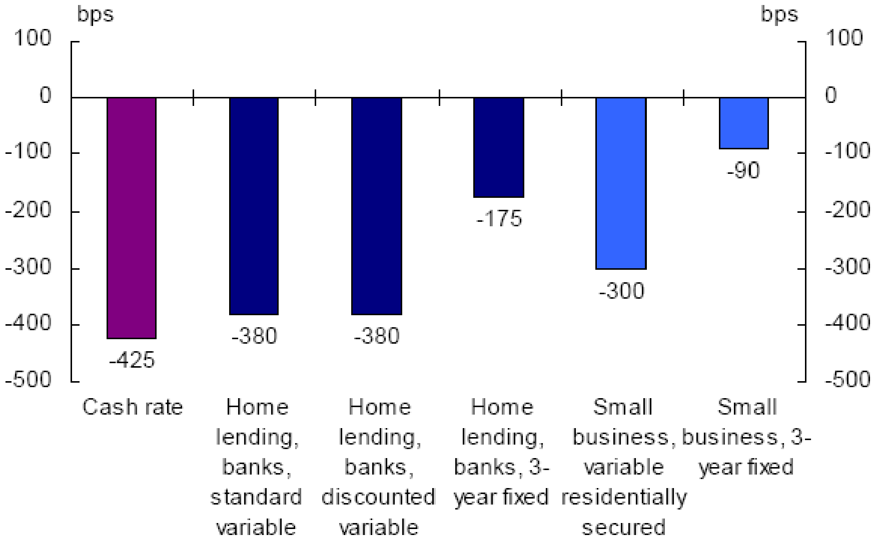
Chart 4.3: Australian Small Business Interest Rates



Source: Reserve Bank of Australia (www.rba.gov.au)

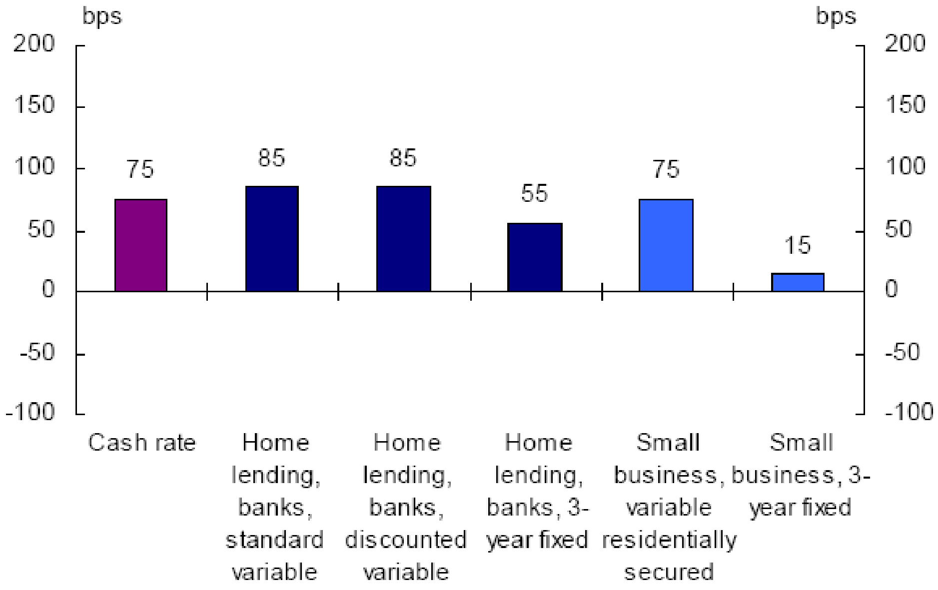
4.4 The Australian Chamber of Commerce and Industry notes that the banks did not fully pass on the reductions in the cash rate between August 2008 and September 2009 to small business borrowers (Chart 4.4) but fully passed on the subsequent increases (Chart 4.5).

Chart 4.4: Changes in lending rates – August 2008 to September 2009



Source: ACCI, *Submission 32*, p. 8.

Chart 4.5: Changes in lending rates –September 2009 to March 2010



Source: ACCI, *Submission 32*, p. 9.

4.5 As a result while the cash rate is still below its longer-term average, the indicator rate on small business loans is now above its longer-term average (upper panel in Chart 4.6). This overstates the average interest rate paid by small businesses, as over time they have either found cheaper products or have offered more security.[2] Even allowing for this, however, the average interest rate on outstanding variable interest rate loans for small business is now back to around the longer-term average (lower panel in Chart 4.6).

Chart 4.6: Small Business Variable lending Rates

Source: Reserve Bank of Australia, *Statement on Monetary Policy*, May 2010, p. 43.

4.6 Professor Sathye notes that the differential between the interest rate charged to small business and that charged to large businesses was narrowing from 2001 to 2008 but has since widened.[3]

4.7 Some calculations by the Australia Institute suggest that this premium is unlikely to be justified by the riskiness of the loans:

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2 Reserve Bank of Australia, *Statement on Monetary Policy*, May 2010, pp 43-44.

3 Professor Milind Sathye, *Submission 6*, p. 2.

> …a large margin of 8.68 per cent on small business loans of that type, much higher than the average margin of 2.13 per cent over all bank lending, which implies a penalty rate on small business of around 6.5 per cent. A penalty interest rate on bank loans may be justified if there were a very high failure rate on bank lending. A 6.5 per cent margin on small business loans suggests around 6.5 per cent of those loans will go bad every year. There is of course no data on small business loan failures. However, for the four big banks as a whole, the total charge for bad or doubtful debts in the year to September 2009 was …just 0.67 per cent of total liabilities. [4]

4.8 The Reserve Bank has provided the following analysis, relating the relative increase in small business interest rates to increased risk:

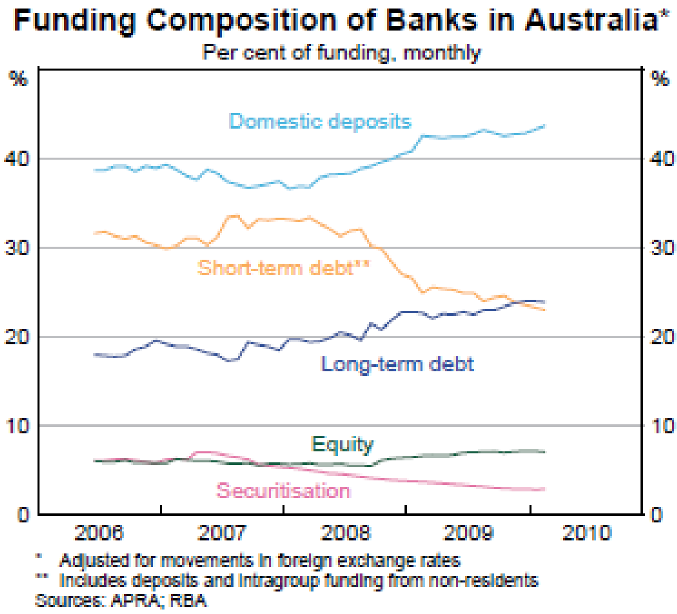
> Most lending to small businesses is secured against residential property, and over the past few years the banks' indicator rates have been representative of the actual rates paid by most small business borrowers. The interest rates on residentially secured, small business loans are currently about 80 basis points above those on prime, low doc housing loans. This compares with a differential of just 30 basis points in mid 2007 and about 50 basis points earlier in the decade. The recent widening in this differential is related to the higher arrears on small business lending…From the late 1990s until 2007, banks adjusted their small business indicator rates mainly in response to changes in the cash rate. As the financial crisis unfolded and banks' funding costs increased, all lending rates have risen relative to the cash rate…the major banks' average variable indicator rate for residentially-secured term loans has risen by about 200 basis points relative to the cash rate since mid 2007…This is larger than the rise of 110 basis points in the housing loan indicator rate but is similar to the increase in the average large business borrowing rate. The greater increase in business rates than housing rates in large part reflects a reassessment of risk margins on business lending in light of the difficult economic and financial conditions of the past couple of years.[5]

4.9 While the media fuels the belief that banks' lending rates should follow (and only follow) movements in the RBA's cash rate, less than half of banks' costs of funds vary with the cash rate. Large proportions of bank lending are funded by overseas borrowing or by household deposits paying no or low interest. A significant proportion of funds is longer-term and so only very gradually adjusts to movements in short-term interest rates. (Chart 4.7)

4 Mr David Richardson, Australia Institute, *Submission 47*, p. 8.

5 Reserve Bank of Australia, *Submission 2*, p. 4.

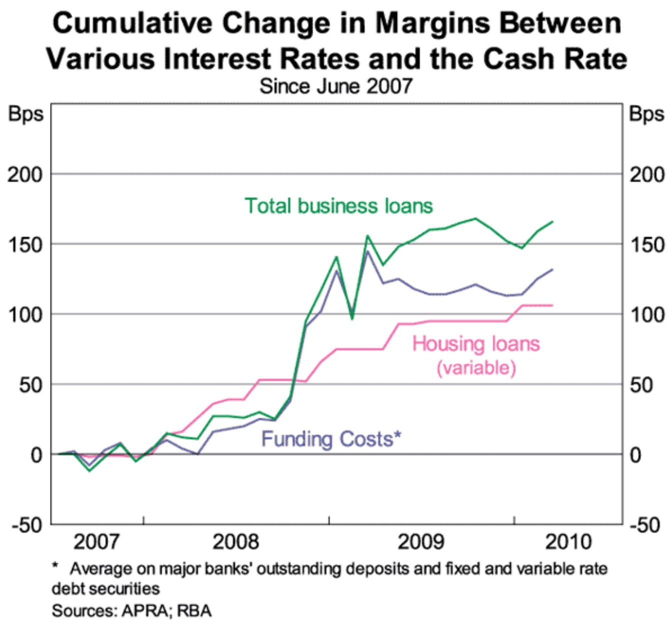
Chart 4.7: Composition of Australian Banks' Funding



Source: Reserve Bank of Australia, *Statement on Monetary Policy*, May 2010, p. 38.

4.10 A better indicator of the 'reasonableness' of the interest rates charged by banks is therefore to compare movement in these rates with movements in the banks' overall cost of funds. This is done in Chart 4.8, and shows that overall business loan interest rates have risen by more than the banks' cost of funds. Given the evidence discussed above that interest charged on small business loans has increased more than that on large business loans, this suggests small businesses have been getting a poor deal.

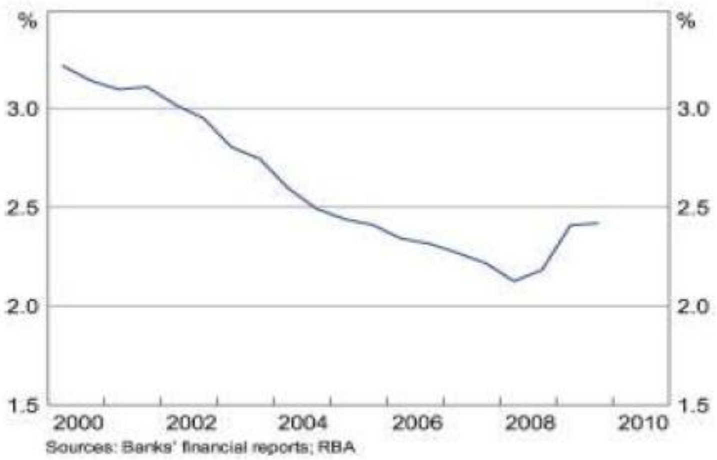
Chart 4.8



Source: G Debelle, 'The state of the mortgage market', address to Mortgage Innovation Conference, 30 March 2010, www.rba.gov.au

4.11 The larger increase in banks' lending interest rates than in their cost of funds is consistent with the recent widening in their overall interest margin (Chart 4.9).

Chart 4.9: Major banks' net interest margin



4.12 The Australia Institute's interpretation is:

> The clear impression from watching bank interest rate changes is that official interest rate changes are taken as the signal to change bank lending rates whether bank costs justify an increase or not. It looks like a textbook example of oligopolistic pricing in which the main players set a common price to maximise their collective earnings…Price leadership itself is not illegal even if the end result is the same as illegal collusion…In the case of banking, it is actually the RBA that acts as an unofficial price leader. The RBA announces interest rate changes which are followed by the banks, at least on their lending side.[6]

4.13 Small business representatives observe that small business interest rates are less politically sensitive than are home loan rates:

> Since mid-2008 we have seen the spread between small business loans and the cash rate increase from around 200 basis points in 2008 to over 400 basis points in 2010. To put this into some perspective, if that skimming of the 200 basis points occurred in the residential mortgage market, it would be akin to the banks adding an additional 40 basis points for each of the five interest rate increases that we have had over the past seven months. I suspect that, if this had actually happened, there would have been riots in the streets. The fact that this has not happened in relation to the gouging of small businesses is in part because no-one within government feels any compulsion to name and shame the banks on this

6 Mr David Richardson, Australia Institute, *Submission 47*, p. 5.

particular issue. This is despite the fact that small business directly employs over five million Australians.[7]

4.14 The National Farmers' Federation has called for greater transparency concerning bank interest rates:

> Unfortunately it is extremely difficult for consumers of credit to keep financial institutions to account for their decisions regarding interest rates. It is all too difficult, particularly for farm businesses, to monitor how much of the official cash rate cut is being passed on by their own financial institution, or indeed to monitor the actions by competing financial institutions. The NFF believes that, in the interests of enhancing competition within the banking sector, that a mechanism should be created whereby rate change decisions by financial institutions are lodged and publicly reported.[8]

4.15 Treasury thought the banks may have over-reacted and that margins should fall back over time:

> …the risk factors that the banks have factored into the price of lending to small business are probably too high. As economic conditions improve and as things get back to normal, that should come down…I think the banks may have overplayed their hand in terms of the price of risk they are charging to small business.[9]

4.16 The banks commented:

> … that period particularly from October 2008 through to October 2009; there is no question that credit risk during that period became a much dicier proposition. There is no question during that period that the price for credit, quite apart from the cost of funds element demanded by banks, increased.[10]

> …the difference for the Commonwealth Bank between a standard variable rate and a residentially secured home loan is 50 basis points…due to a difference in the risk profile of a home loan and a residentially secured business loan taken out for business purposes. We derive that 50 basis points difference through a statistical model that analyses 20-plus years of history and the difference in the probability of default for a business loan versus a home loan, despite the same type of security.[11]

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7 Mr Stephen Cartwright, Chief Executive Officer, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 88.

8 National Farmers' Federation, *Submission 49*, p. 8.

9 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 3.

10 Mr James Tate, Chief Product Officer, Westpac, *Committee Hansard*, 12 April 2010, p. 71.

11 Mr Ian Narev, Commonwealth Bank, *Committee Hansard*, 12 April 2010, p. 102.

> Over the past couple of years, banks have generally also raised risk margins and strengthened non-price loan conditions, such as collateral requirements and loan covenants.[12]

4.17 The above discussion refers to the average situation across all sectors of small business. Different sectors have faced different increases in interest rates:

> …you would find interest rates for, say, anyone associated with commercial property are probably relatively more than for other sectors of the economy.[13]

4.18 There are also differences across banks. The Commonwealth Bank told the Committee:

> Since the period that the cash rate peaked in July 2008, we have reduced our residentially secured business reference rate by 2.53 percentage points, and over the same period comparative rates by other major banks have been reduced by less than 2.1 percentage points.[14]

Security for small business loans

4.19 There are widespread reports of banks having tightened lending criteria and demanding more security, such as asking for security over the home of a small business owner before they will advance them a loan:

> …banks have imposed stricter lending criteria, such as higher loan to valuation ratios et cetera.[15]

> …the REI survey found that four-fifths of respondents believed that the requirements by financial institutions, such as loan evaluation ratios and asset-backing mortgages over personal assets etcetera, were more stringent compared with the period before October 2008.[16]

> Even when [estate agents'] rent rolls were considered as an asset, the loan to valuation ratio had changed markedly since the global financial situation, despite the risk associated with the rent rolls remaining unchanged. This lending ratio had dropped from around 90 per cent before the GFC to about 65 per cent in more recent times.[17]

> …the internal costs associated with obtaining finance have increased, as banks require more documentation and information in relation to lending.[18]

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12 Reserve Bank of Australia, *Financial Stability Review*, March 2010, p. 29.

13 Dr Guy Debelle, Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 19.

14 Mr Ian Narev, Commonwealth Bank, *Committee Hansard*, 12 April 2010, p. 102.

15 Mr Greg Evans, ACCI, *Committee Hansard*, 10 May 2010, p. 14.

16 Mr Kreitals, Real Estate Institute of Australia, *Proof Committee Hansard*, 10 May 2010, p. 42.

17 Mr Kreitals, Real Estate Institute of Australia, *Proof Committee Hansard*, 10 May 2010, p. 42.

18 Mr David Liddell, Senior Policy Officer, Queensland Tourism Industry Council, *Proof Committee Hansard*, 10 May 2010, p. 45.

> …the major banks were asking for increased collateral to support loans…[19]

> We are finding that members are being asked now to provide collateral in the form of their own homes, whereas previously they have not been asked for this by the financial institutes.[20]

> Like many sectors of the economy, credit access has tightened for farmers since the global financial crisis. We have seen a noticeable impact on banks' treatment of loan security requirements…[21]

> …whereas two or three years ago they might have loaned 85 per cent of the value of the business, today it will be about 35 per cent of the value of the business with the rest made up by your home and a mortgage on your home; and your dog has to sign it and everything else so that everything that you own is at risk on a daily basis.[22]

4.20 But, even with the home as security, the interest rate charged is higher than for a home loan.

4.21 The Australian Industry Group is concerned about this emphasis on security and its implications for small business:

> There has been little incentive for businesses to improve their risk profile via better management, with the view that the banks only look at asset backing to determine the interest rate.[23]

4.22 The banks responded:

> The first and primary criteria that we apply is the ability of the business to be able to service the loan, to be able to pay for the loan, and to be able to operate within the environment of their business plan. The volatility of potential earnings for a small business tends to be on average higher, because there is less security about where income comes versus, say, a wage earner…We do not want to go and seek access to the asset that secures that particular loan. We look to the ability of the business to service the loan, and for a small business we see in the evidence over the years that there is greater risk associated with a small business supporting a loan than there is with, say, a salary earner.[24]

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19 Mr Richard Payne, Queensland Motor Trades Association, *Proof Committee Hansard*, 10 May 2010, p. 46.

20 Mr Payne, Queensland Motor Trades Association, *Proof Committee Hansard*, 10 May 2010, p. 46.

21 Mr Charles Burke, Vice-President, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, p. 59.

22 Mr John Cummings, Chairman, NARGA, *Committee Hansard*, 12 April 2010, p, 35.

23 Australian Industry Group, *Submission 14*, p. 7.

24 Dr Anthony Poiner, General Manager, National Segments and Operations, St George Bank, *Committee Hansard*, 12 April 2010, p. 73.

