

# Inquiry into Access of Small Business to Finance

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ANZ Submission to the  
Senate Economics References Committee



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# EXECUTIVE SUMMARY

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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. Approval rates initially fell but then stabilised at around 80% through 2009.

The overall picture masks good growth in lending at the smaller end of the market. ANZ regards businesses with total lending of less than \$500,000 as small business. Lending to this segment grew in excess of 10% over the last 12 months in a difficult economic environment. Looking ahead we are expecting overall business lending to return to growth this financial year (12 months to September 2010) and a continued healthy market for small business lending.

The global economic crisis has been difficult for most businesses, not least small business. ANZ recognises this and the important contribution small business makes to the economy, including as a major employer. We are committed to supporting customers who are running viable small businesses to manage through difficult economic times. To assist our small business customers and indicate our continued support for this sector, we have:

- committed to make \$8 billion in new lending to small and medium enterprises available in the 2008-09 financial year (for ANZ this ends on 30 September 2009). This amount was equivalent to ANZ's total lending to small and medium enterprises in 2008;
- employed up to 100 additional small business specialists in branches and business centres across Australia;
- extended support to small business in difficulty by providing easy access to our dedicated specialists, who are trained to help small business customers experiencing financial difficulty, through our toll free hotline and repayment deferrals and fee waivers; and
- 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](http://www.sbhub.com.au)).

ANZ regularly reviews its lending criteria in response to shifts in the broader economic environment. In response to the global economic crisis and uncertain economic outlook, we tightened lending criteria for higher risk segments that showed signs of deterioration with higher than expected credit losses, and we continued to price for the risk associated with lending to small business and increased cost of funds.

## EXECUTIVE SUMMARY

This submission contains further detail on the matters mentioned above. ANZ would be pleased to provide any further information about this submission as required, and can be contacted as follows:

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# ANZ'S COMMERCIAL BANKING BUSINESS

## ANZ'S COMMERCIAL BANKING BUSINESS

ANZ provides products and services to small businesses through its Commercial Banking Division. Commercial Banking delivers products and services to small and medium-sized enterprises through dedicated managers focussing on Business Banking, Small Business and Regional Commercial and Agribusiness segments. ANZ provides a range of credit products to business customers including overdrafts, lines of credit, car and equipment loans and credit cards. ANZ also offers small business customers a range of other banking products including transaction accounts and merchant services (i.e. EFTPOS terminals).

Small Business Banking serves customers with lending of up to \$500,000. ANZ considers these businesses to be 'small business' and they typically have 20 or fewer employees. We have approximately 113,000 lending customers in this segment of our business. These customers have access to small business specialists through our extensive branch network, business centres, via our Small Business Call Centre and over the internet.

Larger businesses are managed through Business Banking. These businesses have lending of more than \$500,000 and up to \$10 million. These customers typically have a dedicated relationship manager who is responsible for tailoring their banking arrangements to their needs and managing those arrangements as needed.

Regional Commercial Banking is dedicated to supporting commercial and agricultural businesses across regional and rural Australia, including regional Small Business customers. This segment offers many of the same products as the above segments, but also offers specific products for farming business, such as revolving lines of credit which are specifically structured to account for typical (i.e. infrequent) agribusiness cash flows as interest can be charged in accordance with the customer's income (i.e. monthly, quarterly, half yearly or yearly). In the last year we have added small business managers to our Regional business.

To further expand our business in the rural and regional market, ANZ recently acquired Landmark's financial services business. This gives ANZ greater coverage in rural and regional areas and will enable us to compete more strongly in this market.

Esanda is a division of ANZ which supports the Asset Finance requirements of Small Business customers. As a result of the global economic crisis, several asset finance businesses ceased trading and withdrew from the Australian market. During this time Esanda continued to finance motor vehicle, truck and other business equipment and has continued to support viable small business customers with asset finance needs.

