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9 February 2011

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Dear Sir/Madam

**Re: Submission to the inquiry into access for small and medium business to finance**

CPA Australia represents the diverse interests of more than 130,000 members in over 114 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background, we welcome the opportunity to provide this submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the access small and medium-sized businesses have to finance. This submission is not only made on behalf of our members but also the accounting profession and the broader public interest.

This submission builds on our submissions to the Senate Economics Committee's inquiries into access of small business to finance and competition within the Australian banking system in 2010 and our 2011/12 Federal Budget submission. The submission also draws on round table discussions CPA Australia held with Australian small businesses on access to finance in March 2010 (see Appendix A) and CPA Australia's Asia-Pacific small business survey 2010.

It is clear that debt markets changed quite dramatically during the global financial crisis (GFC). As a consequence, the GFC was a very challenging period for financing of business of all sizes. This is attributed to the scarcity of debt funding, which in part is a consequence of a reduction in funding sources, including a reduction in the number of foreign lenders, changes to the risk profiles of lenders and the increased difficulty of accessing other sources of funding (particularly for large corporates). The consequence of this is that for most businesses of all sizes, the Big 4 Australian banks became the only viable large scale source of funding.

Bank and bank client relationships have also been strained. One initiative that may contribute to improving relationships between banks and small business and reduce the possibility of these relationships being damaged again in the future, is for the Australian Bankers' Association (ABA) to consider expanding its existing Code of Banking Practice to include a code of conduct on small business lending. The Senate Economics References Committee made the same recommendation in its *Access of Small Business to Finance* report.

Other recommendations from our submission are:

+ the government work with lending institutions to develop information and education products that:
    - improve small business knowledge of the range of financing options that may be available to them
    - help small business choose the mode(s) of finance that best suits their needs, and
    - assist small business understand what they may need to do to attract finance from different sources.

+ to help small business develop their financial management skills, the government should provide subsidised training and information products to small business on financial management.

- to help the government, regulators and the business community understand trends in business lending, the government should begin undertaking a regular Bank Lending Survey to measure changes in demand for debt finance by business (categorised by business size) as perceived by senior bankers

Should you have any questions regarding this submission please do not hesitate to contact Gavan Ord on (03)9606 9695 or gavan.ord@cpaaustralia.com.au.

Yours sincerely

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# CPA AUSTRALIA SUBMISSION TO THE INQUIRY INTO ACCESS FOR SMALL TO MEDIUM BUSINESS TO FINANCE

## General comments

### *Small businesses currently accessing debt finance*

CPA Australia's Asia Pacific Small Business Survey 2010 (conducted in October 2010) asked 500 Australian businesses with less than 20 employees whether they currently have a business loan; 25.2% of respondents indicated in the affirmative. This is below the average for the other markets surveyed - Hong Kong, Malaysia and Singapore - where 30.8% indicated they currently have a business loan.

### *Need for additional funds in the past 12 months*

The same survey asked small businesses whether they required additional funds to support their business operations outside of their existing cash resources in the past 12 months; 24.8% of Australian respondents indicated the need for additional funds, which was well below the average for the other markets surveyed, which was 35%.

### *Reasons why additional funding was sought*

When asked why such businesses sought additional finance, the three main reasons cited by Australian small businesses were:

- to cover increasing expenses (30.5%)
- business growth (28.1%)
- business survival (27.3%)

The reasons for seeking additional funds in the other markets surveyed were overwhelmingly for business growth and associated reasons (purchasing assets and stock).

### *Reasons for not seeking finance*

The survey also asked small businesses that did not seek finance in the last 12 months the reason for not seeking finance. The overwhelming reason in the Australian market was that they did not need such funds. Therefore, except only in a small number of cases, lending conditions, loan procedures and the cost of finance were not cited as reasons for not applying for finance.

This does not mean that such issues are not of concern to small business – anecdotal evidence, including the opinions raised in our round table discussions certainly suggests that they are. It may be because of the lack of alternative sources of finance that Australian small businesses have accepted such lending conditions and costs and/or they are accessing sources of finance that are not an appropriate match for the purpose the finance is being used, such as credit card financing of assets.

See the following table for the reasons for not seeking finance:

| | Australia | Singapore | Hong Kong | Malaysia | Total |
|---|---|---|---|---|---|
| | 2010 | 2010 | 2010 | 2010 | 2010 |
| The business had sufficient funds under its existing arrangements | 48.8% | 67.0% | 63.3% | 60.4% | 55.7% |
| The business did not need additional funds | 61.2% | 50.9% | 39.5% | 42.9% | 53.7% |
| Procedures to obtain funding from a financial institution are too complicated | 2.6% | 5.9% | 8.3% | 15.4% | 5.7% |
| Interest rates were too high | 4.2% | 15.3% | 20.2% | 15.4% | 10.0% |
| It was considered unlikely a financial institution would provide the funding required | 3.7% | 8.5% | 6.4% | 5.5% | 5.2% |
| A previous loan was rejected | 0.3% | 0.0% | 2.8% | 2.2% | 0.9% |
| The likelihood of unreasonable terms and conditions | 1.3% | 1.7% | 5.5% | 8.8% | 3.0% |
| The risk of not being able to repay the loan | 5.3% | 6.8% | 4.6% | 14.3% | 6.6% |
| The potential to lose control of the business | 1.3% | 5.9% | 3.7% | 6.6% | 3.2% |
| The business no longer needed the additional funds (eg cancelled investment plans) | 3.9% | 9.3% | 14.7% | 16.5% | 8.2% |