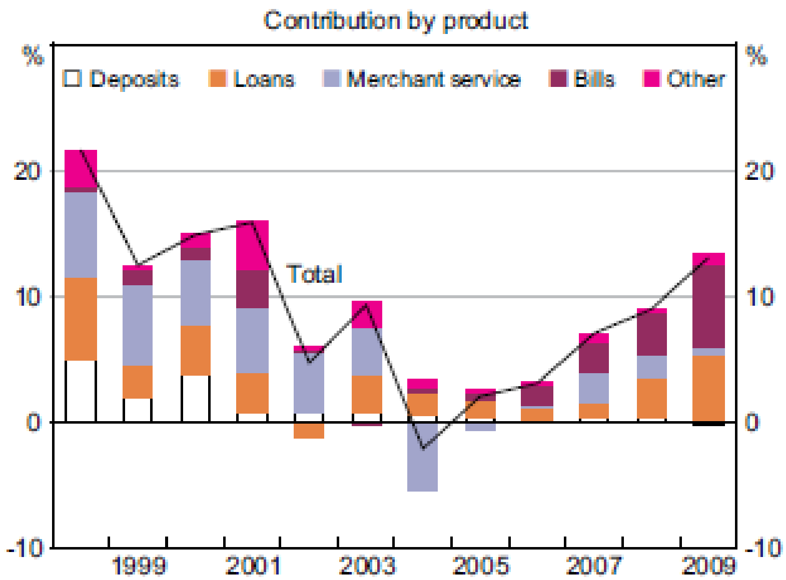
Fees

4.23 The Reserve Bank commented in their submission:

> The RBA Bank Fees Survey shows that in the 2008 financial year, banks' fee income from businesses (both small and large) amounted to $6.7 billion. …During the 2009 financial year, banks' fees appear to have risen more quickly than in previous years. Liaison suggests that the faster growth is mainly due to a greater incidence of existing fees, owing in particular to the reduced availability of fee waivers. However, fees are only a small part of the overall cost of a loan for most businesses. In 2008, lending fees were equivalent to about 50 basis points on the stock of banks' outstanding business lending, less than one-tenth of the average interest rate paid on outstanding business loans.[25]

4.24 The Reserve Bank has since released its 2009 survey of bank fees. It showed that fee income from business had accelerated, rising by 13 per cent to $7.6 billion, despite lending to the business sector being little changed in the year. Most of the increase came from higher fees on loans and bill facilities, rather than on deposits (Chart 4.10).

Chart 4.10: Growth in Banks' Business Fee Income



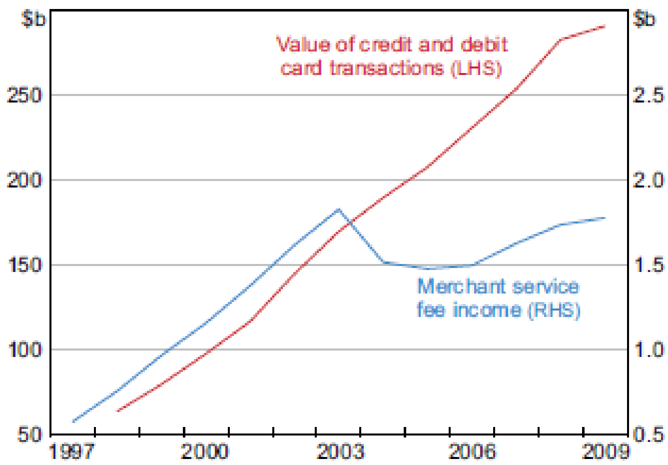
Source: *Reserve Bank Bulletin*, June Quarter 2010, p. 32.

4.25 Merchant service fees charged for providing credit and debit card transactions services account for about a quarter of fees banks charge business, and around three-quarters of these fees are paid by small businesses. The Reserve Bank notes that

25 Reserve Bank of Australia, *Submission 2*, p. 6.

since their credit card interchange reforms in 2003, these fees have been restrained (Chart 4.11).

Chart 4.11: Merchant Service Fee Income and the Value of Purchases



Source: *Reserve Bank Bulletin*, June Quarter 2010, p. 33.

4.26 A specific example of increased fees raised by ACCI is increases of around $1,000 on overdraft facilities which banks have attributed to being required to put aside capital for unused lines of credit.[26] The Pharmacy Guild report their members are facing significant increases in fees such as business facility fees and application fees.[27]

4.27 By contrast, the banks claim:

> There have been significant downward movements in bank fees for small business and other customers over the last 12 to 18 months, and in some cases, an abolition of certain fees.[28]

4.28 Asked specifically about fees and penalties applying to overdrafts, the Australian Industry Group replied that this had been raised by their members in 2009 but seemed less of a problem this year.[29]

26 ACCI, *Submission 32*, p. 11.

27 Pharmacy Guild of Australia, *Submission 19*, p. 3; Mr Scott McGregor, Pharmacy Guild of Australia, *Proof Committee Hansard*, 10 May 2010, p. 41.

28 Australian Bankers' Association, *Submission 23*, p. 6.

29 Dr Peter Burn, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 46.

Chapter 5

Competition in the market for small business finance

Introduction

5.1 The increase in margins on small business lending, and some complaints about lack of finance, suggest that competition may not be as intense as it should be in the market for lending to small businesses.

Views about current extent of competition

5.2 A strong consensus emerged from small businesses across industries that competition had declined and was now inadequate among lenders:

> …number one on our wish list would be an increase in competition because we have seen concentration within the marketplace in recent times.[1]
>
> …52 per cent of respondents were of the view that there has been a reduction in competition in the small business lending market over the last 12 months to two years.[2]
>
> There also appears to be relatively little price competition across the major lenders.[3]
>
> We see a return to competition in the market as being absolutely essential. We would also be concerned if there were any further diminution of competition in the market through acquisitions or mergers, be they between banks or other large financial service organisations.[4]
>
> ,,,as far as automotive finance goes there are really only two players in the market at this stage and certainly all the major businesses typically have a relationship with those financiers.[5]

5.3 The Reserve Bank acknowledge that competition for small business lending has been lacking, at least temporarily:

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1 Mr Jock Kreitals, Manager, Policy, Real Estate Institute of Australia, *Proof Committee Hansard*, 10 May 2010, p. 55.

2 Housing Industry Association, *Submission 7,* p. 10.

3 WA Small Enterprise Network, *Submission 18,* p. 4.

4 Mr Greg Evans, Director of Economics and Industry Policy, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 10 May 2010, p. 10.

5 Mr Richard Payne, Principal Policy Director, Queensland Motor Trades Association, *Proof Committee Hansard*, 10 May 2010, p. 46.

> Since the onset of the crisis, competition in lending has decreased. The easing in competition is to some extent cyclical. During periods of strong economic growth, banks tend to compete aggressively for business lending by cutting their margins and relaxing their lending standards. However, when the economic and business outlook is uncertain and loan losses are rising, as has been the case over the past couple of years, banks see the loans as being more risky and pull back a little.…as the Australian economy strengthens, there may be some incentive for new or existing lenders to expand their lending in this sector and compete away some of this spread.[6]

5.4 The bankers themselves concede that the global financial crisis reduced competition:

> Immediately prior to the global financial crisis when credit was very cheap, very cheap credit meant that there was fierce competition amongst a whole range of lenders to provide businesses with loans. That choice, that competition, has undoubtedly diminished as a number of those players have been forced out of the market, but we are seeing signs of those players returning.[7]

5.5 The Australia Institute's David Richardson views the manner in which banks change their interest rates synchronously as indicative of a lack of competition:

> A good example of the exploitation of market power on the part of the banks follows the increases in official interest rates by the Reserve Bank of Australia. Objectively bank costs have not changed from one day to the next but the banks use the official interest rate decisions as cover to increase their interest charges…The clear impression from watching bank interest rate changes is that official interest rate changes are taken as the signal to change bank lending rates whether bank costs justify an increase or not. It looks like a textbook example of oligopolistic pricing in which the main players set a common price to maximise their collective earnings. Usually explicit collusion to set prices is illegal but there is implicit collusion that may take other forms. For example, one firm may emerge as the price leader occasionally announcing changes in prices that are copied by other participants in the market…In the case of banking, it is actually the RBA that acts as an unofficial price leader. The RBA announces interest rate changes which are followed by the banks, at least on their lending side. Hence the RBA acts as the price leader and the banks follow the leader irrespective of their costs.[8]

5.6 There are hopes of improvement in competition:

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6 Reserve Bank of Australia, *Submission 2*, pp 4, 6.

7 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 5.

8 David Richardson, Senior Research Fellow, Australia Institute, *Submission 47*, p. 2.

> Competition in the small business lending market has eased from the strong levels just prior to the onset of the financial crisis, but we think it should recover as the economy continues to strengthen.[9]

5.7 Business, however, is yet to observe this:

> We have not seen a significant increase in competition, no.[10]

The role of non-ADI lenders

5.8 The global financial crisis has reduced the role of lenders who are not authorised deposit-taking intermediaries (banks, building societies and credit unions).

5.9 The Reserve Bank estimates that:

> The non-ADI lenders were about 10 per cent of the market in 2007…they are probably about five per cent of the market now…[11]

5.10 In some cases the tougher global financial conditions may have hastened but not caused the demise of non-ADI lenders:

> …certainly with some of them—their business models were not sustainable in a medium-term sense. They were sustainable in 2007, but they were obviously not sustainable in the height of the crisis and they probably would not have been sustainable going forward.[12]

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9 Dr Guy Debelle, Assistant Governor (Financial Markets), Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 18.

10 Mr Philip Chidamo, Chief Economist, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 46.

11 Dr Debelle, Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 24.

12 Dr Debelle, Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 25.

Bank switching costs

5.11 The Council of Small Business of Australia's submission focuses on reducing switching costs between banks as a way of improving competition. They advocate the Government:

> …regulate with respect to some of the high costs of switching banks that currently exist. For example, bank account number portability, like mobile phone number portability, has the capacity to promote choice, reduce costs and increase productivity.
>
> …work with State and Territory governments to overcome other barriers to switching banks that are attendant on business loans for mortgage-secured businesses, such as stamp duty costs.[13]

5.12 Questioned at the hearing, other business representatives also indicated this is an issue:

> We certainly have some anecdotal evidence of transaction costs associated with switching banks or financial institutions…some [businesses] have indicated that they find it difficult to switch banks or it is just too costly for them to switch banks, so therefore it is a hindrance…[14]
>
> …the government must act as it did in the household mortgage sector to reduce the barriers to switching providers. We believe the Productivity Commission should do a full review of the costs and constraints faced by small business when they engage with banks to secure finance.[15]
>
> If exit fees act in an almost prohibitive way for the transfer of funds from one institution to another, they effectively act in an anticompetitive manner in the market.[16]
>
> I, for one, changed our financial institution about 15 years ago after our family had been with them for a hundred years, and it was not an insignificant cost to us with all the extra things such as stamp duty and all that sort of activity which made what seemed a simple business decision at the time start to look like maybe we should not be doing it because there was going to be a direct out-of pocket cost.[17]

5.13 Treasury also highlighted the importance of switching:

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13 Council of Small Business of Australia, *Submission 27*, p. 3. See also the comments by their chief executive officer, *Proof Committee Hansard*, 10 May 2010, p. 78.

14 Mr Chindamo, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 51.

15 Mr Stephen Cartwright, Chief Executive Officer, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 88.

16 Mr Peter Anderson, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 10 May 2010, p. 14.

17 Mr Charles Burke, Vice-President, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, p. 66.

…switching is probably one of the best things you can do in terms of stimulating competition…[18]

5.14 They were, however, less critical of the current amount of switching:

…Australia's switching rates are actually no lower—and probably higher—than other major countries.[19]

5.15 Rival lenders are also opposed to banks' high exit fees:

…they are in our view operating as a definite brake on the ability of consumers to leave…[20]

5.16 A report by the House Economics Committee recommended that:

…as part of the adoption of responsibility for the regulation of credit…the government consider mechanisms…for addressing unfair entry and exit fees.[21]

5.17 In particular, exit fees (or 'early termination fees') on variable interest rate loans and establishment fees for new loans act as a disincentive to change banks. This was put to the banks:

Senator HURLEY—… Can you comment on the ease of any businesses being able to take advantage of that and whether you see that has eased or become more difficult?

Mr Münchenberg—I do not know of any reason why it would have become more difficult. I would have thought that it is reasonably straightforward for business customers, subject to whatever arrangements they have in place.[22]

5.18 The Committee is not aware of any study of the size of exit fees on loans to small business but an indication may be gleaned from a study by ASIC in 2008 on exit fees on home mortgage loans. This found that exit fees have been increasing, both absolutely and as a proportion of total bank fees.[23] A typical exit fee charged by a major bank for a repayment of a $250,000 variable interest rate loan after three years

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18 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 4.

19 Mr Murphy, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 4.

20 Mr Mark Degotardi, Abacus, cited in House of Representatives Standing Committee on Economics, *Competition in the Banking and Non-Banking Sectors*, November 2008, p. 84.

21 House of Representatives Standing Committee on Economics, *Competition in the Banking and Non-Banking Sectors*, November 2008, p. 86.

22 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 6.

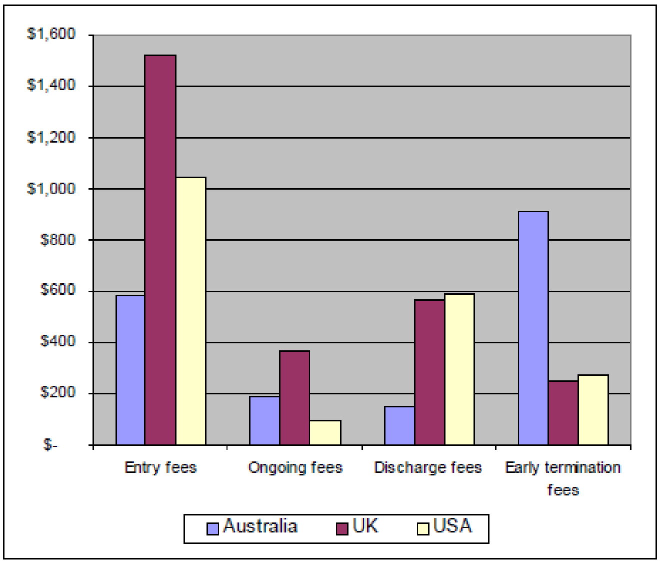
23 ASIC, 'Review of mortgage entry and exit fees', Report no. 125, April 2008, p. 7.

was around $1,000 and over 90 per cent of mortgage products from major banks had exit fees.[24]

5.19 The study also shows that exit fees charged in Australia are much higher than those charged by banks in the UK and US (Chart 5.1). A similar conclusion was reached by the Reserve Bank:

> …by international standards we have relatively high exit fees on mortgages…[25]

Chart 5.1: Comparison of selected bank fees



Source: ASIC, 'Review of mortgage entry and exit fees', Report no. 125, April 2008, p. 11.

5.20 Treasury suggested exit fees could be challenged:

> With exit fees it is questionable and some people say that they could be challenged as a term of an unfair contract. So the government has introduced—under the new credit legislation—capacity for individuals to challenge unfair conditions in terms of contracts…Treasury questions exit fees...[26]

5.21 Section 72(4) of the Uniform Consumer Credit Code states:

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24 ASIC, 'Review of mortgage entry and exit fees', Report no. 125, April 2008, p. 8. Smaller banks charged an average of $700 and building societies and credit unions an average of $400. The majority of building society and credit union mortgage products did not have exit fees.

25 Mr Ric Battellino, Deputy Governor, Reserve Bank of Australia, quoted in House of Representatives Standing Committee on Economics, *Competition in the Banking and Non-Banking Sectors*, November 2008, p. 78.

26 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 5.

> A fee or charge payable on early termination of the contract or a prepayment of an amount under the credit contract is unconscionable if and only if it appears to the Court that it exceeds a reasonable estimate of the credit provider's loss arising from the early termination or prepayment, including the credit provider's average reasonable administrative costs in respect of such a termination or prepayment.[27]

5.22 As far as ASIC was aware, however, no cases had proceeded under this section.[28] A likely reason is the legal costs for an individual borrower are dauntingly large when there is no guarantee of a case being successful. Justice Morris may not have helped when in a related case he ruled that:

> …there is no implied obligation to refrain from charging an unconscionable establishment fee, rather, that a lender is at risk if it charges an unconscionable establishment fee.[29]

5.23 Small businesses do not have access to this consumer protection so are even less able to challenge exit fees.

5.24 Some business organisations are reluctant to embrace a ban on exit fees:

> I am hesitant to bandy around the word 'ban'. Given that my members are essentially participants in the free market capital economy that we have, they would want the right at all times to charge whatever fees they want in their own businesses. So I think it would be fair to say that, rather than dictating what fees and charges an institution could or could not charge, the key is transparency. [30]

5.25 Bank exit fees are not the only impediment to switching banks:

> It could be relationship factors. They are used to dealing with one bank, one branch and so forth and so on. [31]
>
> There is also a perception amongst small businesses that there is not much benefit from trying to shop around, as the banks all have similar application and assessment processes.[32]
>
> During the crisis people who had solid banking relationships have tended to say, 'Look, I'm going to really value this.'[33]

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27 ASIC, 'Review of mortgage entry and exit fees', Report no. 125, April 2008, p. 22.

28 ASIC, 'Review of mortgage entry and exit fees', Report no. 125, April 2008, p. 23.

29 Justice Morris in *Director of Consumer Affairs Victoria v City Finance Loans and cash Solutions 2008*, cited in ASIC, 'Review of mortgage entry and exit fees', Report no. 125, April 2008, p. 23.

30 Ms Jaye Radisich, Chief Executive Officer, Council of Small Business of Australia, *Proof Committee Hansard*, 10 May 2010, p. 77.

31 Mr Chindamo, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 52.

32 NSW Business Chamber, response to questions on notice.

33 Mr James Tate, Chief Product Officer, Westpac, *Committee Hansard*, 12 April 2010, p. 76.

> Anecdotal evidence from our members suggests that banks are currently less interested in winning additional business from small business customers. Some members have stated that banks are worried that businesses trying to leave their current provider must be doing so because they represent a bad risk.[34]

5.26 Another barrier to switching between banks is stamp duties. Under the *Intergovernment Agreement on Federal Financial Relations*, stamp duties on mortgages are scheduled to be abolished before 1 July 2013.[35]

5.27 Bank account portability has been suggested as another means of facilitating switching. Asked about this, the Australian Bankers' Association responded:

> Whilst we can appreciate the appeal of such a concept, this will not be pursued by the wider industry at this stage given the very high cost, complexity and disruption involved in the potential implementation of such a facility. By way of background, the account number (including the BSB component) is a unique (to each bank) identifier which permits all the bank's systems and customers' systems (e.g. payroll, accounting packages etc) to 'know' where to send funds. Financial institutions maintain separate IT systems for the different payment clearing systems and each IT system is integrated into many other product and accounting systems. Account portability would mean a fundamental change to each of the IT systems used to exchange payments and substantial rebuilding of other systems. Moreover, many businesses and service providers, including government departments (such as ATO and Centrelink) have IT systems which store BSB and account number information for their staff (for payroll purposes) and customers. It would require them to also update their IT systems and payment records at considerable expense.[36]

Committee view

5.28 Exit fees are not the only factor reducing switching between banks, but this is no justification for maintaining this impediment to competition. While there are valid arguments for some exit fees on fixed-rate loans, no convincing justification has been put forward for exit fees on variable-rate loans. It is not a sufficient response to say that excessive exit fees may be challenged in the courts. This is too expensive and risky an option for a small business.

Recommendation 1

5.29 The Committee recommends that banks abolish exit fees on variable-rate loans. If banks do not do so by the end of 2010, then guidelines or regulations, or if necessary new legislation, should be used to compel them to do so.

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34 NSW Business Chamber, response to questions on notice.

35 *Report on Australia's Future Tax System*, December 2009, p. 479.

36 Australian Bankers' Association, response to questions on notice.

5.30 The Committee supports the abolition of stamp duties on mortgages.

The Government's bank funding guarantees

5.31 The bank funding guarantees were the subject of a report by the Committee in 2009. The Committee did not call for a repeal of the guarantees but called for a review of the premia charged for the wholesale funding guarantee.[37]

5.32 The Committee also expressed concern that:

> The introduction and implementation of the guarantees served to greatly increase the lack of confidence in those institutions not the beneficiaries of guarantees, with the consequence that most experienced unsustainable requests for redemptions within a very short period.[38]

5.33 Treasury regards the schemes as positive for small business:

> Without the Guarantee Scheme, banks (including both majors and non-majors) would have had no choice but to ration credit to businesses and consumers, and charge higher interest rates.[39]

5.34 The guarantees have probably benefited smaller domestic banks, but at the expense of the larger domestic banks, foreign banks operating as branches and unregulated entities such as mortgage trusts. Given the arguments (developed further in the following chapter) about smaller banks lending more to small business, the guarantees have therefore probably had a supportive role for small business lending. It could have been even more supportive if the smaller, lower-rated, banks were not charged a higher premium for the wholesale funding guarantee than are the large banks.