# ANZ SUPPORT FOR SMALL BUSINESS

## ANZ SUPPORT FOR SMALL BUSINESS

ANZ recognises that the global financial crisis has been difficult for small business. We are committed to supporting small business customers who are running viable businesses. ANZ made a number of commitments to help our small business customers manage through the difficult economic times, including:

- making \$8 billion in new lending available in the 2008-09 financial year (for ANZ this ended on 30 September 2009).
- providing easy access to our dedicated specialists, who are trained to help small business customers experiencing financial difficulty, through our toll free hotline (1800 252 845); and
- considering tailored solutions on a case-by-case basis including: deferred or reduced repayments for periods of up to 12 months (with interest capitalised into the loan), fee waivers and repayment extension periods - temporary adjustments to customer lending limits including business credit cards and overdrafts.

We also held a series of free workshops Australia-wide to assist small business operators develop their skills in cash flow management, marketing techniques and how to write business plans, reflecting ANZ's commitment to small business operators and industry. The sessions are available to both ANZ and non-ANZ small business owners and feature industry experts from Google, Marketing Angels, [businessplans.com.au](http://businessplans.com.au), C.A.D. Partners and ANZ's own specialists. Around 3,300 small businesses registered to attend one of the workshops.

We also employed additional small business specialists in branches and business centres across Australia. The investment of 100 specialists will boost customers' frontline access to small business specialists, with about 85% of the new small business specialists located in our 820-strong branch network, including in rural and regional areas. To date we have filled approximately 80 positions. We appreciate that small business owners want to deal with people who understand the pressures and needs of running a business, so we look to hire staff with experience in family-run businesses. We also provide a variety of ways to interact with our frontline specialists including our business centres and branches or over the phone and internet.

In addition, we provide our small business customers with an online small business hub ([www.sbhub.com.au](http://www.sbhub.com.au)) which allows customers access to business tools and data about their industry and other market trends. We have also recently launched Business Insights, a business intelligence tool to assist small business customers better understand their customers. Business Insights can be used to improve the efficiency of marketing spend and customer service.

# SMALL BUSINESS LENDING STATISTICS

## SMALL BUSINESS LENDING STATISTICS

During the uncertain economic conditions, which have existed since late 2008, ANZ continued to lend to viable small businesses. As growth in the economy slowed:

- finance application numbers fell in small business;
- following the withdrawal of our higher risk "low doc" product in late 2008, approval rates reduced marginally and have remained solid at over 80% on average in 2009; and
- total lending grew in excess of 10% in Small Business Banking, although it was subdued generally across Commercial Banking.

We have also seen a decrease in the quality of our lending portfolio because more customers are behind in their repayments.

### APPLICATIONS AND APPROVALS

Reflecting a decrease in demand for credit from both small and medium sized businesses, total applications declined approximately 18% year-on-year from 2008 to 2009.

During 2009, we approved 83% of applications in Commercial Banking compared with 88% in 2008. Similarly, in Esanda, 70% of applications were approved in 2009 compared with 77% in 2008. The approval rate was affected by both the quality of the applications and tighter lending standards, including the review of the "low doc" product following deterioration in the broader economic climate. We expect the approval rate to increase in 2010 as economic conditions improve. We are already seeing this with the approval rate in 2010 financial year up 4% in the year to date.

### LENDING VOLUMES

Growth in total lending in ANZ Commercial Banking has been subdued since the beginning of the global economic crisis. However, this overall figure disguises the fact that ANZ has continued to provide new lending to businesses of all sizes and in some segments we have had solid growth.

Total lending in Small Business Banking and Regional Commercial Banking, which includes rural and regional small businesses, increased over the last 12 months. In particular, growth in Small Business Banking was in excess of 10% which was significant given the difficult economic environment. This growth reflects continued demand for credit in these markets and ANZ's ongoing willingness to lend to viable small businesses.

Lending to larger businesses through our Business Banking segment declined over the period as larger businesses reduced their demand for credit to reduce their leverage and, in Esanda; growth in total lending was flat.