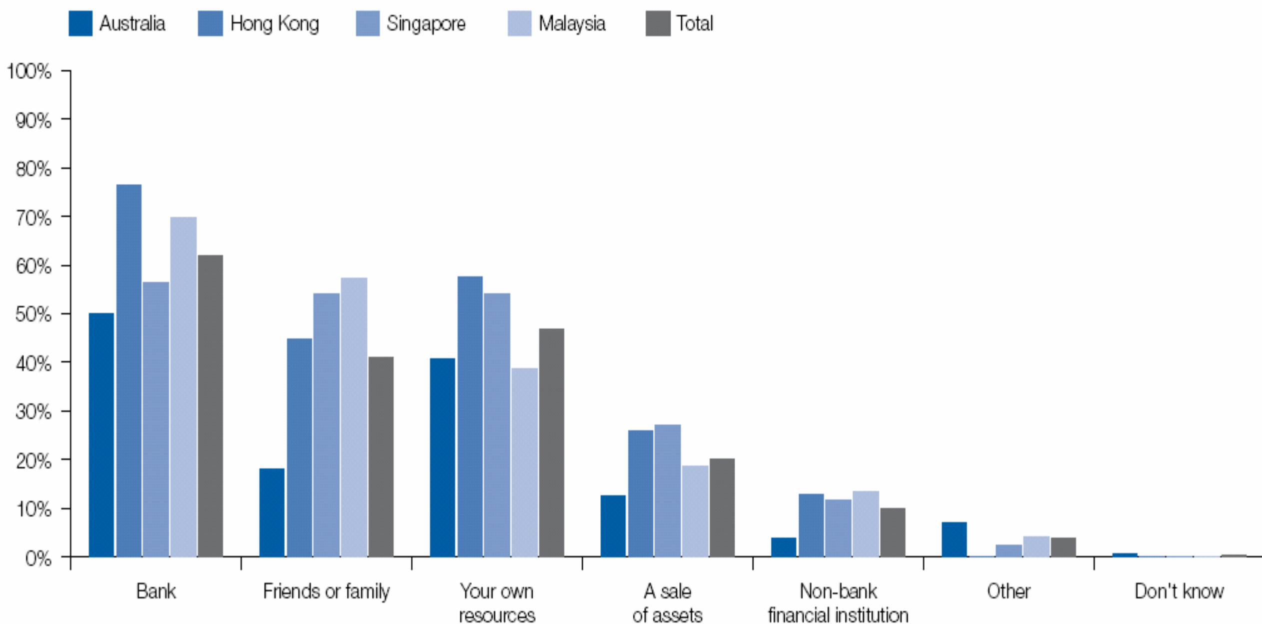
*Question 3-6: Which of the following best describes the reason for not applying for additional funds in the past 12 months? (Multiple response) (Australia n=381, Hong Kong n=109, Malaysia n=91, Singapore n=118)*

[1]

***Sources of additional finance***

For Australian respondents to our small business survey, the most important source of finance was from a bank. It is interesting that despite the reported difficulties accessing finance from banks, Australian small businesses have only marginally increased the funding of their business from their own sources. This is contrary to the reasonable expectation that if debt funding is difficult to access, businesses would seek to improve their cash position to provide an internal source of funding (which seems to be the case for large corporates).

These survey results are reflected in the following table.




[2]

[1] Table 4, page 17 – *The CPA Australia Asia-Pacific small business survey 2010 – Australia, Hong Kong, Malaysia and Singapore*
[2] *Ibid* Figure 5, page 15

*Question 3-4: And from which of the following sources were those 'required additional funds' obtained? (Multiple response) (Australia n=128, Hong Kong n=85, Malaysia n=96, Singapore n=85)*

However, with the survey showing that many Australian small businesses have poor financial management practices, it is therefore not surprising that this is the case. In other words, poor financial management practices may be contributing to an unnecessarily high reliance on bank funding. Governments, lenders, industry associations and accountants all have a role to play in improving the financial management skills of small business. Improved financial management skills can:

- increase the availability of internal sources of finance as a source of funding
- increase the likelihood of accessing external finance (as the business would provide higher quality information for potential lenders), and
- lead to more successful and profitable small business.

**Recommendation 1:**
**The government provide support to small business to develop financial management skills. Such support should be delivered through subsidised training and information products.**

***The state of competition in corporate financing***

In August 2010, CPA Australia held a round table with members involved in corporate financing. The key findings from the round table were:

- corporates experienced a significant shrinkage in funding options during the GFC, however they were still able to access funding, but at higher costs and on stricter conditions than prior to the GFC
- some foreign lenders reduced their exposure to the Australian market or withdrew altogether
- some local lenders reassessed their portfolio and reduced lending to certain sectors, and
- other sources of financing, such as offshore bond markets became very difficult to access or were not available.

Corporates were therefore forced to rely on funding from domestic sources, in other words the Big 4 Australian banks, and from internal sources through improved cash management.

For the corporates at CPA Australia's round table, the key lessons learned from the crisis were:

- While they may use alternative funding arrangements, most businesses can not become overly-reliant on non-Big 4 sources of finance. In other words, corporates have realised that the Big 4 banks are a less risky funding option.
- Good business practice should not be forgotten. Many corporates admitted that the easy credit days prior to the GFC lead them to drop good business practice.
- Good business practice helped to unlock cash tied up within many businesses, and such cash has become an important source of finance.

## Specific comments in response to the terms of reference

**1) the types of finance and credit options available to small and medium business (SMEs) in Australia**

The CPA Australia Asia-Pacific small business survey 2010 asked small business the types of financing they have used. Australian respondents were the most likely to not consider any funding at all and they were the least likely to consider working capital financing (vendor, debtor and inventory financing), instead relying on credit cards and overdrafts to meet their working capital needs.

The survey results on the types of financing used is reflected in the below table:

| | Australia | | Singapore | | Hong Kong | | Malaysia | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 |
| Credit cards | 61.8% | 62.6% | 46.6% | 45.7% | 28.9% | 36.8% | 55.1% | 38.3% | 51.8% | 50.5% |
| Bank loan (secured)* | – | 33.1% | – | 41.4% | – | 33.8% | – | 41.3% | – | 36.2% |
| Overdrafts | 33.3% | 29.5% | 25.7% | 28.9% | 29.9% | 32.8% | 40.5% | 28.9% | 32.6% | 29.8% |
| Leasing | 30.0% | 22.5% | 19.0% | 20.7% | 30.4% | 19.9% | 26.3% | 6.5% | 27.5% | 18.8% |
| Loan or equity injection from family or friend* | – | 17.6% | – | 30.8% | – | 33.8% | – | 32.8% | – | 25.7% |
| Hire purchase | 21.6% | 17.1% | 30.6% | 31.7% | 50.5% | 21.4% | 51.2% | 34.8% | 33.9% | 23.7% |
| Bank loan (unsecured)* | – | 12.2% | – | 19.7% | – | 32.3% | – | 17.9% | – | 18.2% |
| Chattel mortgage* | – | 8.1% | – | 2.9% | – | 11.9% | – | 7.0% | – | 7.6% |
| Vendor financing | 8.2% | 4.7% | 12.6% | 11.1% | 32.8% | 11.4% | 22.9% | 17.9% | 16.2% | 9.4% |
| Debtor financing | 3.7% | 3.3% | 11.2% | 11.5% | 22.1% | 10.0% | 23.4% | 19.9% | 12.0% | 9.0% |
| Inventory financing | 1.4% | 2.7% | 5.8% | 12.5% | 27.9% | 12.9% | 11.2% | 9.5% | 8.8% | 7.6% |
| International trade financing | 2.9% | 1.6% | 7.8% | 17.8% | 21.1% | 13.9% | 15.1% | 7.0% | 9.3% | 7.7% |
| Other | 5.9% | 2.5% | 2.4% | 1.0% | 2.0% | 1.0% | 6.3% | 2.0% | 4.6% | 1.9% |
| None | 23.3% | 20.5% | 29.6% | 15.9% | 11.3% | 16.4% | 9.8% | 14.4% | 19.8% | 17.9% |

* Option not provided in 2009

*Question 3-1: Which of the following types of business financing has your business ever used? (Multiple response) (Australia n=516, Hong Kong n=201, Malaysia n=201, Singapore n=208)* [3]

Our small business round table discussions also highlighted the long-standing issue of businesses using the wrong form of finance; for instance, using short-term finance, such as credit cards, for a long-term asset.