5.35 The Australian Bankers' Association opined that:

> The guarantees, for which the banks paid more than a billion dollars in fees, supported market confidence and stability during a period of great uncertainty internationally, and facilitated the continuing provision of affordable credit by banks to their small business customers.[40]

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37 *Government measures to address confidence concerns in the financial sector – The Financial Claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding,* September 2009, p. 19.

38 *Government measures to address confidence concerns in the financial sector,* p. 31.

39 Treasury, *Submission 50*, p. 14.

40 Australian Bankers' Association, response to question on notice.

The Government's support for mortgage-backed securities

5.36 Initially, the programme of support for residential mortgage securitisation could have been attracting some lending to home lending at the expense of small business loans.

5.37 With the second tranche of the programme, Treasury regarded the scheme as supportive for small business:

> …the Government's direct investment of up to $16 billion in the residential mortgage-backed securities…market has enabled smaller lenders to lend at competitive interest rates and maintain a higher level of lending and market share than would otherwise have been possible. Applicants' small business lending commitments are taken into account under the second tranche of this initiative…. The extension to the RMBS program includes an additional objective of supporting lending to small businesses. Consequently, lenders who seek support under the RMBS program are encouraged to outline how active they are in lending to small business and to allocate part of the proceeds raised under the program to lending to small business. This is one of the factors that the AOFM assesses when deciding whether to support an RMBS deal.[41]

41 Treasury, *Submission 50*, pp 14-15.

Chapter 6

Structural change in the market for small business finance

Introduction

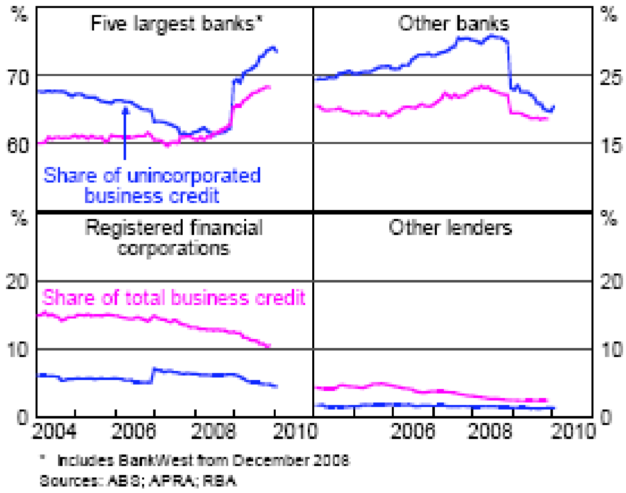
6.1 The Australian banking market is dominated by four large banks, now accounting for around ¾ of the market. This has resulted from a series of mergers going back more than a century (Charts 6.2 to 6.6).

6.2 The Committee has commented in an earlier report:

> A consequence of these mergers has been a long-run tendency towards increased concentration within the Australian banking industry. There was a temporary reduction in concentration with the deregulation of the 1980s, mostly reflecting the entry of foreign banks and conversion of the larger building societies, but this has now been overwhelmed by the ongoing mergers. As a result the Australian banking market is now, by some criteria, the most concentrated it has been for more than a century…The Australian banking market is now quite concentrated by international standards. This is likely to be one reason it is more profitable, and has wider interest margins, than banks in most comparable countries…[1]

6.3 Since the start of the global financial crisis, Westpac has taken over St George and the Commonwealth Bank has taken over BankWest, further entrenching the dominance of the four majors (Chart 6.1)

Chart 6.1: Lenders' shares of business credit



Source: Reserve Bank of Australia, *Submission 2*, p. 6.

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1 Senate Economics References Committee, *Report on Bank Mergers*, September 2009, pp 5-6.

Chart 6.2: Commonwealth Bank family tree

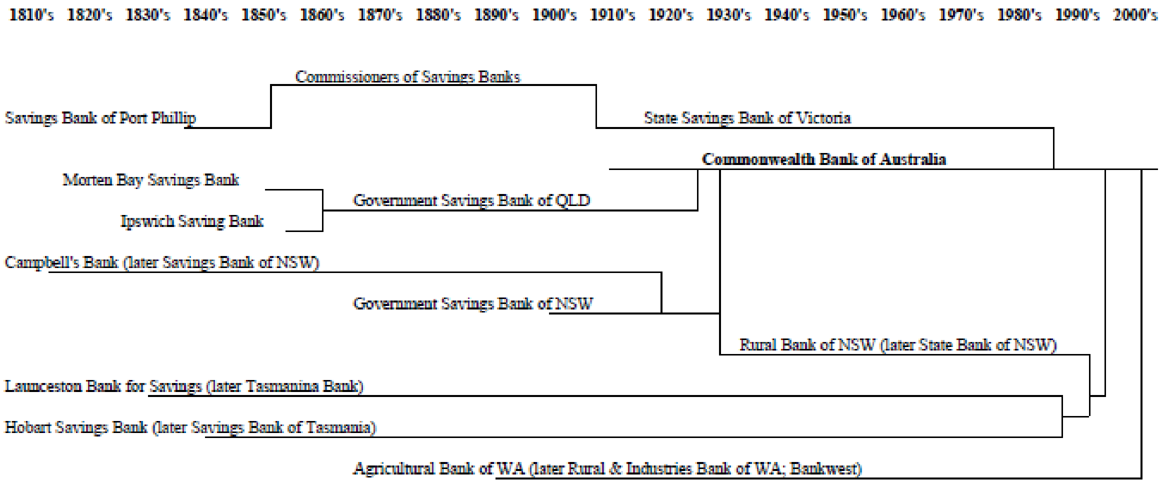


Chart 6.3: ANZ Bank family tree

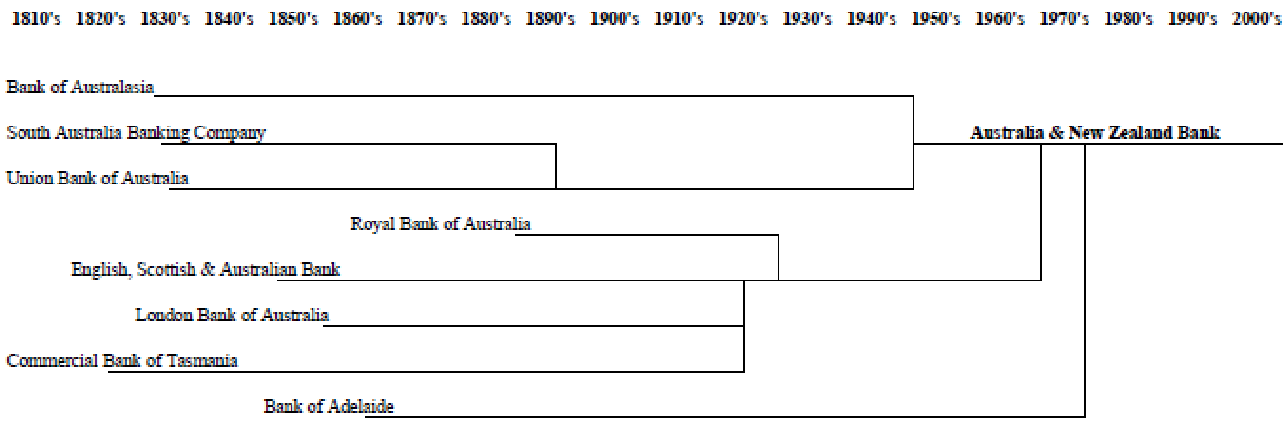


Chart 6.4: National Australia Bank family tree

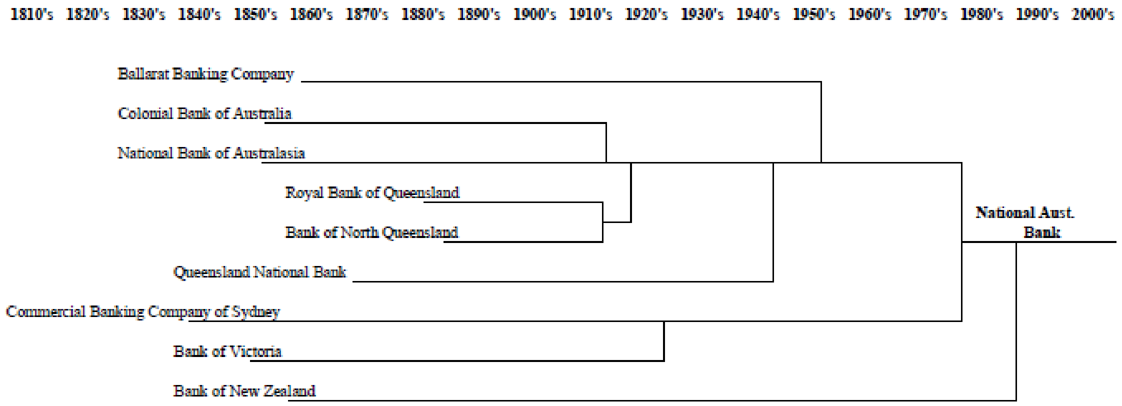
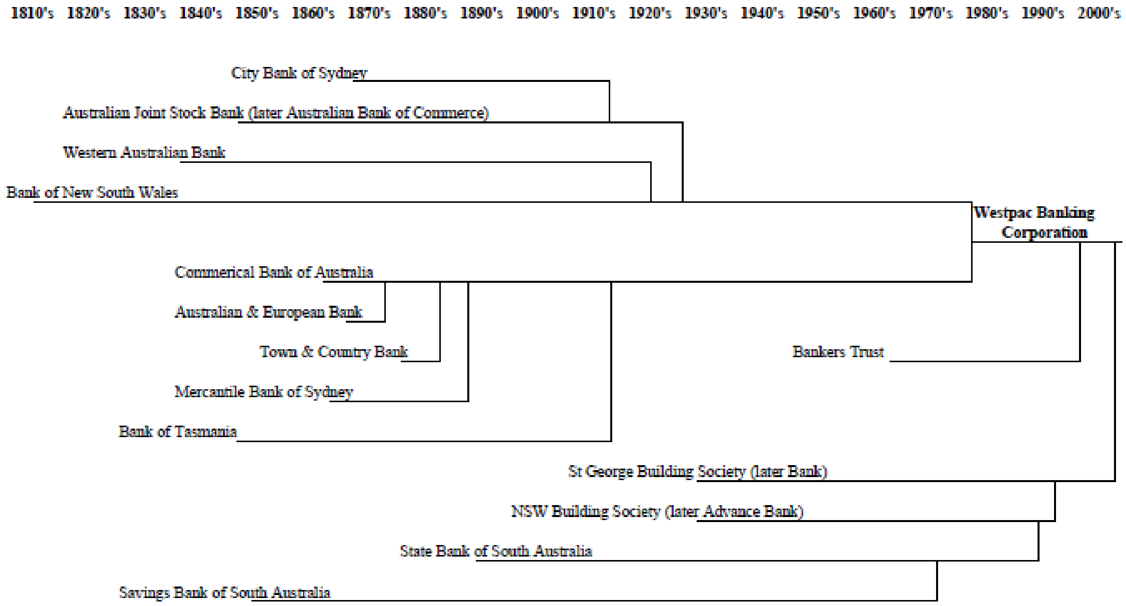


Chart 6.5: Westpac Bank family tree



Implications for small business lending

6.4 As banks become larger they are more able to make large loans to large companies. It has been suggested that this may lead to them being less interested in lending to small business.[2] Overseas studies have found some empirical evidence that larger banks make a smaller proportion of their loans to small business.[3]

6.5 A tendency for mergers between banks may also go some way to explaining the observation that internationally:

> …there is anecdotal and increasingly statistical evidence that Small and Medium Enterprises have not benefited from this financial deepening to the same extent as other borrower groups…[4]

6.6 A cross-country study by World Bank economists concluded that more concentrated banking systems particularly disadvantage smaller businesses:

> Our results indicate that in more concentrated banking markets firms of all sizes face higher financing obstacles and are less likely to receive bank financing. This effect decreases as we move from small to medium and large firms…[5]

6.7 Treasury offered some support to the proposition that larger banks lend more to larger companies (to the extent that 'local' refers to regional banks such as St George and BankWest that have been taken over by national banks):

> Senator EGGLESTON—Do you suppose that the local banks might have a better perception of local economic circumstances and be more prepared to consider propositions because they better understand the local economy?

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2 See the discussion in Group of Ten, *Consolidation in the Financial System*, January 2001, pp 278-286. A related concern often expressed is that foreign banks are less interested than domestic banks in lending to small businesses, although the evidence for this is mixed; see J Hawkins and D Mihaljek, 'The banking industry in the emerging market economies: competition, consolidation and systematic stability: an overview', Bank for International Settlements, *BIS Papers*, no 4, August 2001.

3 This literature is summarised in Group of Ten, *Consolidation in the Financial System*, January 2001, pp 284-5; A Berger, R Demsetz and P Strahan, 'The consolidation of the financial services industry: causes, consequences and implications for the future', *Journal of Banking and Finance*, 1999, vol 23, no 2, pp 135-194; E Carletti, P Hartmann and G Spagnolo, 'Implications of the bank merger wave for competition and stability', *Risk Measurement and Systemic Risk*, CGFS Conference volume, no 2, October 2002, pp 39-42 and Senate Economics References Committee, *Report on Bank Mergers*, September 2009, p. 36.

4 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, provided by NARGA in response to a question on notice, p. 1.

5 T Beck, A Demirgfi-Kunt and V Maksimovic, 'Bank competition, financing obstacles and access to credit', *World Bank Policy Research Working Papers*, no. 2996, March 2003, p. 2.

Mr Murphy—Yes.[6]

6.8 The Australian banks have implicitly agreed, as they have indicated that they are being constrained in their involvement in making loans to large business by their size. While they do not put it in these terms, this suggests that as they become larger they will focus a larger proportion of their attention on very large loans and by implication a smaller proportion of their assets will be in loans for small business. For example, then Westpac CEO David Morgan commented:

> To out it bluntly, the Australian majors need scale…Westpac often finds itself competing against organisations ten times our size. So no one should be too surprised when we do not feature in the 'mega deals'. Size does matter when it comes to lead bank roles and taking on the exposures involved.[7]

6.9 The Reserve Bank also implicitly support this view as they comment:

> The major banks are a particularly important source of debt funding for small businesses…Foreign-owned banks provide only a small share, in part because they do not have a substantial branch network.[8]

6.10 Small business loans make up 12 per cent of St George's loan book but only 5 per cent of the larger bank Westpac's loan portfolio.[9]

6.11 Asked for their view, the Australian Prudential Regulation Authority replied:

> Some historical context may be of use here. In some countries such as the United States and Japan, the current larger banks originated as ‘city’ banks with a focus on large business lending, while smaller banks started in regional centres and naturally had more focus upon personal and smaller business lending. This is not the historical pattern in Australia. In Australia, the current smaller banks and other ADIs typically originated as home lenders and personal lenders, and the larger commercial banks dominated not only large corporate loans, but small and medium enterprise loans. Based on statistics available to APRA as at end-December 2009, there is no clear pattern that supports the view that large banks concentrate on lending to large business while smaller banks focus on small business. There is considerable variation from bank to bank depending on their business strategy, with some larger banks having a relatively higher share of lending to small business. Regional banks as a group tend to have a relatively high share of small business loans to total loans.[10]

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6 Mr Jim Murphy, Executive Director, Treasury, *Committee Hansard*, 12 March 2009, p 30.

7 David Morgan, 'Changing the game', address to Trans Tasman Business Circle, 26 July 2007. Since this speech was given, some of those larger organisations would have shrunk or closed.

8 Reserve Bank of Australia, *Submission 2*, p. 2.

9 Westpac, *Submission 31*, p. 2.

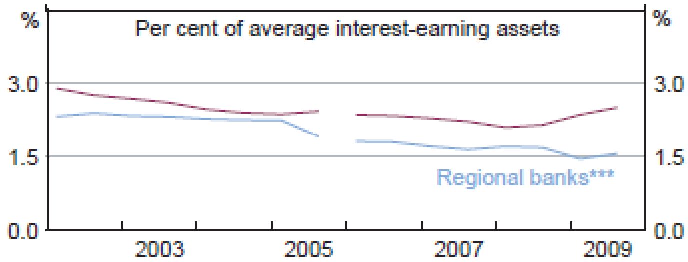
10 APRA, responses to questions on notice.

6.12 APRA also did not believe their 'large exposure' limits would have the effect of precluding smaller banks lending to large companies:

> APRA has large exposures limits for different classes of counterparty as a percentage of the ADI's capital base. The maximum for non-Government non-ADI counterparties is 25 per cent of capital; typically, there are limited exposures beyond 10 per cent of capital to this category of borrower. It is unlikely that APRA's requirements would limit the ability of ADIs to lend to large businesses and thus have the suggested impact on lending to small business. ADIs also have their own limits on exposures to individual borrowers and sectors as part of their internal risk management and these limits are aimed at avoiding a concentration of exposures to individual counterparties, groups, sectors or geographical regions.[11]

6.13 As well as having less enthusiasm for small business lending, there is some evidence that the major banks (the upper line in Chart 6.2) tend to have wider interest margins than do the regional banks.

Chart 6.2: Australian Banks' Net Interest Income



Source: Reserve Bank of Australia, *Financial Stability Review*, March 2010, p. 18.

6.14 Some business groups have also expressed concern that mergers are leading to an overly concentrated banking industry:

> …our marketplace must stay open to new entrants. Secondly, we must show more scepticism about claims that the merger of second and third tier financial institutions will not lessen competition. It does, it has and it will.[12]

> Consultations with small businesses suggest that over and above the lack of credit due to the recent tightening related to the GFC, there is potentially a lack of competition in the market for lending to small businesses.[13]

> When you see…a functioning oligarchy…then obviously it is going to be an issue in terms of the provision of competition…[14]

11 APRA, responses to questions on notice.

12 Mr Stephen Cartwright, Chief Executive Officer, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 88.

13 Australian Industry Group, *Submission 14*, p. 9.

> The ARA notes widespread concern regarding the lack of competition in the banking sector leading to higher fees and interest rates, standard non-competitive products and a general ignorance and disinterest about the lending requirements of small business.[15]

6.15 Large banks may centralise credit assessment, with adverse consequences:

> …loan applications from Far North Queensland may be assessed in Sydney, where there is no "local" knowledge of regional industries. This has impacted on the ability of rural and other localised industries to obtain funding.[16]

6.16 There is evidence that the ever larger banks are losing credit assessment abilities relevant to small business lending:

> In a recent poll conducted by ACCI during March 2010, 34 per cent of the 215 business respondents reported that their business bankers do not have adequate understanding of their business' cash flows and its ability to service any current or prospective loan obligations.[17]
>
> We have observed over the last decade and a half that there has been a stripping out of trained business lending officers within the banking system in favour of lending for households…It has basically meant the demise of the local bank manager, and that has had an impact on the capacity of banks to assess risk.[18]

6.17 Westpac refers to actions it has taken which might offset this tendency, commenting:

> Westpac commenced a significant investment in grassroots banking in 2009, including bringing back the local Bank Manager and empowering branches to better support local communities. The 18 month program is well progressed - Westpac has created over 1,300 roles which include 530 new Bank Managers and 59 regional managers and will have recruited over 700 new branch staff by mid-year to support our renewed focus on customerfacing representation. Business customer representation has also been increased, with 150 new commercial bankers recruited in 2009 and another 50 are expected to have been recruited by the middle of this year. St George has similarly significantly increased the numbers of its SME relationship managers in the past two years.[19]

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14 Mr Stephen Cartwright, Chief Executive Officer, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 99.

15 Australian Retailers' Association, *Submission 45*, p. 6.

16 Commercial Asset Finance Brokers Association of Australia, *Submission 22*, p. 2.

17 Australian Chamber of Commerce and Industry, *Submission 32*, p. 20.

18 Mr Greg Evans, Director of Economics and Industry Policy, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 10 May 2010, p. 10.