## SMALL BUSINESS LENDING STATISTICS

### DELINQUENCIES

As a result of the difficult economic conditions, the number of businesses who are behind on loan repayments has increased. In most business segments, the number of delinquent customers began increasing noticeably around February 2008. This was before the onset of the financial crisis but reflects a higher interest rate environment at the time, with the RBA's cash rate peaking in March 2008. Since then, interest rates have decreased but the financial crisis has significantly affected some small businesses' cashflows. The proportion of customers who are 90 days or more overdue with their repayments has increased across all business segments. While it has now stabilised and is reducing in some areas, we expect delinquencies to be higher for some time as the economy recovers.

As noted previously we have put in place arrangements to assist customers who are in financial difficulty. These include providing access to dedicated specialists, trained to help small business experiencing difficulty and considering tailored solutions on a case-by-case basis to enable these customers, where possible, to manage through temporary difficulties.

# SMALL BUSINESS LENDING POLICIES

## SMALL BUSINESS LENDING POLICIES

As shown by rising delinquencies, the fallout from the global economic crisis has increased the number of borrowers who have found themselves in difficulty. Small businesses are vulnerable to reduced consumer spending. To protect the interests of both the bank and borrowers who could find themselves in difficulty in a slowing economic environment, we believe it is prudent to ensure our interest rate settings and lending policies accurately reflect the level of risk associated with different forms of lending. In particular, the uncertain economic outlook which existed for much of 2009 warranted a more conservative approach by banks.

### SMALL BUSINESS LENDING CRITERIA

It is prudent for all banks to review their lending criteria on a regular basis in response to the broader economic climate and, while ANZ continues to lend to small business, we initially implemented tighter lending standards in response to adverse economic conditions impacting certain segments of the portfolio. In particular we withdrew our "low doc" product for small business.

As economic conditions improve we are continuing to review our lending criteria. For example, in March 2010, ANZ streamlined the loan application process and implemented a process of self-certification whereby we rely on the Business Activity Statement and GST payments when assessing the loan applications for some small business secured lending customers with a proven trading history of at least one financial year.

### SMALL BUSINESS INTEREST RATES

In setting interest rates, ANZ considers our funding costs and the inherent risk profile of the lending portfolio. The global economic crisis impacted on both these fronts and required us to consider all interest rates, including those to small businesses, to ensure they adequately reflected the cost and risk of lending. When looking at a specific lending decision we also consider the individual risk of the transaction and/or the customer. As a result, businesses with different risk profiles may receive different interest rates for similar lending.

ANZ lends to start-up small businesses and offers a range of unsecured small business lending products. In some cases, this involves lending to small businesses with limited history of financial success. Notwithstanding our assessment of business plans as part of the lending decision, a proportion of small businesses will fail. As such, lending to small businesses carries a greater risk than some other forms of lending (e.g. residential mortgages) and this will affect the interest rate charged to some small business borrowers. In comparison, residential mortgages are considered less risky as we are lending to customers who are in employment, have a record of income and the loan is secured against the value of the home. This makes the loan much more secure.

Taking into account these factors, ANZ passed on as much of the RBA's reductions in interest rates as appropriate. The higher risk of the small business lending portfolio, and potential losses

## SMALL BUSINESS LENDING POLICIES

stemming from the economic conditions, accounted for the differential in Small Business lending rates over residential mortgage rates.

### Cost of funds

Banks obtain funding to lend to customers from customer deposits and wholesale funding markets.

The market for deposits has been highly competitive over the last year as banks have sought to rely more on this as a relatively stable source of funding rather than more volatile wholesale funding (in particular short-term funding). This competition has put upward pressure on the rate banks and other deposit-taking institutions must pay customers for their deposits. Research published in the March RBA Bulletin found that 'the average cost of the major banks' new deposits is currently slightly higher than the cash rate, compared with about 150 basis points below the cash rate prior to the onset of the financial crisis.'<sup>1</sup> Small business customers have benefited from these higher deposit rates.