As stated in our previous submissions on small business access to finance, CPA Australia suggests that government, lenders, industry associations and accountants all have a role to play in increasing small business awareness of these other forms of financing and when they may be an appropriate financing option. Such awareness is key to the uptake of these forms of financing. With the cost of credit card and overdraft financing potentially high, any moves that lead small businesses to use other forms of financing (where appropriate) may lead to more successful and profitable small businesses.

CPA Australia has, in conjunction with Small Business Victoria, developed a detailed guide to financial management, called *Achieving Financial Success*. The guide includes explanations of different forms of financing and when such financing is most suitable. Small Business Victoria is using this guide in its financial management training.

**Recommendation 2:**
**The government, lenders, industry associations and accountants develop and distribute information and education products that:**
- **increase small business awareness of different forms of financing,**

[3] *Ibid* Table 6, page

+ **when such forms of financing may be a suitable financing option, and**
+ **how and where to apply for such financing.**

This recommendation is supported by a recommendation in the OECD Brasilia action statement for SME and entrepreneurship financing (in March 2006) *"…informing SMEs of the range of financing options (e.g. public guarantee programmes, business angels, and bank loans) will ensure greater take-up of schemes."*

## 2) the current levels of choice and competition between lending institutions, but not limited to, credit availability, fees, charges, comparative interest rates and conditions for business finance

In March 2010, CPA Australia ran four round table discussions with members involved with small business to gauge their views on small business access to finance (see Appendix A for a summary of those discussions). Many participants stated that they believe there has been a reduction in competition between lenders to small business since the beginning of the GFC. With small business having few alternatives to bank financing and foreign lenders unlikely to become active in this area, the dominance of the Big 4 banks as lenders to small businesses looks set to continue for the foreseeable future.

The round table discussions highlighted that businesses did feel a shift in the power in the relationship between banks and borrowers, and that businesses felt that this allowed banks to impose tougher compliance requirements on business borrowers. Members however also stated that the change in the compliance requirements also reflected a reassessment of risk by lenders.

CPA Australia is generally not critical of a tightening of lending conditions, nor of the banks seeking additional security and information. However, such actions do have consequences for small business, and the challenge for lenders is to find the balance between imposing suitable lending conditions and giving suitable businesses reasonable access to finance at a cost that reflects the risk of such lending.

However, changed lending conditions (including implementing additional reporting requirements) were, at times, imposed with great speed and (often) lack of warning. In our view, the inadequate time many businesses had to adjust their systems to meet the new conditions added to the pressure many businesses felt during the GFC; the banks could have handled this better.

It should also be noted that large corporates, in an August 2010 CPA Australia round table, also shared their view that competition in their end of the financing market had also decreased and that the GFC demonstrated to them the important role of the Big 4 Australian banks in providing large-scale. Large corporates also identified a small but growing presence of Asian banks (particularly from China and Japan) in providing finance to well-known companies in specific sectors.

## 3) Credit options available from banks, non-bank lenders and second tier lenders

As discussed in the response to the first term of reference, while there is a wide range of financing options available to small business in Australia, our 2010 *Small business survey* shows that Australian small businesses stick fairly closely to what could be considered vanilla financing options. While the supply of credit to SMEs from banks may have ebbed, we have not seen other finance providers step into any gaps that may have emerged.

## 4) the impact of financial institution prudential requirements and banking guarantees on lending costs and practices

No comment.

## 5) comparison between credit options available to SMEs located in regional Australia and metropolitan areas

Regional members involved in our small business round tables expressed concern that bankers in regional areas do not have the authority to assess and authorise loan applications (there was no discussion on differences in the credit options between regional and metropolitan areas). One member stated this

experience can be detrimental to credit applications: "*You are hard pressed to find business managers, or account managers* [with a bank] *that have the background and skills to argue the toss with head office*."

**6) the impact of lenders' equity and security requirements on the amount of finance available to SMEs**

It is evident from all four small business round-table discussions that the banks are requesting increased security for both new and existing loans. From the beginning of the GFC, the banks were acutely aware that the fallout from this crisis would change the risk profile of most businesses. One step they undertook to mitigate their risks was to review their loan portfolios with additional rigour. The result was that many businesses were required to agree to changed loan conditions that included either security that had not been previously required or an increase in the level of security that supported the loan.

Participants in our round tables also stated that the banks are scrutinising the types of security they are prepared to accept. In days gone by, some established businesses were able to borrow based on the assets on their balance sheet. Now the banks are looking at the quality of these assets. In particular, intangibles such as goodwill, cash flow and profitability no longer cut the grade as quality assets.

This increased demand for security for business lending could have a detrimental effect on future borrowing (say for growth), because the security required for such lending may not be available as it is already pledged as security.

We have received considerable feedback from members that banks have also reduced the loan-to-valuation ratio that they will accept. This means that there is an increased requirement for equity contributions before a loan application is approved. Although this may not necessarily be detrimental to the business, it will have impacts on SMEs, in particular on cash flow. Business owners also have to factor in that they will have to contribute more of their own money to a project before deciding whether to undertake such a project.

Feedback from members and from other sources strongly indicates that banks are lending, but that the majority of lending is only on a fully collateralised basis (secured lending). Limiting of unsecured lending can have a significant impact on the working capital of businesses.

**7) policies, practices and strategies that may restrict access to SME finance, and the possible effects this may have on innovation, productivity, growth and job creation**

This submission identifies a number of trends in financing that is restricting the flow of finance to small business in comparison to prior to the GFC. However, it must be stated that the we are unlikely to see a return to the same lending conditions that existed prior to the GFC for the foreseeable future and nor is a return to such lending conditions desirable.

The trends restricting the flow of finance have been driven by a change in the risk profile of businesses as a result of the GFC. This has resulted in:

- lenders reviewing their loan portfolios and demanding security where such security was not previously required or demanding additional security (which in turn is tying up security which can no longer be pledge against other borrowing)
- an increase in compliance reporting
- an reduction in loan to value ratios – thus requiring more equity from investors
- a decline in unsecured lending

Members in the round tables also noted that the lack of experience and skills of many business bankers is in fact counterproductive to accessing finance and is leading to unnecessary information requirements.

On the other hand, some businesses are finding it difficult to meet the information requirements imposed by lenders for new loans partly because of the poor recordkeeping. Further the poor recordkeeping and financial management results in many small business being unaware that cash is being unnecessarily tied up in their business instead of being available as an alternative source of finance. Therefore small business practice is contributing to issues to do with the flow of finance to small business.