19 Westpac, *Submission 31*, p. 2.

6.18 National Australia Bank has referred to the virtues of:

> …doing business with customers you can see from the local church spire.[20]

6.19 There has been a reduction in competition within specific segments of the finance market. For example, in the equipment leasing space:

> Lenders whose products are no longer available to Equipment Finance Brokers include ABN Amro Ltd, Adelaide Bank, AGC Ltd (independently of Westpac), Bendigo Bank, Colonial State Bank, G E Commercial Finance, Members Equity Bank, Orix Australia Corp, Societe Generale (SG) Aust Ltd and Suncorp Metway Ltd. Each departure from this market removes a particular expertise or product range, leaving fewer options available to Small Business borrowers.[21]

6.20 A specific merger was raised by the Western Australian Farmers' Federation. They oppose the proposed acquisition by ANZ Bank of the deposit and loan books of Landmark Financial Services. Their concern is that:

> Traditionally, lending facilities provided by Landmark incorporate assessment of the value of a farm business in the decision making process. Effectively, if a farmer sells their produce through Landmark, the lender controls the farm cash flow. Purchase of merchandise, insurance and agronomic services through Landmark also provide an income stream to Landmark. These facets of this lender/borrower relationship in some instances will result in lending criteria being more flexible than is the case in a traditional lender/borrower relationship with a banking institution. Interest rates are generally of a higher level to compensate for increased risk in these instances but a lender such as Landmark will in all likelihood extend finance in times of seasonal downturn beyond which a banking institution will …WAFarmers does not believe that this latitude would be continued under normal banking criteria imposed by the ANZ …The very real threat of the proposed acquisition should it proceed will be that the ANZ will cherry pick the loan book of "secure" borrowers, discard those that don't meet their criteria and retain the deposit book.[22]

Regulated lending

6.21 A possible response is to have regulations mandating minimum proportions of lending to small business:

> I am aware of some South East Asian countries—I think the Philippines—where banks have to put 25 per cent of their loan book into small business.[23]

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20 Mr Joseph Healy, 'Banks, business lending and the economy', 17 February 2010, p. 6, reprinted in NAB, *Submission 44*, attachment 1.

21 Commercial Asset Finance Brokers Association of Australia, *Submission 22*, p. 2.

22 Western Australian Farmers' Federation, *Submission 26*, p. 2.

23 Mr John Cummings, Chairman, NARGA, *Committee Hansard*, 12 April 2010, p. 32.

> …we really need to put in place some sort of structure to ensure that a certain proportion of bank lending continues to go to the small-business sector.[24]

6.22 Professor Sathye doubted this is feasible in Australia:

> The second way could be—of course, it's probably not plausible in Australia in a market economy—to give some sort of mandated target. But that would be interfering in the free market.[25]

Increasing competition from non-bank lenders

6.23 Building societies and credit unions, particularly in regional areas, may be able to provide more competition for the small businesses. They identified as an impediment to their competing that it costs them more to raise funds as many potential customers are under the misapprehension that the mutual organisations do not meet the same prudential standards as the banks:

> But every bit of market research testing we do, and all our dealings with commentators, show us that in particular credit union and building society brands are perceived as less well regulated than the major banks. There is very, very limited understanding of the fact that we have got a harmonised prudential system in Australia. There is very little understanding that on all the risk measures you look at—and it is not just here in Australia but under the Basel Framework globally—the credit union systems have come out as particularly resilient because they are particularly conservative and do not have access to the same kind of risks that internationally operating and complex businesses do, and all the complexity around their balance sheets.[26]

6.24 Abacus suggests allowing building societies and credit unions to style themselves 'mutual banks' may overcome this disadvantage.

Committee view

6.25 In its 2009 report on bank mergers, the Committee supported retention of the 'four pillars' policy. It also recommended that:

> …the Government request the ACCC, APRA and the Reserve Bank to provide a joint annual report to parliament on competition in the retail banking market in Australia, and the provision of affordable banking

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24 Mr Frank Sirianni, Consultant, Pharmacy Guild of Australia, *Proof Committee Hansard*, 10 May 2010, p. 47.

25 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 18.

26 Ms Louise Petscher, Chief Executive Officer, Abacus, *Proof Committee Hansard*, 10 May 2010, p. 36.

facilities to those on low incomes, but taking care not to increase unduly the reporting burden on financial institutions.[27]

6.26 The Committee still holds to these views and also sees value in the annual report addressing the provision of finance for small business.

6.27 The Committee is concerned that takeovers of regional banks by major banks are not only reducing the number of competitors but are specifically removing those banks most interested in lending to small business. Given the evidence it has seen in other inquiries, most recently into the dairy industry, the Committee is concerned that the existing provisions of the *Trade Practices Act 1974* may be insufficient to prevent further undesirable takeovers in the banking industry.

Recommendation 2

6.28 The Committee reiterates its recommendation that the Government retain the 'four pillars' policy of not allowing a merger between any of the four major banks.

Recommendation 3

6.29 The Committee recommends that a moratorium be placed on approval of any further takeovers in the banking industry for one year, unless the bank being taken over is at imminent risk of failure.

Recommendation 4

6.30 The Committee reiterates its recommendation that the Trade Practices Act be amended to inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

Recommendation 5

6.31 The Committee recommends that the Government request the ACCC, APRA and the Reserve Bank to provide a joint annual report to parliament on competition in the retail banking market in Australia, and the provision of finance to small business, but taking care not to increase unduly the reporting burden on financial institutions.

27 Senate Economics References Committee, *Report on Bank Mergers*, September 2009, p. 54.

Development bank

6.32 A number of submissions called for some form of 'development bank' to be established to fill perceived gaps in lending by the private banks:

> …the only feasible way forward is to boost competition through the establishment of a government development bank (similar to the old Commonwealth Development Bank) which will enter the market and become a major player in lending to small business. In making loans, the development bank should adopt basic prudential lending practice (such as examining the borrower's budget to ensure that the business activity is likely to generate sufficient return to easily meet interest repayments on the borrowing and obtaining security on other assets where available). However, the bank should do away with unnecessarily onerous conditions (such as requiring tax returns showing significant tax profits in 5 of the last 7 years, for example). The development bank could also set a reasonable margin on loans to small business (say the bank bill rate plus 2% where security is offered or plus 6% where there is inadequate security).[28]

> I urge Senators to look at the History of the Commonwealth Development Bank, why it was important to Australia post Depression and how it grew many businesses…[29]

> Australia should be following the examples of other nations by establishing a development bank to provide a variety of specialist lending purposes, including lending to small businesses and farmers.[30]

> …for small business to continue and survive, a Peoples Development Bank must be established.[31]

6.33 Some of these submitters referred to the German Kreditanstalt fur Wiederaulfbau bank as an example. KfW (whose name means Reconstruction Credit Institute) is a government-owned bank formed in 1948 as part of the Marshall Plan. It is mostly funded by issuing government-guaranteed bonds. It has a specific business unit which provides loans and start-up capital for small business (over the past two decades particularly active in the former East Germany) and is also engaged in securitisation and advisory services.[32]

6.34 One submitter described it as follows:

> In 2007 it had a balance sheet of €354 billion (A$725 billion), making it one of Germany's 10 biggest banks, employing 3,800 staff. The KfW supports the German economy with tailor-made financing, acting as an

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28 Mr Suryan Chandarsegaran, *Submission 3*, p. 3.

29 Mr Ross Wood, *Submission 10*, p. 2.

30 National Civic Council, *Submission 51*, p. 3.

31 Mr Jim McCormack, *Submission 4*, p. 2. See also Mr Peter White, *Submission 8*, p. 1; Mr Philip Osmak, Submission 13, p. 1; Mr Patrick Ariens, *Submission 52*, p. 1.

32 KfW has an English language webpage: http://www.kfw.de/EN_Home/index.jsp.

"equaliser" in providing low-interest, long-term credit, with repayment-free periods for smaller businesses whose sole credit option is the local branch of a major bank… The advantages of this financing system include:

• long-term loans with a maturity of 10 to 20 years;

• favourable interest rates fixed for 10 years, and even 20 years under the SME Programme;

• a particular advantage is that almost all KfW loans can be repaid fully or partially in advance of maturity and free of charge;

• simple application, loan commitment and loan handling through a regular bank.[33]

6.35 Other countries have similar institutions. The Japan Finance Corporation has a unit that lends up to ¥720 million for up to 20 years at fixed rates to small business, including start-ups. The Industrial Bank of Korea is required to make at least 70 per cent of its loans to small business.

6.36 The Commonwealth Development Bank (CDB) was established around 1960 as part of the Commonwealth Bank group. It was wound down from 1996. A submission describes its history as follows:

> The Commonwealth Development Bank…in its 30-year history, it helped establish over 400,000 small and medium-sized enterprises…the CDB was heavily involved in financing farmers who took up holdings in the Ord River project, the Esperance Land Settlements Scheme in Western Australia, the Coleambally and the Heytesbury Scheme in Victoria, to name only a few such projects. … The CDB was staffed by experienced lenders capable of assessing the long-term feasibility of proposals. The staff included specialists in agricultural science, economics, management, accounting, and engineering. They spent much of their time in the field undertaking assessment and investigation work.[34]

6.37 Professor Sathye commented:

> …the third way could be to have a mechanism, a separate development bank, for small businesses. There are issues with that kind of mechanism because of the cost that is involved in running it and, ultimately, to the borrower. I am coming now from experience from home. We had the Small Industries Development Bank of India, which was acting as a refinancing agency. It was basically raising capital in the market and, because it was a government bank, it was in a position to raise the capital at much lower rates and then lend it on to banks. So it was really refinancing the banks. Because the banks were getting a line of credit available to them, exclusively for lending to small businesses, it was freeing up their resources which were otherwise locked up—because they were able to get the

33 National Civic Council, *Submission 51*, pp 4-5.

34 National Civic Council, *Submission 51*, pp 5-6.

> refinance from the banks. That is a mechanism that can be considered. These are the issues that really require a lot of deep thinking.[35]

6.38 It was suggested that competition from the development bank might lead the commercial banks to lift their game in lending to small business:

> …in the area of mortgages and some commercial areas, it would make it more difficult for the commercial banks not to be competitive on loans for mortgages, small business and farmers.[36]

6.39 Advocates suggested a development bank could also fill the gap during recessions:

> It would help keep credit flowing to businesses, farmers and for mortgages, should the commercial banks be forced to restrict lending. Under such a scenario, development bank loans would support investment, support employment, support taxation revenue levels and keep down the welfare bill.[37]

6.40 Treasury warn that unless there is a specific market gap, such as that met by the Export Finance and Insurance Corporation, a development bank can lead to market distortions such as:

> …assisting lenders rather than borrowers, by providing a cheap source of funding that can be lent onwards at normal market rates; stimulating lending to borrowers who would not meet standard credit conditions, and who are not in a position to repay their loans; and/or 'crowding out' existing commercial providers of credit (or depositors and investors if loans are made through a commercial provider), leading to reduced competition.[38]

6.41 Business representatives were also unenthusiastic:

> …it is probably in the best interests of our economy if that type of transformation in the competitive environment is brought about from within the financial institution market itself...rather than from the government getting back into the business of banking.[39]

> The creation of a development bank represents a permanent solution to what is not expected to be long-term problem…a development bank is not a market based solution, and may result in funds being rationed to particular sectors of Government interest rather than the most deserving small businesses.[40]

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35 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 18.

36 National Civic Council, *Submission 51*, p 7.

37 National Civic Council, *Submission 51*, p 7.

38 Treasury, *Submission 50*, p. 21.

39 Mr Peter Anderson, ACCI, *Proof Committee Hansard*, 10 May 2010, p. 13.

40 NSW Business Chamber, responses to questions on notice.

6.42 Unsurprisingly, the banks were not keen on a rival being established:

> There is no compelling case. If the objective is to create greater competition in banking by setting up a major player in banking that is government owned, then the result would be to disproportionally affect small financial institutions, which will erode competition. There have been a number of major problems with government owned banks in Australia recent history, which have required significant investments of taxpayer funds.[41]

6.43 A variant of the development bank idea is to have a refinancier:

> The purpose of that re-financing could be to free up the funds of the banks. So if you have a pie, X amount is allocated to small businesses and the banks will be trying to reduce that pie more and more because it is not profitable. I am an ex-banker. If I have a profitable opportunity available out there in the market, why should I lend to a small business when I can make more money on the other side? One way to handle that is to free up this money. The way to free up the money is to have a re-financing mechanism that can help to push the money to the small business sector. The re-financing that was available with SIDBI, which is the Small Industries Development Bank of India, is exclusively for small businesses. So the banks lend for small businesses and, in turn, go to the SIDBI and take a re-finance from the SIDBI, and SIDBI then provides them with the finance. That channel goes to small businesses only— nothing else—and it frees up the funds of the bank.[42]

6.44 Something similar was suggested by Abacus, the representative body for building societies and credit unions:

> …the government probably needs to investigate whether there is some merit in allocating some funding specifically for small business lending and specifically in regional and rural communities, and we would argue that we are one of the people that are best placed to put in that funding.[43]

Committee view

6.45 The Committee notes the suggestion of a development bank but prefers to increase competition within the existing commercial banks.

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41 Australian Bankers' Association, response to questions on notice.

42 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 19.

43 Mr Mark Degotardi, Head of Public Affairs, Abacus, *Proof Committee Hansard*, 10 May 2010, p. 36.

Postal bank

6.46 Another suggestion was that competition could be increased if Australia Post is given a banking licence. It was noted that their new CEO has extensive banking experience.

6.47 The National Civic Council gave the example of the UK Post Office:

> The UK government has just announced that it is expanding its Post Office into lending more widely…[44]

6.48 One business organisation described it as 'an option that is worthy of examination' but had some reservations:

> …the question I would be asking about the Australia Post model in dealing with business lending: to what extent would they already have relationships with businesses and therefore be close enough to them to be able to make quick, insightful judgments? For me, there would be a question mark about that.[45]

6.49 Another was more enthusiastic:

> Senator XENOPHON—…what about the speculation that Australia Post be turned into a bank? …Would another entrant into the marketplace make a difference from your point of view in terms of making it easier for small businesses?
>
> Mr Cummings—Without a doubt.[46]

6.50 Australia Post certainly has a wide branch network but its officers have no expertise in credit assessment. A model that may work would be for the local post offices to receive applications, make a recommendation based on the knowledge of the local postmaster of the character of the applicant and their view of the viability of the project (eg the local postmaster may have an informed view about whether the existing local pizza outlets seem busy enough that an additional one would also be viable) and then a final decision is made at a regional office staffed by newly hired experienced bankers.

44 National Civic Council, *Submission 51*, p. 3.

45 Mr Paul Orton, Director, Policy and Advocacy, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 93.

46 Mr John Cummings, Chairman, NARGA, *Committee Hansard*, 12 April 2010, p. 39.

Banks' service to small businesses

6.51 A number of submissions referred to customer dissatisfaction with banks' services to small businesses, including claims about unreasonable increases in interest rates, poor communication and changes to loan conditions made unilaterally without notice.[47]

6.52 Submissions also referred to onerous lending conditions imposed by banks. For example, ASIC said that small businesses it had consulted referred to the following:

> (i) The family home was usually required as security. Security requirements were also often 'excessive' sometimes exceeding the loan by a factor of 10 or 15 times.
>
> (ii) Applicants without equity in property had to show serviceability by financial statements or cash flow predictions.
>
> (iii) The banks sometimes asked for multiple personal guarantees irrespective of the quality of the business, and blanket guarantees over assets in other entities unrelated to the transaction.
>
> (iv) Applying for a corporate card required a lot of paperwork and the giving of a personal guarantee.[48]

6.53 Particularly critical is the Council of Small Business of Australia, which:

> … has consistently received evidence over the past two years of:
>
> • The withdrawal of pre-approved loans, lines of credit, overdrafts, etc;
>
> • A disproportionate increase in small business loan rates relative to mortgage and corporate loan rates;
>
> • Higher credit assessment hurdles;
>
> • Outright denial of access to credit (in circumstances where credit has previously been available);
>
> • Re-assessment of already agreed loans and terms; and,
>
> • The adoption of inappropriate lending policies (i.e., local managers turning a blind eye to the purpose of a given loan, offering a housing product for a business loan).

6.54 The banks themselves argue that:

> Each proposal from a small business is judged by the bank on its merits. Banks lend money after assessing that a customer has the capacity and

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47 See, for example, the Melbin family, *Submission 5*; Australian Industry Group, *Submission 14*, p. 7; Pharmacy Guild, *Submission 19*; Motor Trades Association of Queensland, Submission 20; COSBOA, *Submission 27a*; NSW Business Chamber, *Submission 33*, pp 7-8 and ASIC, *Submission 17*, p. 4.

48 Australian Securities and Investments Commission, *Submission 17*, p. 3.

> willingness to repay, that they understand the risks they are taking and have the capacity to manage those risks. This is consistent with the need to preserve a sound banking system and a healthy small business sector.[49]
>
> Westpac experienced no material change in the number of complaints from our SME customers throughout the financial crisis. In fact, complaints data for Westpac over 2008 and 2009, which includes complaints regarding access to finance and related matters, details a slight decline in the number of complaints lodged. Of these, over 77 per cent of complaints were resolved at the first point of contact, and nearly 84 per cent were finalised within 5 days.[50]

6.55 There are suggestions that as banks become larger the quality of service to small business may decline, particularly if duplicate branches are closed and local managers moved.[51] A survey by CPA Australia of its members concluded:

> Strong views were expressed by members that the business bankers they deal with are inexperienced and were therefore unlikely to have the necessary skills to appropriately assess credit applications. Members stated that this is adding to the burden on business in securing finance and maintaining finance facilities as they are having to spend extra time providing additional explanations and information on their industry and business which an experienced banker may not normally require. Members also commented that the turnover in business bankers is adding to this burden as this potentially creates a need to re-explain their business to a new person. Regional members expressed concern that bankers in regional areas do not have the authority to assess and authorise loan applications.[52]

6.56 Another perspective was that small businesses would be more satisfied with their interactions with banks if they were better prepared for their dealings with them:

> Every banker and other lender I speak to say most loan applications have totally inadequate financial statements to support their request. This results in most not getting past ‘first base’ or at best, a game of ‘pass the parcel’ over the coming weeks or months between the bank relationship manager, bank credit risk department, the SMB and their external accountant.[53]

6.57 Another submitter felt that banks do not help in this process as:

> It can also be difficult for small businesses to understand the compliance requirements imposed by lenders and provide appropriate information. If a loan application is refused, it can be difficult for the applicant to understand

49 Australian Bankers' Association, *Submission 23*, p. 2.

50 Westpac, *Submission 31*, p. 3.

51 Choice's submission to the Committee's inquiry into bank mergers drew on Roy Morgan polling indicating that larger banks consistently have lower customer satisfaction. See *Report on Bank Mergers*, p. 17.

52 CPA Australia, *Submission 46*, p. 5.

53 Attaché Software, *Submission 15*, p. 1.

> the reasons for the rejection, and discover what they can do to improve the likelihood of acceptance at a future date.[54]

Banks as advisers to small business

6.58 Since the deregulation of the 1980s, there has been concern that banks do not give enough attention to advising small business about appropriate products and amounts of debt, as distinct from just marketing loans to them. A House committee was told that banks regarded providing advice as 'paternalism', but the committee thought this kind of paternalism was appropriate.[55]

A small business loan guarantee

6.59 The NSW Business Chamber raised the possibility of a guarantee of small business loans in Australia for a limited period. The proposal envisages it covering about 75-85 per cent of the amount of the loan, so as not to give rise to excessive moral hazard, limited to loans below a certain size and appropriately priced.[56]

6.60 The Council of Small Business of Australia commented:

> I think there could be a lot of value in it for the community and it would be worth exploring. There are obvious risks associated, but I am quite sure that Treasury has the nous to mitigate those, as long as there is political will to try something different.[57]

6.61 The Council drew an analogy between a prospective agency offering a guarantee and the Australian Business Investment Partnership, known colloquially as 'Ruddbank':[58]

> There was very little talk at the time of the introduction of Ruddbank about the potential benefit that would accrue to small businesses through that particular piece of legislation…[It] actually had enough scope in it to support other funds to support activities such as helping out small businesses. I realise it is quite controversial but, given that I think you would agree that your role is to assess the entire array of options that might exist in support of small businesses going forward, this is one which potentially could be revisited or be in a modified format. So in countries like the UK, China and Singapore they all established particular funds in

54 WA Small Enterprise Network, *Submission 18*, p. 2.

55 House of Representatives Standing Committee on Industry, Science and Technology, *Small Business in Australia: Challenges, Problems and Opportunities*, 1990, p. 205.