As a result of the global financial crisis, the cost of wholesale funding increased dramatically. The marginal cost of term wholesale debt reached a peak in March 2009 at levels which, if maintained, would have greatly increased borrowing costs to consumers. Fortunately, the cost has declined significantly since then. However, the average cost of ANZ's term debt portfolio continues to increase as debt issued prior to the financial crisis matures and is replaced by more expensive funding. This will continue to put pressure on the cost of providing credit.

While for around a decade banks' funding costs moved in line with RBA official rate movements, this nexus has been broken. Research published in the March RBA Bulletin found that 'banks' overall funding costs remain significantly higher relative to the cash rate than they were in mid 2007, mainly due to the large increases in the cost of deposits and long-term wholesale debt'<sup>2</sup>.

### Role of the Government guarantee

As discussed above, immediately following the onset of the financial crisis, the cost of funds on global wholesale funding markets increased dramatically as investors became reluctant to lend and supply dried up. Immediately after the collapse of Lehman Brothers in September 2008, wholesale funding markets were effectively closed to Australian financial institutions and most institutions globally.

To respond to this problem, governments of developed economies around the world provided support for financial institutions to gain access to wholesale borrowing, including guarantees on debt issuance, and guaranteeing deposits to prevent loss of confidence and a run on banks. On 12 October 2008, the Australian Government announced that it would provide similar guarantees. The Prime Minister's announcement acknowledged that the Australian banking

<sup>1</sup> Brown A, Davies M, Fabbro D & Hanrick T (2010) 'Recent developments in Bank Funding Costs and Lending Rates', *RBA Bulletin*, March Quarter 2010, p 35.

<sup>2</sup> Brown et al, p 35.

## SMALL BUSINESS LENDING POLICIES

system is affected by global events and, if the Australian Government did not follow international developments, Australian financial institutions could find it more difficult to borrow in international financial markets. The Australian Government's decision to put in place wholesale funding and deposit guarantees was a rational response to the environment. ANZ supported the Government's provision of the schemes.

The wholesale funding guarantee facilitated access to global funding markets for Australian banks. Between the collapse of Lehman Brothers and the start of the Government wholesale funding guarantee, ANZ did not issue any material volume of new term funding (>1 year) on global markets. Without this scheme, Australian banks would have found it difficult to maintain an adequate supply of credit in the economy. However, the need for this has now passed. ANZ did not use the bank guarantee after July 2009 and supported the removal of the guarantee in an orderly way as has occurred.

### Pricing for risk

Interest rates set by the banks must take account of the risk of lending money. That risk is determined primarily by two factors:

- **Probability of default** – How likely a customer is to be unable to repay their loan. Small business customers have a higher probability of defaulting than Mortgage/Retail customers; and
- **Loss given default** – The amount the bank can recover if a customer defaults on a loan. A significant proportion of small business loans are unsecured, therefore the bank generally will be able to recover less than other forms of lending with higher security (e.g. mortgages).

The higher probability of default and loss given default for small business customers when compared to mortgage customers requires us to hold a higher level of capital for small business lending. A requirement to hold three times as much capital for small business customers than residential mortgage customers is typical as mortgages have a 20% floor limit applied to the loss given default. This increases the cost of providing small business loans relative to retail lending.

As noted above the number of small business customers who are 90 or more days past due on their credit facility has increased as a result of the financial crisis. This has increased the cost of providing small business lending to allow for an increased likelihood of losses in the portfolio.

# OUTLOOK FOR SMALL BUSINESS LENDING

## OUTLOOK FOR SMALL BUSINESS LENDING

ANZ's outlook for small business lending for 2010 is positive. We are expecting good growth across our Commercial Banking business in the 12 months to September 2010 and expect to have positive growth in all Commercial segments. Growth is expected to continue to be strongest in Small Business Banking and Regional Commercial Banking.

ANZ has a desire to grow its market share in small business. We have recently acquired Landmark Financial Services to increase our competitive edge in rural and regional areas. ANZ remained 'open for business' and willing to lend to viable small business during the financial crisis and this will continue as the economy and businesses emerge from the crisis and look to expand.