The lack of knowledge of many small businesses to a broader range finance alternatives is also restricting the flow of finance to SME.

***The importance of reasonable access to finance for SMEs***

Reasonable access to finance will be a key issue for many businesses during the recovery. For SMEs, the issue will be more pressing because of their lack of well-developed alternatives to bank finance.

The recovery will see many businesses having to increase their stock on hand to meet rising demand; hence their working capital will have to grow to fund such an expansion. With access to unsecured finance (in particular) remaining difficult, and very few small businesses using alternative sources of finance (such as debtor financing), improving the cash position will be the main avenue for many businesses to fund the expansion of their working capital. This will require businesses to implement (or continue) good financial management processes. However, it is important to remember that improved cash management is no panacea; for some business models, external finance is very hard to substitute.

***The importance of access to finance for employment***

In a global survey conducted on behalf of CPA Australia, the Association of Certified Chartered Accountants (United Kingdom) and the Certified General Accountants Association of Canada in 2009[4], it found, not surprisingly, that employment by SMEs is sensitive to the supply of finance. The survey found that SMEs facing tough credit conditions, and SMEs facing severe cash flow problems, are almost three times as likely to lay off staff as those SMEs not so affected.

***The importance of access to finance to facilitate the sale and purchases of business***

Some members involved in our round table discussions made the point that it has become difficult to sell businesses because potential buyers have difficulty raising the necessary finance to purchase the business. This has resulted in some business owners simply closing their business. This view is shared by David Bird, chairman of business brokers BizExchange, who was reported to have stated, *"A number of brokers have reported that overly restrictive bank lending criteria have prevented some quality businesses changing hands."*[5]

***Policies, practices and strategies that may enhance access to finance***

As the Minister for Small Business, Senator The Hon Nick Sherry stated in a recent speech:
*"Regrettably, the relationship between banks and small business can often be fraught.*

*I encourage lenders to get closer than ever to business and urge them to look to fill the gap in funding as much as the regulators will permit and to price risk realistically."*[6]

We support the Minister's statement and encourage the Parliamentary Joint Committee to support recommendation 6 of the Senate Economics References Committee *Access of Small Business to Finance* report being "*The Committee recommends that the Australian Bankers' Association meet with small business representatives to develop a code of practice for lending to small business*". We have raised this recommendation with the Australian Bankers' Association (ABA) and to date have not had a response as to whether they would develop such a Code.

It should be noted that the UK, Canada and Ireland have specific codes of conduct relating to lending to small to medium sized enterprises and that such a Code would therefore bring Australian banking system into line with best practice. The UK and Canadian codes are codes of their respective bankers' association and the Irish code has been released by the Irish financial services regulator. The ABA previously had voluntary guidance for its member banks on working with small businesses (called *Banks and small business working together*). This guidance was withdrawn when the current Code of Banking Practice was released in 2004.

It has been argued that the current ABA Code of Banking Practice effectively covers the areas covered by the overseas small business codes and the guidance previously issued by the ABA. However as shown in the comparison between the ABA Code of Banking Practice and the overseas small business codes at Appendix B, this is not correct. There are significant gaps that could be corrected in an expansion of the ABA Code of Banking Practice or in a separate code of practice.

[4] *Surviving the drought: Access to finance among small and medium-sized enterprises*, Economist Intelligence Unit, October 2009.

[5] Fenton-Jones, M 'Crimped by big banks loan criteria', *Australian Financial Review*, 02 March 2010, page 49

[6] Address to the Council of Small Business of Australia Quarterly dinner – 25 November 2010

Such a specific Code would provide the framework for banks to improve their relationship with small business and more clearly set out the rights and responsibilities of banks and borrowers and enable banks "*to get closer than ever to business"*. This would no doubt lead to improved outcomes in small business lending.

**Recommendation 3:**
**CPA Australia recommends that the Parliamentary Joint Committee support recommendation 6 of the Senate Economics References Committee report titled *Access of Small Business to Finance,* being that the Australian Bankers' Association meet with small business representatives to develop a code of practice for lending to small business.**

Governments in a number of major economies (including US, UK and Canada) produce a regular bank lending survey to measure changes in demand for finance by business as perceived by senior bank officials. Such surveys build the knowledge of the governments, regulators and the community on business lending trends. Knowledge of bank lending trends would significantly increase if the Australian government were to adopt the same survey. Such knowledge could be very useful for policy makers.

**Recommendation 4:**
**CPA Australia recommends that the government commence a regular Bank Lending Survey to measure changes in demand for debt finance by business (categorised by business size) as perceived by senior bankers.**

## 8) The need for any legislative or regulatory change to assist access by SME to finance

None of CPA Australia's recommendations involve legislative or regulatory change. Our strong preference is for improvements in access to finance to be driven by following non-legislative means:

- Governments providing information and training to small business to help small business improve their financial management and knowledge of financing products
- Lenders improving their relationship with small business in line with a specific industry code of practice for SME lending
- Greater knowledge of business lending trends through a survey of senior bank officers'
- Improving the skills and experience of business bankers

## 9) any other related matters

***Business bankers***

While appreciating that lenders have made available an increasing number of business bankers, members believed that such moves have yet to result in improved relationships, and in some cases the poor skills and knowledge of some business bankers have been counterproductive to relationships. For example, the business banker seeks unnecessary information as they do not have the skills to make a professional judgement on what is necessary and not necessary to make an informed decision.

Given this, we believe that banks and other business lenders should consider providing additional technical training to their business-banking staff so that such staff have a reasonable understanding of financial matters and the industries in which their clients work.

***The ease of moving between providers of banking services***

Some members believe that the effect of the increase power of the Big 4 Australian banks as the predominate source of business finance and the hassle (perceived or actual) of switching banks is that many small businesses feel captive to their bank.

The reduction in competition has resulted in a shift of power to the banks, which according to members is impacting the ability of small business to negotiate competitive deals. With this lack of choice, members expressed concern with the impact this would have on small business switching banks. As one member points out in relation to the problems of switching between banks: "*The government was well intended when it said a few years ago that it would make switching banks easier. However, no one took account of the huge opportunity cost, particularly the government, when a small business has to go and start looking around to get another finance facility. It's not only the business finance, but also the personal, all the ancillary finance and hire purchase etc, that needs to be changed and they just don't have the time. In addition, with small businesses required to use personal assets to secure loans, switching carries large costs.*"

Another member agreed, "*There is a large cost associated with transferring banking – stamp duty in particular. So the business owners then say, 'why should I spend $100,000 to transfer my banking across?' Therefore, potentially, the banks have certain leeway to leverage up their requirements on businesses in the form of fees, information, security and any other compliance requirements, which could be difficult to work around in a cost-effective manner due to the lack of competition and costs associated with switching financiers.*"

With small business lending mixed with security over personal assets and personal guarantees and transactional banking, switching small business lending can be problematic and time consuming.