56 NSW Business Chamber, *Submission 33*, pp 12-13.

57 Ms Jaye Radisich, Chief Executive Officer, Council of Small Business of Australia, *Proof Committee Hansard*, 10 May 2010, p. 79.

58 The Senate Standing Committee on Economics released a report on this proposal in May 2009.

recognition of the fact that many of the larger banks simply stop lending or change the goalposts when it came to lending to small businesses.[59]

International experience

6.62 The NSE Business Chamber pointed to guarantee schemes for small business loans in Canada, the United Kingdom and the United States.[60] The Reserve Bank provided comparative information on guarantee schemes (Table 6.1 at end of chapter).

6.63 Some overseas schemes have been the subject of study:

> The empirical evidence presented in this analysis shows that Italy's scheme has reached a measure of effectiveness in reducing SMEs' borrowing cost and easing their financing constraints.[61]
>
> …the UK government initiated a loan guarantee scheme (SFLGS) in 1981. In this paper we use a unique dataset comprised of small firms facing a very real, and binding, credit constraint, to question whether a corrective scheme such as the SFLGS has, in practice, alleviated such constraints by promoting access to debt finance for small credit constrained firms. The results broadly support the view that the SFLGS has fulfilled its primary objective.[62]

World Bank study

6.64 A survey by some World Bank economists made the following observations:

> Many countries around the world have therefore made Partial Credit Guarantee (PCG) funds a central part of their strategy to alleviate SMEs financing constraints. Multi- and bilateral donors have supported the set-up of such schemes around the developing world. These schemes seek to expand lending to SMEs, sometimes focusing on specific regions or sectors through reducing lending risk. Specifically, a PCG fund is a risk transfer and risk diversification mechanism; it lowers the risk to the lender by substituting part of the risk of the counterparty by that of the issuer of the PCG…PCG funds (and full credit guarantee funds) have existed at least since the beginning of the 20th century[63] and have become more popular

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59 Ms Jaye Radisich, Chief Executive Officer, Council of Small Business of Australia, *Proof Committee Hansard*, 10 May 2010, p. 74.

60 NSW Business Chamber, *Submission 33*, p. 12.

61 S Zecchini and M Ventura, 'The impact of public guarantees on credit to SMEs', *Small Business Economics*, 2007, p. 204, provided by Professor Milind Sathye in response to a question on notice.

62 M Cowling, 'The role of loan guarantee schemes in alleviating credit rationing in the UK', University of Sussex Institute for Employment Studies working papers, no WP7, February 2007, provided by NARGA in response to a question on notice.

63 Uruguay established a scheme in 1896!

over the past decades. In spite of their recent growth and initial evidence suggesting success of some of these funds, there is a dearth of analysis to systematically inform the process of design of PCG funds, pricing of their guarantees, their regulation, and the implication that PCG fund characteristics have with respect to the prudential regulation of banking portfolios covered by such guarantees.[64]

6.65 Their analysis leads them to conclude:

Our survey shows an important role of government in partial credit guarantee schemes around the world, but mostly limited to funding and management, and much less in credit risk assessment and recovery. This might be for the better, as we also find that where government is involved in credit risk assessment and recovery, default rates are typically higher. Older schemes are also more likely to be government funded and managed and also have higher loan losses, consistent with the notion that the costs and liabilities of a PCG fund become obvious only after some time. We find a surprisingly low incidence of risk-based pricing and limited use of risk management mechanisms.[65]

Reservations

6.66 Treasury do not support such schemes. They note:

The majority of OECD countries have implemented or expanded existing guarantee schemes for small business loans since the onset of the global financial crisis. However, these schemes have generally been unsuccessful in stimulating credit to small businesses. According to the OECD, such guarantee schemes and extensions have not produced the desired results, and ‘the stagnation in lending is true even of banks in countries where…credit guarantee schemes exist.[66]

6.67 Treasury points to the following problems with such schemes:

…guarantees of credit do not stimulate demand in the economy, and therefore do not help small businesses generate profits with which to service additional debt; and guarantee schemes can be subject to adverse selection, where the least viable businesses obtain credit guarantees.[67]

6.68 The Reserve Bank characterised the challenge of such schemes as:

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64 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, provided by NARGA in response to a question on notice, pp 2-3.

65 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, p. 25.

66 Treasury, *Submission 50*, p. 20.

67 Treasury, *Submission 50*, p. 20.

> Are you going to be able to find small businesses that have viable propositions which a regular financial institution is not going to be willing to lend to?[68]

6.69 Some World Bank economists warn that getting the pricing right in the scheme is crucial:

> Funding of the scheme through proper pricing of the guarantees and limiting government funding to set-up costs might be important in giving the lenders the proper incentives to monitor borrowers, avoid excessive risk taking and thus minimize loan losses.[69]

6.70 Some business organisations are also hesitant:

> My instincts in that area are that there is a warning bell that rings government failure when we talk about governments guaranteeing loans.[70]

> …we were concerned about that, it is not an area that we would comfortably see government providing guarantees for small business lending. Our resolution to that would be more that we have to promote greater competition within the Australian marketplace rather than seeing taxpayers being exposed to small business lending in that regard.[71]

6.71 Professor Sathye commented:

> There are several countries where governments do get involved—the US, the UK, Canada, Korea and Singapore, just to name a few—and government guarantees are provided to small businesses. The issue that arises is the running of that guarantee scheme, the costs that are involved and whether that leads to some kind of a moral hazard or problems arising out of it. The answer to that question will again be that we really need consider it, study it and look at the feasibility and operation of it in an Australian setting.[72]

6.72 The NSW Business Chamber said that the fee in Canada for the guarantee is up to 300 basis points and in the United Kingdom ranges from 150 to 200 basis points.[73] It may be that at this price very few borrowers or lenders would want to use such a scheme.

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68 Dr Guy Debelle, Assistant Governor (Financial Markets), Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 26.

69 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, provided by NARGA in response to a question on notice, p. 6.

70 Dr Peter Burn, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 48.

71 Mr Greg Evans, ACCI, *Proof Committee Hansard*, 10 May 2010, p. 11.

72 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 18.

73 Mr Micah Green, NSW Business Chamber, *Committee Hansard*, 12 April 2010, p. 94; NSW Business Chamber, responses to questions of notice.

Committee view

6.73 The Committee notes the suggestion of a guarantee for loans to small business but prefers to increase competition within the commercial banks rather than for a government entity to assume the risk.

Table 6.1: Small Business Guarantee Schemes in Selected Countries

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES

	Criteria	Scope	Cost
United States *Small Business Administration (SBA)- 7(a) Loan Program*[1]	*Prior to the crisis* Prior to the crisis, the program generally guaranteed up to 85 per cent of the loss incurred for loans of up to US$150 000, and up to 75 per cent for loans above this threshold (up to a maximum loan value of US$2 million). The exceptions within this program include SBAExpress loans (processed within 3 days), which provide a maximum guarantee of 50 per cent, and the Export Working Capital Loan Program, which guarantees up to 90 per cent (with a maximum guaranteed amount of US$1 million). Loans may be used for a variety of general business purposes including capital purchase and improvements, working capital and debt refinancing under special conditions. Loan maturity is up to 25 years for fixed assets and 10 years for working capital. The 7(a) program applies to small businesses which meet their particular industry's size standards. Generally, manufacturing and mining firms with fewer than 500 employees and non-manufacturing firms with up to US$7 million annual revenues are eligible.	In December 2009 the outstanding guaranteed principal was about US$49 billion. The SBA estimates that, in 2008, it guaranteed about 7 per cent of the value of small business loans (classified as loans less than US$1 million) through this program.[2]	The SBA receives an up-front fee from borrowers of between 2 per cent and 3.75 per cent of the guaranteed portion of the loan. Lenders also pay an annual subscription fee of 0.55 per cent of the outstanding balance of the guaranteed portion of the loan.
United States *Small Business Administration (SBA)- CDC/504 Loan Program*[3]	*Prior to the crisis* This program has provided a full guarantee of debentures issued by non-profit Certified Development Companies (CDCs) to fund loans to SMEs for the purchase of land or construction. The maximum size of an individual guarantee is between US$1.5 million and US$4 million, depending on the loan use and industry.	In December 2009 the outstanding guaranteed principal was about US$24 billion.[4] It is estimated that, in 2008, the SBA guaranteed about 3 per cent of the value of small business loans through this program.	Fees total about 3 per cent of the guaranteed amount.

[1] Small Business Administration, 7(a) Loan Program: http://www.sba.gov/financialassistance/borrowers/guaranteed/7alp/index.html
[2] Small Business Administration (2009), 'The Small Business Economy': http://www.sba.gov/advo/research/sb_econ2009.pdf
[3] Small Business Administration, CDC/504 Loan Program: http://www.sba.gov/financialassistance/borrowers/guaranteed/CDC504lp/index.html
[4] Small Business Administration: http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_bud_lperf_upbreport.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
United States *Small Business Administration (SBA)*	*Temporary measures for 7(a) and CDC/504 programs* - extended to end-May 2010 unless funds exhausted earlier The maximum guarantee was temporarily raised to 90 per cent for 7(a) loans, except those processed under SBAExpress. SBA's maximum exposure per loan remains at US$1.5 million. The loan criteria and coverage for the CDC/504 program have not been changed.	Since February 2009, the SBA received an additional US$680 million in funding to temporarily provide the higher guarantee levels on 7(a) loans and waive loan fees on 7(a) and CDC/504 programs.[5]	The SBA has temporarily removed the up-front fee for loans with maturity of longer than 12 months. The SBA has temporarily removed some fees on CDC/504 loans.
United Kingdom *Enterprise Finance Guarantee Scheme*[6]	The Enterprise Finance Guarantee (EFG) Scheme was instituted in January 2009, replacing the Small Firms Loan Guarantee (SFLG) Scheme with expanded eligibility.[7] The EFG guarantees a maximum of 75 per cent of the loan amount for loans between £1 000 and £1 million (previously £5 000 to £250 000). Businesses with annual turnover up to £25 million (previously £5.6 million) are eligible. The scheme covers loans repayable between 3 months and 10 years. A relatively wide range of loan uses are guaranteed including investment, working capital and refinancing.	The total value of guarantees between January 2009 and March 2010 was capped at £1.3 billion. The scheme was extended to allow for an additional £500 million of guaranteed loans over the 12 months to March 2011.	Borrowers pay 2 per cent of the outstanding balance of the loan annually.
United Kingdom *Working Capital Scheme*[8]	From March 2009 to 2011, the Government will guarantee up to 50 per cent of credit lines for businesses with annual turnover of up to £500 million.	The maximum amount to be guaranteed between March 2009 and 2011 is £10 billion.	The Government charges a fee based on the both expected and unexpected loss plus an administrative fee.

[5] Small Business Administration (2010), 'SBA Recovery Lending Extended Through May', Media Release 29th March: http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_10-15.pdf

[6] Department of Business, Innovation and Skills, Enterprise Finance Guarantee: http://www.bis.gov.uk/policies/enterprise-and-business-support/access-to-finance/enterprise-finance-guarantee

[7] Department for Business, Enterprise & Regulatory Reform (2008), 'Small Firms Loan Guarantee, Annual Report for Financial Year 2007/08': http://www.bis.gov.uk/files/file47204.pdf

[8] European Commission (2009), 'Working Capital Guarantee Scheme': http://ec.europa.eu/community_law/state_aids/comp-2009/n111-09.pdf; Department for Business, Enterprise and Regulatory Reform (Unknown), 'Working Capital Scheme Factsheet': http://www.cw-chamber.co.uk/UserFiles/File/WorkingCapitalSchemeFactsheet.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
Canada *Small Business Financing Program*[9]	Prior to April 2009, the scheme guaranteed 85 per cent of loans up to CA$250 000. From April onwards, the maximum loan amount has been increased to CA$500 000, of which a maximum of CA$350 000 can be used to purchase or improve equipment and finance leasehold improvements. Loans must be for capital purchases or improvements only, and may not be used to finance things such as working capital or research and development. A maximum of 90 per cent of the project cost may be funded. The maximum loan term is 10 years. Only businesses with annual revenues of CA$5 million or less are eligible. A cap on the Government's obligation applies to each lender. The Government will pay 85 per of the loss on defaulted loans up to the sum of: 90 per cent of the first CA$250 000 in loans registered, 50 per cent of the next CA$250 000, and 12 per cent of all loans in excess of CA$500 000 made from the 1st April 2009 (10 per cent for loans made prior to this date).	The aggregate contingent liability over a five-year window is capped at CA$1.5 billion. For loans made between April 1, 2004, and March 31, 2009, the maximum liability was CA$667.4 million.	Borrowers pay a registration fee of 2 per cent of the amount loaned at origination. An annual administration fee of 1.25 per cent of the amount outstanding is also payable.
Canada *Export Development Canada-Export Guarantee Program*[10]	Provides guarantees on loans to large and small companies for export-related activities and/or foreign investments. From March 2009, the guarantee is available to companies involved in export trade who do not meet the traditional eligibility criteria of CA$5 million in export sales or 15 per cent of total sales derived from exports.[11] The mandate has been temporarily expanded for two years from March 2009 to guarantee domestic activities. The program guarantees 90 per cent of the loan amount for loans up to CA$500 000 and 75 per cent for loans between CA$500 000 and CA$10 million. There is 100 per cent coverage for loans to make direct investments abroad.	Export Development Canada's contingent liability limit across all its programs, including the Export Guarantee Program, was increased from CA$30 billion to CA$45 billion in March 2009.[12]	For loans under CA$500 000 the borrower pays a fee at origination based on their credit worthiness. Loans above CA$500 000 attract an up-front fee of 0.25 per cent of the guaranteed portion of the loan. EDC's guarantee fee is equal to the loan interest spread over the prime rate plus 50 basis points (based on the average quarterly outstanding balance of the loan).[13]

[9] Industry Canada (2009), 'Canada Small Business Financing Act Annual Report 2008-2009': http://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/h_la02973.html
[10] Export Development Canada, Export Guarantee Program: http://www.edc.ca/english/financing_export_guarantee.htm
[11] Export Development Canada, Domestic Powers: http://www.edc.ca/english/domestic_finance.htm
[12] Export Development Act: http://laws.justice.gc.ca/en/E-20/FullText.html
[13] Export Development Canada, Solutions for Bankers: http://www.edc.ca/english/docs/FI_detailed_e.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
Canada *Business Development Bank- Operating Line of Credit Guarantee*[14]	This scheme, introduced in June 2009, fully guarantees increases in existing lines of credit provided by financial institutions to businesses. It applies to expansions in lines of credit of between 25 and 40 per cent when the line of credit is between CA$400 000 and CA$40 million. The line of credit must be secured against short term assets such as accounts receivable and inventory. The guarantee is provided for 12 months and can be renewed annually.	The maximum contingent liability is unclear. It has been allocated CA$100 million of capital.[15] Announced in June 2009, the duration of the program has not been declared.	A fee of 0.25 per cent of the guaranteed amount paid at the time of set-up and renewal.
Japan *Credit Guarantee System* and *Credit Insurance System*[16]	Guarantees 80 per cent of the loan amount under the Credit Guarantee System.[17] Depending on the particular guarantee, the loan value may be up to ¥80 million to ¥400 million. Businesses must be classified as SMEs according to employee numbers and capitalisation to be eligible. The size cut-offs depend on the industry, but at most a firm may have up to ¥300 million capitalisation or less than 300 employees.	At end-March 2009, outstanding guaranteed liabilities amounted to around ¥33 trillion, accounting for approximately 13 per cent of all loans to SMEs according to the Government-owned institutions' own records.[17]	Borrowers pay a fee of between 0.5 per cent and 2.2 per cent of the loan amount depending on credit risk.
Japan *Securitisation Guarantee*[18]	The scheme provides guarantees of up to 70 per cent on unsecured loans to SMEs for the purpose of securitization as well as guarantees for securitized instruments.	Between July 2004 and March 2009, the value of loans under the guarantee scheme was ¥94.3 billion.[19]	N/A

[14] Business Development Bank of Canada, Operating Line of Credit Guarantee: http://www.bdc.ca/en/about/federal_budget/bcap/olcg2.htm
[15] Business Development Bank of Canada (2009), 'Government of Canada Announces $450 Million in New Funding for BDC to Assist Canadian Businesses', Media Release 15th June: http://www.bdc.ca/en/about/mediaroom/news_releases/2009/20090615.htm
[16] Credit Guarantee Corporation (2009), 'Credit Guarantee System in Japan 2009': http://www.zenshinhoren.or.jp/pdf/English_Annual_Report.pdf
[17] Japanese Finance Corporation (2009), 'Credit Insurance Programs': http://www.c.jfc.go.jp/eng/pdf/AR_2009_02_c.pdf
[18] Japanese Finance Corporation (2009), 'Securitization Support Programs': http://www.c.jfc.go.jp/eng/pdf/AR_2009_03_b.pdf
[19] Japanese Finance Corporation (2009), 'Securitization Support Programs': http://www.c.jfc.go.jp/eng/pdf/AR_2009_02_b.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
Singapore *Loan Insurance Scheme (LIS)*[20]	*Prior to the crisis* Scheme to help companies secure trade financing lines by assisting them to insure against insolvency risks by commercial insurers. The Government subsidises a portion of the insurance premium for commercial insurers to cover against default. The insurer covers 75 per cent of the loan amount. There is no specified maximum for loan values, although loan amounts above SGD1 million may be vetoed by the insurer. The maximum repayment term is 1 year. The loan must be secured against working capital. The scheme is open to companies of any size meeting local shareholding or business presence requirements.	Over the year to December 2009, the Singapore Government's Special Risk Sharing Initiative and enhanced financing schemes supported about SGD8 billion in lending. The Government expects their schemes will support up to SGD8.4 billion in new lending to end-January 2011. The amounts attributable to the Loan Insurance Scheme are not available.[21]	Borrower pays 0.45 per cent of the loan value at origination.
Singapore *Loan Insurance Scheme Plus*[20]	*Temporary measures*- Extended to end-January 2011 In February 2009 the Government introduced LIS Plus to aid access to larger tranches of trade financing lines. The Government directly guarantees loans beyond the capacity of current LIS insurers. It applies the same criteria as the LIS (above), but caps the loan size at SGD15 million.		Borrower pays 1 per cent of the loan value at origination.