***Opportunities for, and the obstacles to, the creation of new banking services and the entry of new banking service providers***

It would be presumptuous to believe that foreign lenders or a new domestic lender can enter the Australian market and start lending to small business or grow an existing banking network on anything but a small scale (experience shows us that foreign lenders are mostly interested in corporate lending and lending to particular sectors such as property development). Small business lending not only requires a distribution network but also (and may be more importantly) back office support (particularly a well-managed credit department to assess applications). Such back office support can not be built over night. The easiest way for foreign lenders or a new domestic lender to enter the market is to purchase an existing branch and support network, however there are limited options for such investment outside the Big 4 banks.

Second tier lenders (smaller banks and credit unions) already established in Australia do offer an alternative to the Big 4 banks, however without larger distribution networks and larger back office support (credit departments), it is unlikely that these lenders will become a major source of competition in small business lending. Also impacting the ability of many second tier lenders to provide competition to Big 4 banks in the small business lending market is that many of them are focused on particular geographical areas and/or they focus on home mortgages. Second tier lenders may require incentives to develop the infrastructure they need to move more into small business lending.

It is therefore difficult to identify any easy solution to increasing competition in the small business lending market.

***Comparisons with relevant international jurisdictions***

At Turin in March 2009, a round-table gathering of national governments (including Australia) was held to discuss the impact of the GFC on SMEs (the gathering was held under the auspices of the OECD Working Party on SME and Entrepreneurship). The Turin round table issues paper[7] classified the SME policy responses of governments to the GFC as follows:

- *Supporting sales and preventing depletion of SME working capital*. Policy measures include export credits and insurance, tax reductions and deferrals, better payment discipline by governments, and wages subsidies.
- *Enhance SME access to liquidity, mainly to credit*. Measures include bank recapitalisation, expansion or introduction of loan and credit guarantee schemes by governments for SMEs, direct public lending to SMEs, mediating between lenders and borrowers, monitoring and publicly reporting on lending to the sector, and establishing a code of conduct for SME lending by banks.
- *Helping SMEs maintain their investment level and more generally their capacity* to respond to the recovery through investment grants and credits, accelerated depreciation, research and development funding and tax incentives.

While the provision of credit guarantees to SMEs by governments was widely adopted in many OECD countries, the effectiveness of this policy and other policies have yet to be fully evaluated, thus it is difficult to identify best practice. It should also be noted that most of these measures are designed to solve immediate liquidity issues only, and have a limited life.

***The role and impact of past inquiries into the banking sector in promoting reform***

As discussed above, the Senate Economics References Committee report on *Access of Small Business to Finance* made a number of recommendations. Recommendation 6 relates to the Australian Bankers'

[7] 'Turin Round Table on the impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses Issues Paper', OECD and Intesa Sanpaolo, Turin, Italy, 26 to 27 March 2009.

Association. We have not seen a formal response from the ABA or its member banks to the recommendations. More pressure should be brought to bare on the ABA and its member banks to respond and to justify their response.

# APPENDIX A

## Small Business Access to Finance: A detailed summary of member views-March 2010

### 1. Background

In March 2010, CPA Australia organised four round tables on small to medium-sized enterprises (SME) access to finance. The round table were held in Canberra, Melbourne, Brisbane and Sydney and involved some 60 members who work for or advise SMEs, and who have had recent experience seeking finance for their employer/client.

The below seeks to represent the views of the CPA Australia members who participated in the round table discussions on the access of small business to finance. CPA Australia does not vouch for the accuracy of these views, nor do these views necessarily represent the views of CPA Australia.

All possible care has been taken to accurately represent the views of members expressed in the round table.

Accessing finance is a critical issue for many small and medium-sized enterprises (SMEs). CPAs, as strategic business leaders and finance experts, play a critical role in advising on and assisting business access finance. Our members therefore have a unique and interesting perspective on the issues surrounding access to finance, therefore this document attempts to capture these views for the benefit of the broader community.

We would like to acknowledge the facilitator of these round tables, Jan Barned CPA, who has worked in the finance industry over the past 20 years and the contribution of members who participated in CPA Australia's access to finance round tables in Brisbane (the CPA Australia Queensland Division SME Committee), Canberra (the CPA Australia ACT Division SME Committee), Melbourne (the CPA Australia Victorian Division SME Committee) and Sydney (the CPA Australia New South Wales SME Discussion Group). We would also like to thank those members who contributed their views and experiences through other mediums.

### 2. Introduction

In March 2010, CPA Australia conducted a series of facilitated roundtable discussions with members working within the SME sector to gather their own or their clients recent experiences with raising finance for their business. These sessions were held in Melbourne, Canberra, Brisbane and Sydney.
The outcomes of these facilitated discussions are outlined below.

Generally, the findings from the discussion all concluded that the pendulum had swung from pre GFC environment of lenders being often too generous on lending conditions to the banks being so risk adverse that many SMEs are finding it difficult to raise external finance. Members reported that businesses have struggled with the tightening of lending conditions, not only because it affected their ability to raise finance but also because they reported inadequate notice to amend their business practices and systems to meet the new conditions.

> The pendulum had swung from pre GFC environment of lenders being often too generous on lending conditions to the banks being so risk adverse that many SMEs are finding it difficult to raise external finance.

As a member stated at the Brisbane roundtable 'I think the biggest problem was that the banks were adamant that there were funds available. Yes the funds were available however they lifted the bar so significantly after the crunch came that it made it almost impossible for some successful small businesses to apply for funds. Prior to December 2008, the availability of funds was fairly easy. You basically went in with standard business plan, couple year's financials and they would approve it there and then. What they then wanted after December 2008 was very detailed financial statements, very detailed cashflow statements, and very detailed breakdown and analysis of financial records; information they had never asked for before.'

The main theme to come out of the round tables was the damage done to the relationship between banks and SMEs over the course of the crisis. While members generally understood the need for banks to take a more prudent approach to lending in the current economic environment, such as requiring greater level of security and more information, members expressed the view that banks needed to improve their

transparency and communication on their tighter conditions to business, including providing more notice on such changes.

The roundtable discussions also highlighted a number of other issues that were found to be impacting both potential and existing financing arrangements for SMEs over the past year. These were:

- Banks were still lending however finance is essentially only available where the loan is fully secured by quality assets and personal guarantees
- Increased compliance/information requirements
- The lack of experience of bankers, the high turnover of business bankers and their lack of authority
- Lack of competition
- The economic impacts on small and medium sized businesses

What is interesting to note is that all of these key themes were issues discussed at the roundtable conducted by Minister Emerson on the same topic in March 2009. Given this, some members expressed the view that the banks have done very little to assist in supporting SMEs to access finance during the past year.

### 3. Increased security/collateral requirements

It is evident from all four discussion groups that the banks are requesting increased security for both new and existing loans. From the inception of the global financial crisis, the banks were acutely aware that the fallout from this event would change the risk profile of most businesses. The first step that they undertook was to review their loan portfolios with additional rigour. The result was many businesses were required to agree to changed loan conditions that included either security that had not been required in the past or an increase in the level of security that supported the loan. For most new financings, security was now essential. As a member who owns a small business based in Cairns confirms 'If you are looking at start ups, if these businesses do not have solid equity in their own homes, which is what the bank wants as security, then the banks will not even consider them.'

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With their new risk adverse demeanour, that bank's are also scrutinising the types of security that they were prepared to accept. In days gone past, many established businesses were able to borrow from the assets on the balance sheet. Now the banks are looking at the quality of these assets. In particular, intangibles such as goodwill, cash flow and profitability no longer cut the grade as a quality asset. As a Canberra-based public practitioner stated that one of his customers was 'Wanting to purchase another business that had $100,000 goodwill and the bank said 'No way' but when he went to borrow $100,000 for a car, he walked into the bank and within fifteen minutes walked out with the loan for the car. The banks are looking for tangible security and goodwill does not offer that. The banks cannot quantify goodwill and are concerned that the goodwill will walk with the previous owner.' What makes the current situation even more difficult is that many assets have also suffered from a decrease in value during the GFC. When the banks undertake their annual review, they are now dissecting the balance sheet in more detail than ever before and many businesses are finding that the banks were questioning the implied value of the assets used as security and assigning lesser values.

This approach to asset revaluations has been exacerbated by the suggestions that the banks have decreased the loan to value ratios (LVR) as a response to managing the risk profile of their customers. In many cases the consequences of such action is that the banks are now asking for more security. Such requests may be indirectly affecting cash flow as a member in Brisbane points out: 'small businesses are required to use personal assets to secure loans, such as the family home. With the decreasing value of some of these assets, the banks are now saying that the business has to reduce the level of debt to met decreasing LVR and asset valuations and this is having a major impact on cash flows of small business.' (as they will probably have to use cash to repay debt rather than use it in the business).

Many of the attendees at the roundtables discussions also mentioned that there has been a demise of cash flow and profit lending. The Canberra-based public practitioner stated 'The banks are less willing to lend for future expansion for business where the serviceability of the loan will be tied to future profitability, even where the owner is a very experienced business operator' and a Queensland member goes out on a limb by stating 'Any bank that is telling you that they will do cashflow lending is lying.' They are lending against tangibles that they have a legal right over – the intangibles that they previously used as security has now stopped.' Simply put, the banks want solid security that will provide a 'real' cover for any loan default.

The same member believes 'The current practice of the banks is that they have gone too far. They are only looking for security – if you are a property borrower they are doing 50% LVR, if you are lucky. If you have any other type of business, they will only lend on 80% of your debtors.'

However, as the Canberra-based public practitioner notes, the requests from the banks for additional security can also provide the business with funding that is better suited to the purpose, as was the case for one of his clients: 'The client wanted to extend their current overdraft facility from $250,000 to $ 650,000 to cover the $450,000 for fit out of the two shops [the lease on the shops require a fit out every five years, so the effective life of the fit out is five years]. Last week the bank came back and said that they were withdrawing the overdraft and that the owner now had to take out a lease facility or some other loan facility to cover the $450,000 over a two, three or four year period. The client wanted to keep the full $650,000 facility overdraft, but the bank was only prepared to allow the original $250,000 overdraft. The terms and conditions offered by the bank are very fair and reasonable. I think this is a good thing [as the loan better matched the purpose for which the funds were to be used for], but it is not what the customer wanted.'

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The roundtable discussions uncovered that in addition to tangible security, the banks are also asking for personal and directors guarantees. Although this is not something totally new, a surprise finding was that a number of the members had also been asked to provide key man insurance. One member shared that 'We did have to try and restructure some of our debt and with that came the personal guarantees from all the directors that had not been in place previously. They were asking for more security and they even asked for key man insurance.' This is insurance covers the key personnel in the business and provides the banks with some certainty that the business will continue to operate under the current management. This type of insurance is quite expensive and of course the cost is borne by the business not the bank.

The upshot of these additional security requirements in many cases is that the businesses are now handing over all of the available security to their bank, which in turn will limits their ability to switch banks. When this point was raised, the Canberra-based public practitioner agreed and even questioned the impact on the SMEs ability to seek competitive finance 'That's exactly right – you cannot go elsewhere because you do not have security to offer and this [inability to switch] removes the negotiating power.' The other area associated with the banks securing all of the assets as security, is that this can increase the SME's risk. The inability to diversify their banking facilities (because all the security is held by the existing bank) may have dire consequences in the shifting appetite of the banks. One CPA confirmed that there is risk in banking with only one bank 'What happened was the bank just fundamentally changed its' mind – it said, I don't want to bank you anymore.'

**4. Substantial increase in compliance**

The overwhelming response from all of our discussions was that the banks are asking for additional information from business. Obviously with an increase in the perceived risk, the banks are supplementing the level of security with more detailed financial information from the business. Members also reported that the regular reviews that banks undertake of loan facilities are at a more detailed level than ever before, with not only past financial statements being requested, but budgets and forecasts, in particular cash flow forecasts. The banks are in the business of lending and are looking at the ability of the business to service the loans, particularly under this new regime created by the global financial crisis.

The Chair of the Victorian SME Committee confirms this (when speaking about her employer): 'There is no question about the debt coverage because our financials are very strong. The issues are around the fact we have moved to a new risk assessment and all our loan compliance is sent to Head office and they are sending down more detailed requests for more information.' A Queensland member agrees 'They said that the risk profile had changed, and therefore they had to be more discerning in how they evaluated applications for credit. In our own business, they started asking for information that they had never asked for before.

They were always given an abridged version, however now they wanted much more detail.' The Chair of the Victorian SME Committee also mentioned that her banks had asked for access to the business's ATO portal, a request that a number of the participants at the roundtables had also experienced.

What poses as a potential trap for SMEs is the fact that pre GFC banks were not necessarily enforcing compliance requirements and this has created a dangerous environment for businesses that may not be aware of their obligations. The Chair of the Queensland SME Committee makes the observation 'Often it is only when business is faced with risk of insolvency, that they find out what is in their covenants and this is when their banker finds out too, because it is actually only credit department back in the bank that understands this stuff. This department changes the rules and the manager then has to come and tell you that all is changed.' However in response, another Queensland member pointed out 'They don't change the rules, they apply them. Most SMEs don't understand that really their loans are at call at anytime and it does not have to be a practical default, it can be a technical default and the banks are really good at issuing letters of non waiver – in other words, we will let you run on until we are ready to pull the rug. So the real issue that goes back right to the beginning is 'What are you signing up for' which is the old Caveat Emptor – let the buyer beware.' This view may well be confirmed by one members own experience 'We did have quarterly reporting and we had to meet certain covenants. They had, up to that point, given us a lot of flexibility. Then it became black and white. There was the threat of breach notices if it went beyond what we should have been going beyond.'