[20] International Enterprise (IE) Singapore (2010), 'Loan Insurance Scheme': http://www.iesingapore.gov.sg/wps/wcm/connect/de008f80410f477dbe10bf3ad8984e19/Capital_20091231_LISV3.pdf?MOD=AJPERES

[21] Standards, Productivity and Innovation Board (SPRING) Singapore (2009), 'Government Extends Financing Schemes For One More Year At Revised Terms In Tandem With Economic Recovery', Media Release 28th December: http://www.spring.gov.sg/NewsEvents/PR/2009/Pages/MTI-Media-Release-Government-Extends-Financing-Schemes-For-One-More-Year-At-Revised-Terms-20091228.aspx

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
European Investment Fund (EIF) *SME Guarantee Facility*[22]	The EIF provides capped guarantees partially covering portfolios of financing to SMEs. Financial intermediaries interested in applying for a guarantee must be established and operating in one of the EU member states; Norway; Iceland; Liechtenstein; Croatia; FYR Macedonia; Montenegro; Serbia or Turkey. The facility is comprised of four business lines, known as 'windows': *(1) The Loan Guarantee* - The EIF will guarantee up to 50 per cent of a financial institution's commitment on loans made to businesses with fewer than 250 employees and less than EUR50 million annual turnover or EUR43 million in balance sheet value. There does not appear to be a limit on the loan amount. The loan maturity must be at least 12 months. *(2) The Micro-Credit Guarantee* – The EIF will guarantee up to 75 per cent of financial institution's commitment on loans to businesses with fewer than 10 employees and less than EUR2 million in annual turnover or balance sheet value are eligible. Loans up to EUR25 000 with a maturity of at least 6 months are covered. *(3) The Equity Guarantee* - Covers mezzanine financing and equity investments in SMEs in the seed and start-up phases. The maximum equity investment amount covered is EUR500 000. The EIF will guarantee up to 50 per cent of a financial institution's commitment. *(4) Securitisation* - Guarantees are provided to support securitisation of SME financing instruments. Loans must have a maturity of at least 12 months. The EIF will guarantee up to 50 per cent of the first loss tranche, and up to 100 per cent of other guaranteed tranches. The intermediary is required use a portion of the resources made available through securitisation to finance SMEs.	As at December 2008, the net guarantee portfolio under mandate activity amounted to EUR8.5 billion (corresponding to a maximum first loss liability of EUR0.5 billion).[23]	There are no guarantee fees (except for the securitisation window). However EIF may charge the institution a fee calculated on amounts committed but not utilised under the Loan and Micro-Credit windows.

[22] European Investment Fund, CIP SME Guarantee Facility: http://www.eif.europa.eu/guarantees/cip_portfolio_guarantees/index.htm
[23] European Investment Fund (2009), 'EIF Annual Report 2008': http://www.eif.europa.eu/attachments/about/agm_2009/EIF_AnnualReport_2008.pdf

Chapter 7

Improving financial literacy and codes of conduct

Introduction

7.1 Small business will be better placed to benefit from a competitive market, and place pressure on banks to make the market more competitive, if they have a stronger understanding of financial markets.

Financial training

7.2 The Australian Industry Group recommends enhanced financial training for small business.[1] A positive step here is that the Australian Securities and Investments Commission (ASIC) is developing a small business portal on its consumer website Fido, which should be finalised in the first half of 2010. ASIC explains:

> The purpose of the portal is to explain concepts relating to small business credit, to suggest options for a small business in financial difficulty, and to direct small business to other sources of advice and information.[2]

7.3 Treasury refer to Government initiatives in this area:

> The Government is funding a suite of measures to address these information needs. Initiatives include a network of small business advisory services, a small business support line, a one-stop-shop website, and assistance for small businesses to get on-line. The Government provided $10 million in the 2009-10 Budget to establish the Small Business Support Line, which acts as a launching pad for small business owners seeking specialist advice in areas such as obtaining finance, cash flow management, retail leasing, personal stress and hardship, and marketing.[3]

7.4 The New South Wales Business Chamber thought this was an area in which government could do more:

> It certainly puts a lot into financial literacy from the consumer credit point of view. I think some of those arguments probably also apply to small business finance.[4]

> NSW Business Chamber notes that one of the issues facing small businesses in accessing finance may be a lack of understanding about the

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1 Dr Peter Burn, Australian Industry Group, *Committee Hansard*, 12 April 2010, pp 45-47; and AiG's *Submission 14*, p. 10.

2 Australian Securities and Investments Commission, *Submission 17*, p. 5.

3 Treasury, *Submission 50*, p. 16.

4 Mr Paul Orton, Director, Policy and Advocacy, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 99.

range of financial products available. While most small businesses will be broadly aware of debt and equity, and the different roles these can play, financial tools and concepts such as venture capital, factoring, discounting and business angels are generally less well understood. In this regard, we note the success of the Government's Financial Literacy Foundation, and the role that this organisation has played in raising consumer awareness about everyday financial literacy issues. The Government may wish to consider development of similar informational products or web-based tools for small businesses, particularly focused on access to finance. Dissemination of this information could be promoted through existing Government channels and websites, complemented by promotion through industry association member networks.[5]

7.5 Some lenders also raised the issue:

An area that could lead to an improvement in our ability to satisfy demand for small business lending could be through provision of assistance to small business owners in preparation of business plans and financial forecasts. A well prepared and researched application stands a much better chance of favourable consideration than one which lacks suitable preparation. We find that many applicants aren't sufficiently informed about requirements of financiers. We only lend against tangible property or cash security and often get asked for finance of up to $500,000 where the applicant doesn't have any security available. Some sort of education program would be beneficial.[6]

We have also increased the volume of financial education that we deliver to this segment specifically via Westpac Financial Education, particularly focusing on small businesses managing their cash flow in this climate of uncertainty and increasing costs.[7]

[ANZ Bank has] … provided support and tools to small business customers through our free small business workshops series (run Australia-wide) and our online small business hub (www.sbhub.com.au).[8]

ANZ also provides its small business customers with an online small business hub, which is an online business tool to give them access to lots of information. They can do online courses, see webinars and access information on topics such as cash flow planning, and there is also a chat room. One of the things our small business customers like is to talk to other

5 NSW Business Chamber, responses to questions on notice.

6 Unnamed building society or credit union, cited in Abacus, *Submission 42*, p. 3.

7 Ms Sian Lewis, General Manager, Retail Business Banking, Westpac Banking Corporation, *Committee Hansard*, 12 April 2010, p. 70.

8 ANZ Bank, *Submission 40*, p. 3. See also their evidence, *Proof Committee Hansard*, 10 May 2010, p. 28.

small business customers. The online chat room allows them to talk to each other and to seek other views.[9]

7.6 So did some customers:

A free service assisting farmers develop a better understanding of the business lending process and how to enhance the quality of their loan application would overcome some of the obstacles faced by farmers in the capital raising process.[10]

7.7 CPA Australia was another group to recommend:

…the government work with lending institutions to develop information and education products that improve small business knowledge of the wide range of financing options that may be available to them; help small business choose the mode/s of finance that best suit their needs; and assist small business understand what they may need to do to attract finance from a wider range of sources.[11]

7.8 One bank described a mentoring programme:

It is open to existing and referred customers. Customers of ours may refer members of their value chain and colleagues. It is a day-long program where we have experts who come in and provide some speeches. They also have workshop-type setups where they go through some really structured approaches to business planning, looking at financial capacity, options to grow and how to manage risk.[12]

Comparing financial products

7.9 Treasury referred to:

There are websites available that address some of the issues that you have been talking about—comparing different products.[13]

7.10 The Council of Small Business in Australia took up this point:

The only website that I am aware of that in fact compares small business loans was set up by the Victorian government, the Office of Small Business in Victoria. It was so good that it was essentially borrowed and shared more

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9 Mr Nick Reade, General Manager, Small Business Banking, ANZ Bank, *Proof Committee Hansard*, 10 May 2010, p. 28.

10 NSW Farmers' Federation, *Submission 43*, p. 5.

11 CPA Australia, *Submission 46*, p. 2.

12 Dr Anthony Poiner, General Manager, National Segments and Operations, St George Bank, *Committee Hansard*, 12 April 2010, p. 70.

13 Mr Lonsdale, Treasury, *Proof Committee Hansard*, 10 May 2010, p. 6.

broadly by the Commonwealth government, and it is promoted through business.gov.au. [14]

Codes of conduct

7.11 CPA Australia notes that Canadian and Irish banks have specific codes of conduct relating to lending to small business and suggests the Australian banks could adopt a similar practice.[15] Among the provisions of the Canadian and Irish codes commended by CPA Australia are the following:

- banks recognise the need for open communications with their SME customers. This entails banks committing to outline joint responsibilities and ensuring all information provided about a credit facility is clear and comprehensible and that key items are brought to the attention of the borrower.
- for those SMEs applying for credit, the banks should make the following information available:

  directions on how to apply for credit

  an explanation of the requirements needed to obtain bank credit (such as security, interest coverage, loan to valuation ratios and information and documentation requirements). Where possible, this information should be customised where the bank imposes varying requirements on different businesses

  an estimate on how long it will take before a credit decision will be made.
- each application for credit by an SME should be judged on its own merits
- when a credit application is approved, the bank should inform the customer about the terms and conditions of financing, including information on default, fee details, charges and interest rates and further information needed by the bank both before and after the loan is granted.
- if credit is declined, the bank should inform the customer about:

  the main reason(s) for the decision

  the requirements necessary for the bank to reconsider the application (if applicable)

  information on alternative sources of financing

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14 Ms Jaye Radisich, Chief Executive Officer, Council of Small Business of Australia, *Proof Committee Hansard*, 10 May 2010, p. 76.

15 CPA Australia, *Submission 46*, p. 12.

- sometimes customers will experience significant change in their business conditions (which occurred for many businesses during the crisis). In these circumstances, banks should carefully review the existing arrangement before deciding what action (if any) should be taken
- if there are changes made to the terms, conditions, fees or lending margins of an existing SME credit facility (whether a general change or a change specific to a client), such as requiring additional information and requiring such information with increased frequency, banks should inform the customer/s as soon as possible. Banks should provide clients with a minimum of 15 days' notice of such changes (unless there are exceptional circumstances).
- having regard to the nature, liquidity and value of collateral, a bank should not impose unreasonable collateral requirements for providing credit facilities, having regard to the value of credit being offered.
- a bank must not impose unreasonable personal guarantee requirements on borrowers
- a bank must promptly, at the request of the borrower, return any security held by the bank, to the borrower when all facilities for which security is pledged, has been repaid.
- a bank must have in place procedures for handling of arrears cases without prejudicing a bank's regulatory and/or legal obligations and legal rights, a bank must:

  give the borrower reasonable time, having regard to the circumstances of the case, to resolve the arrears case

  endeavour to agree an approach that will assist the borrower to resolve the arrears problem

  advise the borrower of any possible impact of the default on the other accounts held by the borrower.
- a bank should explain to borrowers the basis on which interest is calculated. Where a bank charges an interest margin on a credit facility, it must notify affected borrowers promptly of such changes.
- nothing in a code for SME lending should prohibit a bank from acting with all necessary speed to withdraw credit when there is reasonable suspicion of fraud etc. [16]

Committee view

7.12 The Committee commends the Australian Securities and Investments Commission for developing a small business portal to explain concepts relating to

16 CPA Australia, *Submission 46*, pp 13-14.

small business credit and those banks which have also developed online tools for small businesses.

7.13 The Committee sees merit in a specific code of conduct being developed to cover small business lending.

Recommendation 6

7.14 The Committee recommends that the Australian Bankers' Association meet with small business representatives to develop a code of practice for lending to small business.

Chapter 8

Rural finance

Introduction

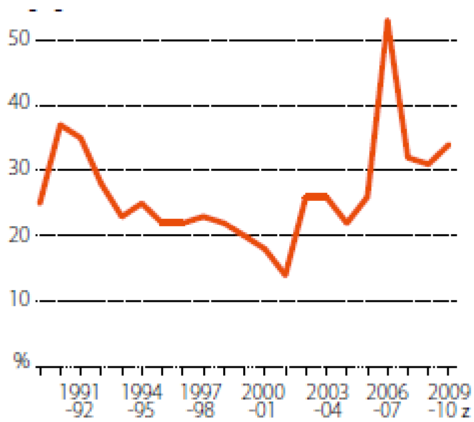
8.1 Farmers are an important category of small business and the discussion in the previous chapters is relevant to them. For example, like other small businesses they emphasised the issue of competition:

> …the need to ensure that there is competition within the marketplace. I think that is one of the key elements here.[1]

8.2 This chapter discusses some issues specific to the rural sector. Its importance is underscored by the fact that interest and fertiliser are the two largest costs for farmers.[2] The average farm has over $400,000 in debt.[3] Farmers surveyed by ABARE in November 2009 expected to increase debt by 4-5 per cent on average in 2009-10.[4]

8.3 The temporary reduction in interest rates to unusually low levels following the global financial crisis has given farmers some breathing space but debt servicing ratios are again rising as interest rates normalise and debt continues to grow (Chart 8.1).

Chart 8.1: Debt servicing ratio, broadacre and dairy farms



Source: P Martin et al, *Australian farm survey results, 2007-08 to 2009-10*, ABARE, April 2010, p. 21.

1 Mr Charles McElhone, Manager, Economics and Trade, National Farmers' Federation, *Proof Committee Hansard*, 10 May 2010, p. 61.

2 P Martin et al, *Australian farm survey results, 2007-08 to 2009-10*, ABARE, April 2010, pp1, 6.

3 P Martin et al, *Australian farm survey results*, p. 7.

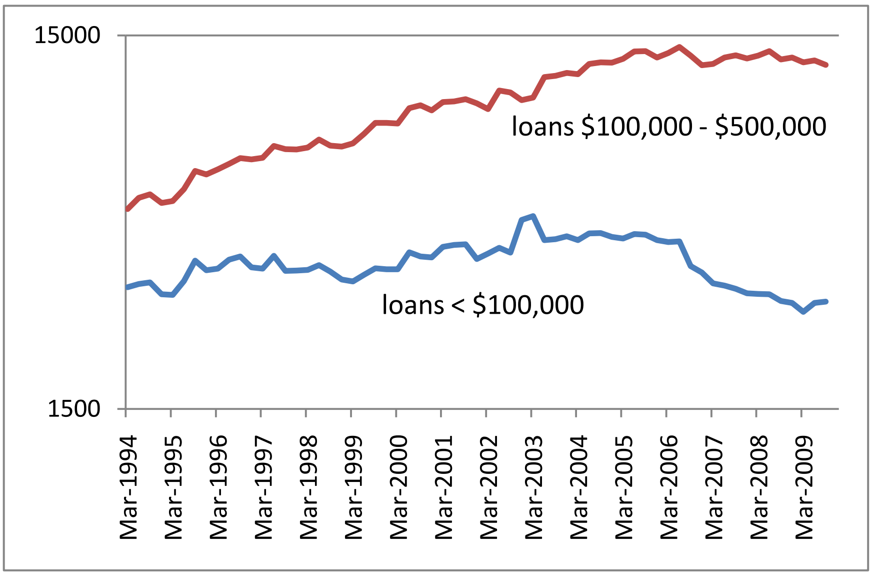
4 P Martin et al, *Australian farm survey results*, p. 20.

Lending to the rural sector

8.4 Banks' outstanding credit to smaller borrowers in the rural sector has declined somewhat in recent years (Chart 8.2). The decline, however, predated the global financial crisis.

Chart 8.2: Banks' credit to the rural sector

$ million, logarithmic scale



Source: Secretariat based on APRA data reported on www.rba.gov.au, Bulletin table D7.

8.5 There has also been some change in the reasons for borrowing:

> Increases in land purchase debt are confined to a relatively small proportion of farms. However, in recent years there has been a substantial increase in debt to fund working capital as many farms have had low cash incomes because of adverse seasonal conditions. In contrast to increases in land purchase debt, increased borrowing for working capital has occurred across a high proportion of farms. In 2006-07, 60 per cent of the total increase in broadacre farm debt was to fund working capital.[5]

8.6 Until recently farmers had found it easy to borrow:

> … since 2003 farm debt has increased by 83 per cent… Obviously credit and money has been relatively easy to obtain over the last four to five years and farmers have invested in that environment quite substantially.[6]

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5 P Martin et al, *Australian farm survey results, 2007-08 to 2009-10*, ABARE, April 2010, p. 20.

6 Mr Mike Norton, President, Western Australian Farmers' Federation, *Proof Committee Hansard*, 10 May 2010, p. 60.

8.7 The problem had more been around ability to repay the debt taken on:

> The big problem for agriculture has been that, whilst we have incurred substantial debt to maintain that productivity growth, the profits to underpin that investment have not necessarily come back to the farm sector.[7]

8.8 More recently the concern has shifted to availability of finance:

> The NFF has received information from members that credit access has tightened.[8]
>
> Until they readjust to the new rules with a shortage of finance—tight money—things are going to be fairly tight in a lot of agricultural enterprises…[9]

8.9 The NFF was at pains not to overstate the problem at the hearing:

> …there are examples of finance being difficult to obtain. I would not suspect that it was a national epidemic. I would suspect that there was still the ability to obtain finance, but there have been some negative impacts from what has happened over the last 12 months….[10]

8.10 Asked about this weakness in rural lending, bankers replied:

> There may be regional variations and that can sometimes be attributed to long-term drought in some areas. It is difficult to get credit and access if farming businesses have been in financial difficulty for some time.[11]

8.11 The Committee heard that wheat farmers in Western Australia are facing particular difficulties in getting finance. The banks attributed this to low wheat prices:

> We have no difference in approach across the country. We have a segment approach—so, we have an approach to the wheat sector and the meat sector. Geography is relevant: there has been less rain in WA than there has been in other parts, but it is certainly no dryer than New South Wales has been. So we do not have any specific policies that make it any different for a Western Australian farmer to borrow than for a New South Wales, Queensland or Victorian farmer…a lot of people believe that the wheat price is headed towards $150 a tonne. It costs them around about $160 to produce that wheat. So they are resorting to on-farm storage, which they have not done for a long time, and the result of that is that customers will be

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7 Mr Mike Norton, President, Western Australian Farmers' Federation, *Proof Committee Hansard*, 10 May 2010, p. 60.

8 National Farmers' Federation, *Submission 49*, p. 4.

9 Mr Norton, Western Australian Farmers' Federation, *Proof Committee Hansard*, 10 May 2010, p. 60.

10 Mr Charles Burke, Vice-President, National Farmers' Federation, *Proof Committee Hansard*, 10 May 2010, p. 71.

11 Mr Steven Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 12 April 2010, p. 4.

> sitting on their stock and not selling, so they will have no cash flow through the business.[12]

8.12 A problem identified by the Committee was that when a farm is struggling due to drought or low commodity prices, the bank views loans to it as having become more risky. It therefore, prudently from its point of view, wants to charge a higher interest rate to compensate for the higher risk of default. The problem, however, is that the higher interest rate may itself make the default more likely.

8.13 Responding to this concern a farmers' representative called for the banks to take a more medium-term perspective:

> …they should probably be looking to reduce the margin for a period of time that allows some breathing space to get the business back to full production at a lot quicker rate.[13]

8.14 Another problem noted by the Committee was that the Reserve Bank effectively has only one policy instrument – its policy interest rate – which it has to set based on the 'average speed' of a 'two-speed' economy, where the mining sector may be overheating while the agricultural sector is struggling:

> There are a lot of people not only in agriculture but also in other small businesses and other industries who are astounded at what is described as the two-speed economy in which there is this exceptional growth currently, which necessitates the interest rates going up on a regular basis, whereas a lot of those people and industries are still endeavouring to recover from the negative impact of the global financial crisis. Again, there is no silver bullet…[14]

8.15 The NFF had some positive views about bank performance:

> By and large, Australian banks have been very supportive of Australian farmers in the last 10 years, in particular through, as most of you would be aware, one of the worst droughts that this country has ever seen. Bank practices are now a lot more balanced and considered. The horror stories of the eighties and early nineties of mass foreclosures are now the exception rather than the norm. So the relationship between the finance sector and agriculture is good one; however, there is always room for improvement.[15]

8.16 Establishing a rural bank attracted only lukewarm interest:

> I would not discount looking at a primary industries bank, but I think we need to explore some other avenues through various legislation, through

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12 Mr Mark Hand, ANZ Bank, *Proof Committee Hansard*, 10 May 2010, p. 32.