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In addition to enhanced reporting requirements, there was agreement among the members that the banks are now requiring additional information that is outside of the current loan agreements or covenants. With both the level of information and frequency of the provision of this information on the increase, one member suggested that the banks are in fact testing the real need for funding 'I think they are trying to create a workload for small business that was beyond their means and then was pushing them to the bounds of whether they really wanted the finance or not.' With the GFC creating new challenges to SMEs, those who have obligations to banks have been really starting to feel the extra burden that comes with meeting bank requirements.

As resources start to be stretched to the limit, preparing additional information to support loans members hold the view that these requests are beginning to impact on the overall operations of the business and in many cases increase the costs. The member who owns a small business in Cairns comments: 'Many businesses have had to let go staff which means that the business owners are now back in their business working. This means that they do not have the resources or the time to prepare the extra information if they don't automatically do it anyway.'

Another Queensland member also points to the direct cost factor under these conditions: 'The [extra reporting requirements] has put an extra burden on a lot of small businesses that were not (appropriately) geared up to provide (the banks with) these extra requests. In my experience, they then had to seek requests from practitioners to prepare the extra information to send into the bank, which then cost them.' A public practitioner from Melbourne confirmed these additional costs have the real potential to impact cash flow: 'My experience is that SMEs with turnover in the $10 to $20 million range, if they were established businesses with established relationships and existing facilities in place, survived quite nicely. However at a time when they had cash flow issues and needed more funds, then the banks would put pressure on them for more security, stricter covenants, increase in reporting requirements including audit obligations that the customer had to meet. The banks have often appointed one of the big four accounting firms to undertake an audit at a cost of $10,000 to $30,000 a quarter to the customer.'

What was very interesting during our discussions was the number of members that actually questioned the usefulness to the banks of this additional information that is being requested. A member working for a Queensland-based mining company comments 'They don't seem to understand what is in the forecast, because they keep asking questions – they just don't seem to get it. I don't think they know what they are looking at, especially for a mining company, unless they have a background in mining. We have been trying a new business model and parts of this are untested, so even the management cannot guarantee the outcomes.' And the chair of the Queensland SME committee agrees: 'I would say it's not just extra requirements, but the very fact that no one knew what was going to happen six months time, yet someone at the bank said you have to forecast it and tell them what you thought on what your earnings were going to be. How can they do this when no one knows – the banks did not know - Ben Bernanke has not got a clue - so how do they think that the business owners will know? But still they ask nonetheless.'

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Another member from Brisbane asked the poignant question 'Do the banks measure the forecasts to actual results?' and the answer was 'No' however another member did clarify the use of such additional information in his view 'The moment you have an investigating accountant assigned to your business is the day that you will find your forecasts pulled apart. Not last month or the month before, but going back twelve months. They will actually engage external accountants to ask the questions about what is going on. So, there is a very fine line to what I would call the 'rope' to which you can continue to lead yourself out and then there's the time when the rope gets yanked, and then it's a very painful experience for those involved.'

We did ask the round tables if SMEs should be preparing this type of information to support business practices, and a number of members were quick to reply that due to the size of SMEs, in most cases owners and operators have a good handle on where the business is at, even without this level of detail. One member provides an interesting take on this topic 'I have not met a small business owner yet that does not know more than the accountant. They have the answer before you even show them the numbers.' Another member states 'I believe that this is where the psyche of big business differs from small business. Small business is much more attuned to who their customers are and how they operate than big business. Big business is normally one, two or three times removed from the client.'

The same member also believes it is not just the numbers that the banks are struggling to understand: 'I think it goes further than what [the members] are saying, not only do they [the business banker] not understand the numbers, they don't understand the nature of the business. They may see a hairdresser this morning, a cafe at lunchtime, a retailer in the afternoon and they cannot get their mind across the variety of industries that small business is in and I think that this then raises the risk profile across the board for all SMEs.'

Most of the members attending the round tables did have a view on the increase reporting requirements and not all was negative. 'In some sense I don't think that the bank asking for extra information is necessarily a bad thing' is the view of one member which another member supports when he stated 'I think the banks are now doing what perhaps they should have always been doing. They are now reviewing the information that you have been casually giving them over the past few years, you cannot begrudge them that.'

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Perhaps the following observation from one member may provide insight into the rationale for increased reporting: 'The banks are asking for more detail than before on regular reporting – I believe that this is a way of gauging how confident you are. So they ask a question and if you tend to load them with almost too much information, they back off. It comes to a point where they don't understand the business, and so they have to have confidence in the people – I think at the end of the day that's a lot of it – they have to have confidence in you and you have to tick all the boxes.' Perhaps this is why we are seeing an increase in the requests for key man insurance?

**5. Bank staff experience, turnover and authority**

During the discussions on increase compliance requirements, members consistently commented on the lack of experience of business bankers. A representative of one of the major banks at the Minister's round table in March 2009 provided one reason for this when he commented that due to staff turnover at the bank, many of their bank managers have less than three years relevant experience. Members experiences over the last twelve to eighteen months indicates that there may well be the demise in the traditional banking relationship between the bank manager and the customer. With the higher level of reporting and more rigorous reviews, coupled with a perceived shift in risk profile and inexperienced bank managers, bank credit teams are playing a larger role than ever before in loan evaluations, both new and existing.

Members experiences over the last twelve to eighteen months indicates that there may well be the demise in the traditional banking relationship between the bank manager and the customer.

One Canberra-based member notes the importance of the traditional banking relationship and the changing landscape: ‘What used to happen, was you would walk into the bank and you would shake the bank managers hand – you knew the bank manager for the last six month, years whatever. Now when I walk into the bank, there is no one there. They don’t know you.’

But just how important is the lack of a long standing relationship between a bank manager and a business? As the same member went on to state ‘In the past the bank manager would go out on the line [to the bank’s credit department] and say ‘These are good customers’ and you would go and talk to the bank manager and you could get a loan on your creditability, but now, it appears that bank managers do not have the expertise to assess business loans appropriately, no matter how experienced.’ One member even went so far as to comment ‘They deliberately put managers in branches that have either no authority or no expertise so they simply cannot approve a loan. I think that’s a policy.’

The level of experience of the bank managers has, in many cases, led SMEs to dedicate additional resources to educate them on how the business operates: ‘The experience of the banker in my previous employment was very good. He would come out and I would present him with a pack and we would discuss it together. He was then redeployed and we started to get new relationship managers through. I had to explain the numbers; they did not understand the business as well. So at the time when you are asking for additional funding and you have to explain the business as well to people that are not familiar with it, there was that double frustration. They were inexperienced in reviewing the financials from a credit risk perspective.’ one member confirms.