13 Mr Burke, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, p. 64.

14 Mr Burke, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, p. 65.

15 Mr Burke, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, p. 59.

> various competition and transparency issues, to see if that rectifies the problem.[16]

Suggested responses

8.17 Around 22 per cent of farms use farm management deposits and the average value is around $28,000.[17] Farmers see them as useful:

> Farm management deposits have been a really successful mechanism for the farming community and we believe they have been a very effective risk management tool to adjust to those big fluctuations in annual income that the farm community experiences. Any way that we can build up the support behind those farm management deposits is very welcome.[18]

8.18 They could, however, be improved:

> Perhaps if they were more applicable to a wide range of businesses, a wider range of businesses would then take them up, particularly in Western Australia with their larger farm sizes. As we go forward, and I suspect it is the same for all Australian farms of larger farm size, the $400,000 figure is not going to be adequate on a multiyear scale.[19]
>
> … one of the bigger limiting factors on the use of FMDs is the fact that they can only be utilised by an individual. Many of Australia's farmers still operate under a family regime. [20]

8.19 A suggestion to ease financial pressures, made by the NSW Farmers' Federation, is the introduction of a "first farm grant", analogous to the first home owner grant, to assist young people to make a career on the land. This could, for example, involve the government paying young farmers a tenth of the cost of buying a farm up to a limit of, say, $100,000.[21] A possible concern is that, as with the home buyers' grants, such a scheme may just push up the price of smaller farms.

Committee view

8.20 The Committee notes that farmers comprise an important class of small business and have had difficulty attracting credit to tide themselves through droughts or periods of low prices.

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16 Mr Burke, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, pp 66-67.

17 P Martin et al, *Australian farm survey results, 2007-08 to 2009-10*, ABARE, April 2010, p. 7.

18 Mr Charles McElhone, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, p. 69.

19 Mr Alan Hill, Western Australian Farmers' Federation, *Proof Committee Hansard*, 10 May 2010, p. 69.

20 Mr Charles McElhone, National Farmers Federation, *Proof Committee Hansard*, 10 May 2010, p. 69.

21 NSW Farmers' Federation, *Submission 43*, p.

Chapter 9

Venture capital

Background

9.1 Venture capital is the very early stage external equity funding that businesses, particularly in innovative industries, may need to start up. The Committee received far more submissions about lending to small business than about the provision of venture capital. A brief discussion of venture capital is included in this final chapter.

9.2 New innovative firms, sometimes called 'gazelles', require some form of equity because until they finish commercialising their product and start making profits they are not in a position to repay debt (and often have little in the way of hard assets to offer as collateral). It is probably only a minority of new firms that are funded by formal venture capital. Most entrepreneurs initially rely on their own savings, or money provided by family and friends (also known as 'love capital'), employees ('servant capital') or individual private investors ('angel capital') or by borrowing from a bank using property as collateral.

9.3 The Reserve Bank note:

> Compared with large companies, small businesses tend to make greater use of debt funding and less use of equity funding; the latter is generally limited to the personal capital of the owners.[1]

9.4 Venture capitalists tend to be more closely involved in the company's operations than a typical shareholder, sometimes acting as a mentor to the company's management or holding a seat on the board. Sometimes the provision of further capital is promised subject to meeting performance benchmarks. Venture capital fund managers typically specialise in certain industries, such as biotechnology or information technology. Some now large and well-known companies, such as Apple, Google, Intel, Microsoft and Starbucks, started life with support from venture capital. Australian companies to have benefited from venture capital include Cochlear (makers of the bionic ear) and ResMed (medical technology).

9.5 As there is inherently more risk in subscribing venture capital than in making a secured loan, the increase in risk and risk aversion that occurs in recessions tends to lead to larger reductions in the provision of capital than in loans.

9.6 The House Economics Committee looked at the medium-term adequacy of venture capital. A review of ABS data suggested to them that:

> …if there is any problem in the venture capital market, it is not a lack of money coming in but either the poor quality of many of the companies

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1 Reserve Bank of Australia, *Submission 2*, p. 1.

seeking funding or excessive conservatism of the venture capital fund managers.[2]

9.7 At least implicitly, Australian governments have apparently regarded the market as under-providing venture capital, as there have been a number of programmes to encourage it. Treasury comment:

> The Government also supports access to financing for innovation by investing in Australia's venture capital market through the Innovation Investment Fund, which was allocated $224.7 million over 5 years in the 2006-07 Budget. In August 2009, a further $64 million was invested through the Innovation Investment Follow on Fund (IIFF) to support venture capital during the downturn. The IIFF is a temporary response to address the lack of capital available during the global financial crisis. The IIFF will enable previously supported companies to continue to develop and to commercialise research.[3]

9.8 The Reserve Bank noted:

> … there is a venture capital market. It is not as large here as it is in other countries.[4]

9.9 As well as capital, many new ventures need loans and some submitters claim this has also become harder to attract:

> …there has been a significant reduction in the availability of start up loans from banks and other financial institutions.[5]

9.10 Industry has noted the problem of securing venture capital for small business:

> …a barrier for the new business starting up with an experimental idea is a financing problem because it is like the chicken and the egg, you have to prove yourself before you can attract finance and you have to have the finance to prove yourself. That is an area where we think ideally the market would provide more funds.[6]

9.11 Asked about the role of government, the Australian Industry Group replied:

> We think that there is a case for government involvement in those areas where information failures occur, if you like, so that the market is not working as efficiently as it might. The feedback we received at the time the Commercial Ready program was axed was that this was having an

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2 House of Representatives Standing Committee on Economics, *Australian manufacturing: today and tomorrow*, August 2007, p. 89.

3 Treasury, *Submission 50*, p. 17.

4 Dr Guy Debelle, Assistant Governor, Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 21.

5 Business Switch, *Submission 9*, p. 1.

6 Dr Peter Burn, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 46.

> influence on the interests of venture capitalists in providing funds to emerging businesses, that that source of liquidity into that area of the market was withdrawn and that the flow-on of that was less venture capital was available to small businesses. That was an area where government intervention was facilitating lending in that area, but that was withdrawn a couple of budgets ago.[7]

Superannuation funds and venture capital

9.12 A potential source of venture capital is superannuation funds, but they appear not to have a large involvement. The House Economics Committee's report commented:

> The reason for the limited involvement of superannuation funds in venture capital is not clear. It may just be that the returns offered by venture capital are inadequate, or it may be that superannuation fund managers are being unduly 'conservative' in their investment practices.[8]

9.13 Their regulator's view is that:

> APRA recognises that investment in venture capital can form a legitimate part of a diversified portfolio. As with all investments, any venture capital investment has to be consistent with the investment objectives and strategy of the fund. The trustee needs to, inter alia:
>
> - make an appropriate assessment of the expected risk and returns of venture capital investment, with specific regard to the risk profile of such investments;
> - undertake due diligence and ongoing monitoring of venture capital investments;
> - consider the liquidity profile of venture capital investments, especially due to the requirement to meet future commitments; and
> - understand there is greater dispersion of returns from venture capital funds; as such, the trustee needs to make a stronger assessment of manager skills.[9]

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7 Dr Peter Burn, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 46.

8 House of Representatives Standing Committee on Economics, *Australian manufacturing: today and tomorrow*, August 2007, p. 95.

9 APRA, answers to questions on notice.

Equity-loan hybrids

9.14 Another possible type of finance is a kind of equity-loan hybrid where repayments on the loan are income-contingent, and so the lender shares more of the risk. The best-known example of such income-contingent loans is the 'HECS' scheme for students. Unlike a normal loan where the lender shares in any bad fortune by not being fully repaid, it would be possible for a lender to also share the benefit of a better than expected performance by being repaid more quickly or even getting a 'bonus' interest rate.

Senator Alan Eggleston
Chair

Government Minority Report

Introduction

Terms of Reference

On 03 February 2010 the Senate referred the following matter to the Senate Economics Committee for inquiry and report.

The purpose of the inquiry was to investigate and report on the current circumstances of issues surrounding access of small businesses to finance, including:

(a) the costs, terms and conditions of finance and changes to lending policies and practices affecting small businesses;
(b) the importance of reasonable access to funding to support small business expansion and the sector's contribution to employment growth and economic recovery;
(c) the state of competition in small business lending and the impact of the Government's banking guarantees;
(d) opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion;
(e) policies, practices and strategies to enhance access to small business finance that exist in other countries; and
(f) any other related matters.

Members of this minority report note that the Government recognises the important contribution small businesses make to national prosperity and supporting jobs. During the onset of the global financial crisis, most small businesses managed to maintain services and production while retaining staff. Evidence suggested that hours of employees were reduced, but there were relatively few retrenchments.

Nevertheless government members had many reports of difficulties for small business in obtaining finance, even for rollovers of existing loans for firms that had a good credit track record.

We note that the government supported small business in a number of ways during the global financial crisis. This took a number of different forms, including reducing financial pressures, providing up to date information and taking measures to improve the availability of finance through financial intermediaries.

The Government's support for small business

1 Availability of finance

The Government senators recognise that the Treasurer's announcement in October 2009 of an extension to the Government's investment in Australian residential mortgage-backed securities (RMBS), further supports banking competition.

The Government directed the Australian Office of Financial Management (AOFM) to provide a further $8 billion of support to new issuances of high-quality RMBS.

In making this announcement, the Treasurer specified the additional objective of supporting small businesses year. This was highlighted in Treasury's submission to this inquiry:

> "The extension to the RMBS program includes an additional objective of supporting lending to small businesses. Consequently, lenders who seek support under the RMBS program are encouraged to outline how active they are in lending to small business and to allocate part of the proceeds raised under the program to lending to small business. This is one of the factors that the AOFM assesses when deciding whether to support an RMBS deal.
>
> To date, AOFM's investment of just under $1 billion of the additional $8 billion has allowed lenders to raise around $4.6 billion in funds. Based on information provided by these lenders to the AOFM, it is expected that over $400 million of these funds will be lent to small businesses."[1]

CEO of smaller lender RESIMAC, Mr Warren McLeland, recently advised the Government that its support for the RMBS market has "been vital to permitting a continual flow of finance to the small business community."[2]

Mr McLeland said that "without such support, there would be literally thousands of Australian small business owners who would have been deprived access to finance." He stated that this included a range of small businesses like those in plumbing, paving, dry cleaning and restaurants.[3]

The company rate will be reduced to 29 per cent in 2013-14 and then cut it further to 28 per cent from the 2014-15 income year.

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[1] Treasury, Submission No. 50, 23 April 2010, pp 15-16

[2] *Treasurer's Economic Note*, 30 May 2010, www.treasurer.gov.au

[3] *Treasurer's Economic Note*, 30 May 2010, www.treasurer.gov.au

2 Small Business Tax Break

The Committee heard that the Government provided direct assistance to small businesses through a special small business tax break. Small businesses were able to claim an additional 50 per cent tax deduction for eligible assets costing $1,000 or more, purchased between 13 December 2008 and the end of 2009, and installed before the end of 2010. The 50 per cent tax break was available to small businesses with an annual turnover of less than $2 million.

This is supported by the Treasury's evidence given in their submission to the inquiry: "The Commonwealth Coordinator General’s report on the progress of the Economic Stimulus Plan to 31 December 2009 stated that ‘$2.4 billion in deductions have been claimed to date under the Small Business and General Business Tax Break.’"[4]

The tax break provided small businesses with an ability to invest in new capital items, such as computer hardware and business vehicles, and to undertake capital improvements to existing machinery and equipment.

3 Tax adjustment to provide cash flow relief during 2009-10

Maintaining cash flow is vital to the viability of small businesses. To help boost cash flow, the Government reduced quarterly pay-as-you-go (PAYG) instalments for small businesses during 2009-10.

This $720 million in cash flow relief for 2009-10 came on top of the boost provided by the Government's discounted December 2008 quarter PAYG instalment, giving a further benefit for small businesses in difficult economic times.

4 Economic Stimulus Plan

Although an economy wide measure, small businesses benefited significantly from the Government's $42 billion Nation Building – Economic Stimulus Plan introduced to support jobs, build infrastructure and invest in long-term economic growth. Around 70 per cent of the stimulus plan is investment in nation-building infrastructure. Tradesmen, other independent contractors and small business suppliers benefited from this investment in local infrastructure.

5 Assistance from the Tax Office

As part of the May Budget, the Government provided $100 million over four years to the Australian Tax Office to assist small businesses and other taxpayers experiencing financial distress to remain viable and in the tax system. To assist small businesses that are having difficulty meeting their tax obligations, the Tax Office’s Small Business Assistance Program works with individual small businesses to help them meet their obligations

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[4] Treasury, Submission No. 50, 23 April 2010, p. 17

In addition, small businesses with short-term cash flow problems were permitted to have the due date of their quarterly or annual tax activity statement payments (e.g. PAYG and GST instalments) extended for up to two months.

6 Small business advice and support

The Government invested $42 million to enhance small business advisory services. The service was provided through the existing Business Enterprise Centres on matters such as developing business plans, preparing applications for finance and cash flow.

The Small Business Support Line, launched by the Government on 3 September 2009, provides initial advice to small business owners and puts them in touch with specialist advisers on matters such as obtaining finance, cash flow management, retail leasing, diagnostic services, promotion and marketing advice, and personal stress/hardship counselling. Support Line advisers link into the nationwide network of Business Enterprise Centres and other small business advisory services around Australia.

The existing Small Business Credit Complaints clearing house has been integrated as part of the service. Issues are referred to the Australian Bankers Association for a response.

Reserve Bank of Australia

We note the Reserve Bank of Australia's submission to the Committee:

> "Lending to small businesses has been little changed over 2009, after growing steadily over prior years. The slowdown reflects both reduced demand from small businesses and a general tightening in banks' lending standards. Small businesses in most industries have been able to access funding throughout the financial crisis, **albeit on less favourable terms than previously.**
>
> Since late 2008, the interest rates on small business lending have been below their averages over the past decade, as the large net reduction in the cash rate has more than offset the increases in banks' lending spreads. Fees have risen, but for most businesses they are only a small part of the overall cost of a loan.
>
> Competition in the small business lending market has eased from the strong levels just prior to the onset of the financial crisis, **but should recover as the economy continues to strengthen.**"[5]

According to the RBA, "Small business borrowers have faced lower loan-to-valuation ratios, stricter collateral requirements and higher interest coverage ratios."[6]

This is consistent with Australia and the world experiencing the worst global financial crisis in 50 years.

[5] Reserve Bank of Australia, *Submission 2*, p. 1.

[6] Reserve Bank of Australia, *Submission 2*, p. 3.

International Regulation

In asking questions of the **National Australia Bank (NAB)**, Senator Pratt raised the issue of the significance of international Basel II Capital adequacy rules. She expressed her concern that these rules encourage banks to favour residential mortgage lending over business lending. She sought information as to how significant those rules are in the situation that small businesses currently face.[7]

Mr Joseph Healy, Group Executive, Business Banking, NAB, responded: "As I mentioned, Basel II makes it more attractive for banks to lend for household mortgages than to business. If you look at the amount of lending into the household sector over the last twelve months, as opposed to the business sector, that will give you an answer to that question. I do not believe it is necessarily a question of one or the other..."[8]

Reduced Competition

Senator Pratt expressed her concern in relation to the major banks understanding the nature of farming businesses with the **National Farmers' Federation**:

> "Clearly the more the banking sector understands the nature of farming businesses, the better it can be at lending. It does appear here that we are risk of losing a specialist service, resulting in further consolidation to the four big banks from the loss of expertise, and emphasis on it at the ANZ."[9]

In his opening statement, Mr Peter Anderson, Chief Executive, **Australian Chamber of Commerce and Industry**, in his opening statement before the committee commented: "It is also worth noting that just a couple of weeks ago, on 8 April, the Australian Bankers Association, in responding to a report by the Australia Institute, said in a public statement that close to 60% of banking fees are not paid by households but by businesses – in other words, we have seen, and our submission points to, the fattening of margins by retail banks at the expense of small business lending. It is not just margins in terms of repricing credit; it is margins in terms of a range of other fees and costs imposed on customers."[10]

This view was partly shared by Mr Steven Munchenberg, Chief Executive Officer, **Australian Bankers Association**:

> "...However, we are aware that there has been a number of concerns expressed for some time now about both access to finance from the banks but also the price that small businesses are paying for that finance. In the

[7] Public Hearing, Canberra, 10 May 2010, p. E27

[8] Mr Joseph Healy, NAB, Public Hearing, Canberra, 10 May 2010, p. E27

[9] Senator Louise Pratt, Public Hearing, Canberra, 10 May 2010, p. E70

[10] Mr Peter Anderson, Chief Executive, Australian Chamber of Commerce Industry, Public Hearing, Canberra, 10 May 2010, p.E9

> large part we think these concerns are based in changes that banks have reasonably and prudently made in their approach to lending through the course of the global financial crisis,.....Nonetheless, the banks have stood by their small business customers and, indeed, have picked up a lot of customers from lenders who are no longer operating because of changes in credit markets."[11]

Senator Hurley, in raising the issue of competition between banks to Mr Jim Murphy, Executive Director, Markets Group, **Treasury**. "..in terms of competition between banks, is it the smaller banks or the smaller institutions that loan more readily to small business or take the risks?"[12]

Mr Murphy in response stated:

> "There are two aspects of that. One, the large majority of funding for small business will come from the major banks. The second point is that, yes, the fringe players – or non-banks or finance companies – have traditionally lent to the riskier end of small business or the riskier end of business. So to some extent both factors have worked against small business in a downturn; whereas both factors will come back into play to assist small business because all financial institutions are there to make a profit. So, as the economy picks up, they will probably start lending more to small business – this is the majors – and as well as that, drop the price of it, one would hope. Also as the economy picks up, the smaller players will come more into operation and become more available for lending to small business."[13]

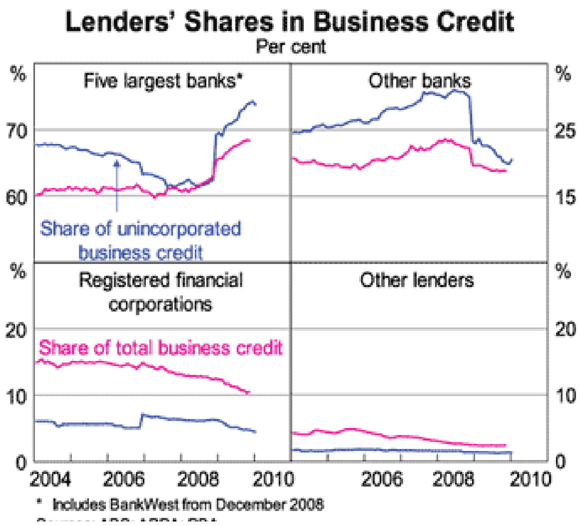
"As the economy strengthens, competition for business lending is likely to pick up; there are already some signs of this in the Reserve Bank's liaison with medium and large sized businesses." (See graph below) [14]

[11] Mr Steven Muchenberg, CEO, Australian Bankers Association, Public Hearing, Sydney, 20 April 2010, p.E1

[12] Senator Annette Hurley, Public Hearing, Canberra, 10 May 2010, p. E4

[13] Mr Jim Murphy, Executive Director, Markets Group Treasury, Public Hearing, Canberra, 10 May 2010, p. E4

[14] Reserve Bank of Australia, *Submission 2*, pp. 5-6



Mr Graham Johnson, General Manager, Industry Technical Services, Supervisory Support Division of the **Australian Prudential Regulation Authority** responded to whether or not small business is being treated differently:

> "I think there are two dimensions to that. One is the demand for credit, particularly after the GFC. Having gone through a period of economic stress like we had, from the evidence available to us, businesses as a whole had less demand for credit. The large end of town, for example, was raising equity and deleveraging, and the smaller end had a fall-off in their approaches to the banks and other lenders for loans.
>
> On the supply side, after something like the global financial crisis, the increase in arrears rates and non-performing loans, the authorised deposit-taking institutions and other lenders actually tightened up their lending terms, as would be expected after something like the global financial crisis. The ADIs did things like reducing the maximum loan they would give to particular classes of borrower, they lowered maximum loan to valuation ratios, had higher interest coverage ratios—those sorts of things—to tighten up their terms, with more stringent covenants, and hence there was a drop-off in the available supply. From that point of view, there were two elements—a demand impact and a supply impact. I do not really know which one dominated."[15]

In response to further questioning regarding the ease of obtaining credit prior to the GFC, Mr Johnson responded:

> "I think that is a fair characterisation. Prior to the GFC the spreads on lending were probably the lowest they had been for the statistics that had been collected. There had been 15 years of economic good times, and non-

[15] Mr Graham Johnson, APRA, Public Hearing, Sydney , 12 April 2010, p E57

> performing loans were at historical lows. I think there was a movement towards lending perhaps without the risk based pricing that should have really been there just prior to the GFC hitting, and then there was the correction after that. Our view is that probably we will not go back to the low spreads that we saw just prior to the global financial crisis."[16]

In response to a question from Senator Pratt concerning the permanent tightening on lending based on authentic risk assessment, Mr Johnson commented that:

> "...lending conditions go through a cycle. They tighten when things get like they have been. As things improve and the outlook gets better, the loan to valuation ratios, maximum loan terms and those sorts of things will probably move back to closer to what they were."[17]

Recommendation from Majority Report

6.3 The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provision and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined to that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, on third (set based on international practice) could be presumed to confer market power unless there is strong evidence to the contrary.

Discussion

This recommendation combines a number of issues that are dealt with separately under the TPA; firstly whether a firm has market power which it misuses, secondly whether a firm misuses this market power to price discriminate in an anti-competitive way, and thirdly what role the TPA should play in limiting takeovers which will result in market power.

While related, these concepts may be better addressed as discrete but interconnected topics.

Abuse of market power

- Section 46 in its current form captures those circumstances which the Committee's draft recommendation appears to be targeted towards.

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[16] Mr Graham Johnson, APRA, Public Hearing, Sydney , 12 April 2010, p E58

[17] Mr Graham Johnson, APRA, Public Hearing, Sydney , 12 April 2010, p E61

  - Through amendments made to the TPA in 2007, section 46 currently states that a firm can have a substantial degree of market power even where it does not substantially control the market, and does not have absolute freedom from constraint by the conduct of competitors, and that more than one corporation may have a substantial degree of power in a market.

- It is unclear whether the Committee is recommending the introduction of a trigger point, such as a predetermined market share, to act as a threshold for investigation, or whether the Committee seeks to go further than a trigger by recommending that a market share be determinative of breaches of various provisions of the TPA.
- The ACCC already considers market share when determining whether a corporation has a substantial degree of power in a market. It is not clear on what basis the inclusion of a requirement to do so would alter the assessment of possible breaches of section 46.
- There is a risk that the introduction of explicit consideration of market share may reduce consideration given to other equally or more important factors, and that it may reduce the consideration given to those firms whose market share is below the threshold, despite the possibility that even low market share firms may have market power.
  - Market share as an indicator of market power will vary in each market, for example it is possible a firm may have market power while having a share of the market in the range of 15 per cent, and similarly, a firm may have no market power despite having a share of the market greater than 50 per cent.
- It is also important to note that in addition to market share not necessarily indicating market power, the existence of market power is not an abuse by itself. The firm must take advantage of that power for a prohibited anti-competitive purpose for a breach to occur.

Price discrimination

- In 1993, the Hilmer Committee recommended that section 49 (prohibiting price discrimination) of the TPA be repealed. This recommendation was accepted and section 49 was repealed in 1995.
- The concern was that section 49 generally discouraged competitive prices and so worked against economically efficient outcomes.
  - The Hilmer Committee concluded that price discrimination generally enhances economic efficiency, except in cases which might be dealt with by section 45 (anti-competitive agreements) or section 46 (misuse of market power).

- The Hilmer Committee's recommendation echoed the concerns of previous inquiries, including the Swanson Review in 1976 and the Blunt Review in 1979.
  - The Blunt Committee’s terms of reference required it to explore avenues for improvement of the market position of small businesses. Notwithstanding this, it recommending a repeal of section 49.
- The Dawson Review (2003) supported the findings of the Hilmer Committee and concluded that no changes should be made to the TPA in relation to price discrimination.
  - It noted that the US law governing price discrimination has been widely criticised for being too complex, deterring price competition and promoting price uniformity. While originally directed at large retailers, in practice it has been applied mainly against small businesses who grant discounts in order to compete against large sellers or those engaging in vigorous competition.
  - The Federal Trade Commission now only takes action against price discrimination under the broader competition law.

Mergers

- The existing test already prevents the achievement of market power through merger and acquisition takeovers as proposed in the draft recommendation.
- Section 50 of the TPA prohibits mergers or acquisitions that would have the effect, or likely effect, of substantially lessening competition (SLC) in an Australian market. The ACCC assesses each merger on its merits according to the specific nature of the transaction, the industry and the particular competitive impact likely to result in each case.
- The ACCC and other competition agencies consider market share as just one part of their competition analysis in assessing the likely competition effects of a proposed merger, while also taking into account numerous other considerations such as the closeness of competition between the merger parties, competition from imports, substitutes, the threat of competitive entry, the presence of maverick firms, dynamic characteristics of the market, countervailing power of customers, and vertical integration of the merged firm. Focussing on market share to the exclusion of these other important factors may obscure the true competition effects of a merger.
- Australia’s SLC test for mergers is consistent with merger laws in many other OECD countries including the US, Canada, UK and New Zealand.

Minority Senators' Recommendations

Recommendation 1

The government should continue to explore initiatives to support small business by innovative measures that will assist their general financial viability and facilitate their access to finance.

Recommendation 2

The government should continue to monitor banks' behaviour towards small businesses through its regulatory bodies. The government should also set up its programs targeted to small business to allow for timely feedback on financing and related issues, and ensure that the Minister for Small Business has immediate access to this information.

Recommendation 3

The Government should consider an ongoing assessment of Basel II capital adequacy rules, to ensure that capital requirements are commensurate with real risk.

Senator Annette Hurley
Deputy Chair

Senator Louise Pratt

Senator Doug Cameron

Additional Comments by Senator Xenophon

Introduction

1.1 In addition to the Committee's Report, which includes six recommendations to better support small business' access to finance, it is important to note the need for increased support for small rural businesses, in particular farmers, in terms of access to finance, whether through improved support from existing financial institutions or through the establishment of a Development Bank, as was canvassed during the Committee Inquiry process.

Rural business

1.2 There are approximately 140,000 farm businesses in Australia, 99 percent of which are family owned and operated.[1] The majority of these rural businesses rely on bank finance to be able to invest in infrastructure and equipment to advance their business output. The average farm has over $400,000 in debt, with two largest costs for farmers being interest and fertiliser.[2]

1.3 Indeed, in its submission to the Committee, the National Farmers Federation said that:

> "Rural debt has escalated by over 85% since 2002-2003, due to drought conditions, placing the agriculture sector at considerable exposure to increasing credit cost."[3]

1.4 Outstanding credit to borrowers in the rural sector has been on the decline since 2006 for loans less than $100 million, and since 2008 for loans between $100 million and $500 million.

1.5 While the decline of loans less than $100 million preceded the global financial crisis, there have been reports that this decline was only exacerbated by the tightening of credit markets during the global financial crisis. The timing also seems to suggest that the approval of larger sized loans were directly impacted by the global financial crisis.

1.6 According to the National Farmers Federation,

> "The NFF has received information from members that credit access has tightened. There have been cases where the global financial crisis has had a noticeable impact on banks treatment of loan security requirements, with a

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1 National Farmers Federation, *Submission 49*, Pg 4

2 ABARE, *Australian farm survey results 2007-08 to 2009-10,* April 2010, Pg 1 and Pg 6

3 National Farmers Federation, *Submission 49*, Pg 4

clear increased sensitivity by the banks to their financial exposure. Some loans that would be offered prior to the GFC are no longer readily available."[4]

1.7 Interestingly, during the Inquiry, the Committee identified that when a farm was struggling financially as a result of drought conditions or low commodity prices, the bank would move to charge a higher interest risk to compensate for the higher risk of default. However, this in itself would result in greater likelihood of default occurring because of the added financial pressure it placed on farmers.

1.8 Further, the inquiry also heard that, as a result of non-bank lenders being unable to receive the Government bank funding guarantees offered in 2009/2010 to support financial institutions during the global financial crisis, non-bank lenders were unable to extend finances to businesses including farmers where they might otherwise have been able to or where AAA financial institutions may have been able to.

1.9 The Government's bank funding guarantee was withdrawn on 31 March 2010. However, specific support for small business moving forward was raised by the NSW Business Chamber during the inquiry.

> **Mr Cartwright—**… we do believe that there is scope for the Australian government to take on a role as guarantor of the small business finance market as a temporary means by which we can free up access to small business finance. This is not a revolutionary concept. Such government guarantee schemes already operate in Canada, the UK and the US. Under our proposal such a scheme would be self-funding, ensuring absolutely no cost to taxpayers. The guarantee would be priced. It would share the risk between government and the banks and it would ensure that Australian banks could once again feel relatively confident about lending to the small business sector.[5]

1.10 Such schemes currently exist internationally.

United States:

The Small Business Administration, established in 1953, administers a programme which helps small businesses apply for loans up to US$5 million from banks and acts as a guarantor.

Canada:

Under the Canada Small Business Financing Program, the government guarantees 85 percent of loans up to C$500,000.

Singapore:

4 National Farmers Federation, *Submission 49*, Pg 4

5 Senate Economics Committee, *Proof Committee Hansard*, Pg 89, 12 April 2010

The Standards, Productivity and Innovation Board provides loan guarantees for small business.[6]

1.11 While these schemes are not specific to rural small business, a similar program introduced into Australia could go some way to assisting the sector and provide greater support for financial institutions who provide small business finance or, specifically, finance to rural businesses.

1.12 The inquiry also heard that the establishment of a 'Development Bank' could be useful to provide better, easier and increased access to finance for small business, such as is the case in Japan and Korea:

Japan:

The Japan Finance Corporation has a unit that lends up to ¥20 million for up to 20 years at fixed rates to small business, including start-ups.

Korea:
The Industrial Bank of Korea is required to make at least 70 percent of its loans to small business.[7]

1.13 Such a bank would ensure a focus on small business financing, both for start-ups, innovative companies and rural businesses.

Conclusion

1.14 Farmers are in a unique position, affected by seasonal conditions, low commodity price outlooks, stricter financial policies, and rising interest rates, which have all heavily impacted their reliance and accessibility to finance in the last decade.

1.15 Small business represents around 2 million actively trading businesses in Australia and employs more than 40 percent of total employed persons around the country.[8] Agriculture, specifically, contributes approximately 3 percent towards Australia's Gross Domestic Product.[9]

1.16 It is vital, therefore, that this sector is appropriately supported and assisted to enable growth and to invest to allow it to remain competitive, both on a domestic and international level.

6 Australian Chamber of Commerce and Industry

7 Australian Chamber of Commerce and Industry

8 Australian Bureau of Statistics

9 National Farmers Federation, *Submission 49*, Pg 4

Recommendation 1

That the Government establish a small business guarantee scheme in Australia, similar to those already in place in the United States, Canada and Singapore.

Recommendation 2

That the Government re-establish a 'Development Bank' in Australia, similar to those in place in Japan and Korea, and along the lines of that which existed previously – the Commonwealth Development Bank which was established in 1960 and wound down from 1996.

Nick Xenophon
Independent Senator for South Australia

Appendix 1

Submissions Received

Submission Number	Submitter
1	Confidential
2	Reserve Bank of Australia
3	Mr Suryan Chandrasegaran
4	Mr Jim McCormack
5	A, R and D Melbin
6	Professor Milind Sathye
7	Housing Industry Association Ltd
8	Mr Peter White
9	Business Switch
10	Mr Ross Wood
11	Dr Kevin Cox
12	Confidential
13	Philip and Gail Osmak • Supplementary Submission
14	Australian Industry Group
15	Attache Software
16	Mr Peter Phillips
17	Australian Securities and Investments Commission (ASIC)
18	WA Small Enterprise Network
19	The Pharmacy Guild of Australia
20	Motor Trades Association of Queensland
21	Confidential
22	Commercial Asset Finance Brokers Association of Australia Ltd (CAFBA)
23	Australian Bankers' Association Inc
24	Confidential
25	Sensis Pty Ltd
26	The Western Australian Farmers Federation (Inc) (WAFarmers)
27	Council of Small Business Organisations of Australia (COSBOA)
28	Mortgage and Finance Association of Australia (MFAA)

29 National Association of Retail Grocers of Australia (NARGA)

- Supplementary Submission

30 Queensland Tourism Industry Council

31 Westpac

32 Australian Chamber of Commerce and Industry

33 NSW Business Chamber

34 Shire of Yilgarn

35 Commonwealth Bank of Australia

36 Victorian Employers' Chamber of Commerce and Industry

37 Real Estate Institute of Australia

38 Light of Day Inc

39 Confidential

40 ANZ

41 Chamber of Commerce and Industry Queensland

42 Abacus - Australian Mutuals

43 NSW Farmers' Association

44 National Australia Bank

45 Australian Retailers Association

46 CPA Australia

47 The Australia Institute

48 Dr Pi-Shen Seet and Dr Chris Graves, Business School, The University of Adelaide

49 National Farmers' Federation

50 Treasury

51 National Civic Council

52 Mr Patrick Ariens

Additional Information Received

- Received from the Australian Industry Group; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from the Commonwealth Bank of Australia; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from the APRA; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from the Reserve Bank of Australia; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from the Reserve Bank of Australia; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from the New South Wales Business Chamber; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from the New South Wales Business Chamber; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010, 'NSW Business Chamber and Commonwealth Bank Business Conditions Survey'.
- Received from the Australian Bankers' Association; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from NARGA; answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010.
- Received from the NARGA; attachment 1 to answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010: 'The Typology of Partial Credit Guarantee Funds around the World'.
- Received from the NARGA; attachment 2 to answers to Questions on Notice taken at a public hearing in Sydney on 12 April 2010: 'The Role of Loan Guarantee Schemes in Alleviating Credit Rationing in the UK'.
- Received from the Queensland Tourism Industry Council; answers to Questions on Notice taken at a public hearing in Sydney on 10 May 2010.
- Received from Professor Milind Sathye; document provided in response to a Question on Notice taken at a public hearing in Sydney on 10 May 2010.

Appendix 2

Public Hearings and Witnesses

SYDNEY, MONDAY 12 APRIL 2010

BAYER-ROSMARIN, Ms Kelly, Executive General Manager, Business Products, Commonwealth Bank of Australia

BREWIS-WESTON, Mr Symon, Executive General Manager, Local Business, Commonwealth Bank of Australia

BROADBENT, Mr John, Head, Domestic Markets Department, Reserve Bank of Australia

BURKE, Mr Tony, Director, Taxation and Security Issues, Australian Bankers Association

BURN, Dr Peter, Director Public Policy, Australian Industry Group

CARTWRIGHT, Mr Stephen, Chief Executive Officer, New South Wales Business Chamber

CHAPMAN, Mr Keith, Executive General Manager, Supervisory Support Division, Australian Prudential Regulation Authority

CHINDAMO, Mr Philip, Chief Economist, Australian Industry Group

CUMMINGS, Mr John Watson, Chairman, National Association of Retail Grocers of Australia

DEBELLE, Dr Guy Lawrence Geoffrey, Assistant Governor Financial Markets, Reserve Bank of Australia

GREEN, Mr Micah, Policy Adviser Tax and Competitiveness, New South Wales Business Chamber

HENRICK, Mr Kenneth Michael, Chief Executive Officer, National Association of Retail Grocers of Australia

JOHNSON, Mr Graham, General Manager Industry Technical Services, Supervisory Support Division, Australian Prudential Regulation Authority

LEWIS, Ms Sian, General Manager Retail Business Banking, Westpac Banking Corporation

McLENAGHAN, Mr John, Head of Government and Industry Affairs,
Commonwealth Bank of Australia

MUNCHENBERG, Mr Steven, Chief Executive Officer,
Australian Bankers Association

NAREV, Mr Ian, Group Executive, Business and Private Banking,
Commonwealth Bank of Australia

ORTON, Mr Paul, Director Policy and Advocacy,
New South Wales Business Chamber

POINER, Dr Anthony, General Manager National Segments and Operations,
St George Bank

TATE, Mr James, Chief Product Officer,
Westpac Banking Corporation

VAN RIJSWIJK, Mr Gerard, Senior Policy Advisor,
National Association of Retail Grocers of Australia

CANBERRA, MONDAY 10 MAY 2010

ANDERSON, Mr Peter, Chief Executive,
Australian Chamber of Commerce and Industry

BULTITUDE, Ms Susan, Manager, Funding Markets Unit, Financial System Division, Treasury

BURKE, Mr Charles, Vice-President,
National Farmers' Federation

DEGOTARDI, Mr Mark, Head of Public Affairs,
Abacus—Australian Mutuals

EVANS, Mr Greg, Director of Economics and Industry Policy,
Australian Chamber of Commerce and Industry

GOO, Dr Siwei, Adviser, Economics and Industry Policy,
Australian Chamber of Commerce and Industry

HAND, Mr Mark, General Manager, Regional Commercial Banking,
ANZ Bank

HEALY, Mr Joseph, Group Executive, Business Banking,
National Australia Bank

HILL, Mr Alan, Director, Policy,
Western Australian Farmers' Federation

KREITALS, Mr Jock, Manager, Policy,
Real Estate Institute of Australia

LIDDELL, Mr David John, Senior Policy Officer,
Queensland Tourism Industry Council

LONSDALE, Mr John Peter, General Manager, Financial System Division,
Treasury

McELHONE, Mr Charles, Manager, Economics and Trade,
National Farmers' Federation

McGREGOR, Mr Scott, National Councillor,
Pharmacy Guild of Australia

McINERNEY, Mr Dallas James, Group Manager, Government Affairs and Public Policy, National Australia Bank

MURPHY, Mr Jim, Executive Director, Markets Group,
Treasury

NASH, Ms Jane, Head of Government and Regulatory Affairs,
ANZ Bank

NORTON, Mr Mike, President,
Western Australian Farmers' Federation

PAYNE, Mr Richard John, Principal Policy Director,
Motor Trades Association of Queensland

PETSCHLER, Ms Louise, Chief Executive Officer,
Abacus—Australian Mutuals

RADISICH, Ms Jaye Amber, Chief Executive Officer,
Council of Small Business of Australia

READE, Mr Nick, General Manager, Small Business Banking,
ANZ Bank

ROWBOTHAM, Ms Jaclyn, Principal Adviser, Financial System Division,
Treasury

SATHYE, Professor Milind,
Private capacity

SIRIANNI, Mr Frank, Consultant,
Pharmacy Guild of Australia

WOLFE, Mr Graham, Chief Executive, Association,
Housing Industry Association

WYHOON, Mr Chris, Executive Officer, Farm Business,
Western Australian Farmers' Federation

Glossary

ABARE	Australian Bureau of Agricultural and Resource Economics.
ABS	Australian Bureau of Statistics
ACCI	Australian Chamber of Commerce and Industry
ADIs	Authorised deposit-taking institutions; banks and bank-like intermediaries supervised by APRA.
APRA	Australian Prudential Regulation Authority, the supervisor of financial intermediaries and superannuation funds.
ASIC	Australian Securities and Investments Commission; Australia’s corporate, markets and financial services regulator.
Basel capital requirements	Internationally agreed common standards relating the capital banks are required to hold to the riskiness of their assets.
Fido	The consumer website of ASIC.
FMD	Farm management deposit.
GFC	Global financial crisis; the period from late 2008 when a number of globally significant financial institutions failed or came under stress, triggering a marked slowdown in the global economy.
NFF	National Farmers' Federation.
OECD	Organisation for Economic Co-operation and Development; international government-funded economic research body specialising in comparative studies.
SMEs	Small and medium-sized enterprises.