The other issue that surfaced when discussing bankers experience was the authorisation policy. In particular, during the discussions in Brisbane, where two of our members came from regional areas, it was noted that regional managers are referring business back to capital cities, which in some instances could impact on the how the business manages the relationship. A Rockhampton-based member notes that for their business ‘Our banking is all done in Brisbane, not in Rockhampton. Our CFO is based in Brisbane and his job for the last six months has been to talk to the banks constantly.’ Although some would argue that this should be one of the roles of the CFO [Chief Financial Officer], it appears that the banking relationship has shifted gear since the beginning of the GFC and can be, in some instances, very demanding on the resources of the business.

Our members in Canberra have had similar experiences. One Canberra-based member states ‘Part of the issue with the banks in Canberra is that everything is referred to either Sydney or Melbourne and this is most likely the issue with most regional centres’ and another Canberra-based member pointed out that this then can threaten the loan application process ‘You are hard pressed to find business managers, or account managers [with a bank] that have the background and skills to argue the toss with head offices.’ The real issue for these regional centres is that when a portfolio is referred, then the likelihood that each individual business will be assessed on the merits of the business is reduced. As the Canberra member says ‘It then becomes a real issue of ‘tick the box’.’

Interestingly, at the Minister’s roundtable in March 2009, the banks were adamant that the demand for finance had decreased. At the time, the representatives from the industry bodies argued that this was, in part, due to the ‘tick the box’ mentality that had surfaced in the face of managing changing risk assessments and that demand had not changed, it was simply the fact that most applications were not meeting the standards set by the credit departments and therefore, the applications were never processed. When we raised these differing views with the members, the response was that both were correct. As one member stated ‘I would say that both demand has dropped and also the compliance issues have come into play. Some tasks that were marginal when the boom times were on just are not possible now under the current economic conditions, the price isn’t there in the market.’ One member from a large business who attended the Brisbane round table stated and other members agreed that business is just disinterested in going to the banks because it is too much hassle and too much expense to have all the information prepared. With manager’s time poor, it is easier to finance the business internally. These businesses have not even bothered to go to the banks.

What becomes critical under current circumstances is how the information is prepared and presented to the bank. A Sydney public practitioner believes this is a particular issue for micro businesses ‘They don’t even know how to approach the bank in the first place. There is no assistance out there to tell them what they will need - for example, three year financials, three years of tax returns, a business plan etc. They don’t know how to do it and currently they are too busy trying to survive on a day to day basis to be able to do it.’ A Canberra public practitioner does provide some practical advice ‘Presentation is everything. You have to have cash flow forecasts, figures, everything that is in a good light – the more paperwork the better. They even want to see photos – really the best presentation they can get. If you are lacking on anything to do with figures or forecasts, you have no chance. Even though they are taking on larger portion of security, they still

want to see forecasts because they would much rather see you pay back the loan than foreclose and then they will keep you as a client.'

Presentation is everything!

It therefore appears that the lack of experience by many banker managers and the elevated level of information that is required is placing additional strain on SMEs to service the needs of the banks and ensure that they can continue to access appropriate finance during this time.

**6. Lack of competition**

One of the first responses to the global financial crisis was that some foreign banks pulled out or reduced their exposure to offshore lending in a bid to ensure adequate finance was available to their domestic customers. Australia was not immune to this move and the presence of foreign banks has reduced. This coupled with the mergers of a number of second tier banks with major banks has resulted in a reduced range of possible lenders.

One member stated that 'The government has failed by allowing the big four to take over the smaller banks like BankWest and St George. What they should have done is follow the example set by the UK and taken these banks over and kept them until some improvement. This would have kept the competition in the market. There is definitely a lack of competition.' The Chair of the Victorian SME Committee agrees 'When we were getting competitive quotes for funding for an investment, we found that there would be two banks close together, and another two further apart, but the gap between the two groups was substantial. The goal posts have shifted and what tells me is that there is less competition out there.'

Some members stated that the root cause of the issues discussed in this paper is the lack of competition. This has resulted in a shift of power to the banks that is impacting on SMEs ability to negotiate competitive deals. As a Sydney-based member states, 'A lack of competition is still going to be a problem. Now with a number of the second tier banks gone, the major four will just sit back and dictate what they want. I think that there needs to be viable alternative sources because then the big four will actually have to work for their market share.'

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It appears that the lack of competition has also impacted the role of the finance broker. With resources dedicated to the increase in compliance and other bank requirements, coupled with the limited ability of some SMEs to appropriately assess finance alternatives, a number of members believe the role of the finance broker has been critical to these businesses. However, the loss of a number of second tier financiers has resulted in limiting the offer that the finance brokers have available, as a member who attended the Canberra roundtable observed 'They do not have the variety on offer to give alternatives and due to lack of competition, the offers are not as good as they used to be. Also, these brokers are at the end of the chain, so when they are applying on behalf of a customer, their application is, in some instances taking up to six to eight weeks to assess when previously it would have taken two weeks. Many small business owners rely on brokers, as they are doing everything for their business and therefore it is beneficial for them to use brokers.' This then raises the question as to whether SMEs have the ability, given these circumstances, to optimise their financing arrangements.

With the role of the finance broker limited and the lack of viable second tier financiers, the ability for business to switch financiers comes into question. Asa prominent Queensland member points out 'The government was well intended when it said a few years ago that it would make switching banks easier. However no one took account of the huge opportunity cost, particularly the government when the small business has to go and start looking around to get another finance facility. It's not only the business finance, but also the personal, all the ancillary finance and hire purchase etc., that needs to be changed and they just don't have the time, particularly now when the business owners have been required to work back in the business and have the extra burden of the additional information required by the banks. In addition, with small businesses required to use personal assets to secure loans, switching carries large costs.' Another member agrees 'This is good point on costs. There is a large cost associated with transferring banking – stamp duty in particular. So, the business owners then say, why should I spend $ 100,000 to transfer my banking across?' Therefore, potentially, the banks have certain leeway to leverage up their requirements on businesses in the form of fees, information, security and any other compliance requirements, which could be difficult to work around in a cost effective manner due to the lack of competition and costs associated with switching financiers.'

## 7. Economic Impact

The new tighter credit conditions have created many flow-on effects for SMEs. From our discussions with members, it becomes apparent that businesses are being faced with a number of different challenges during this time of transformation.

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Until recently, Australia had been in one of the lowest interest rate environments in history. One of the more surprising outcomes from the roundtable discussions was that during this low interest rate period, most members saw an increase in cost of funds for business. The Chair of the Victorian SME Committee stated 'It is more expensive to borrow in the low interest rate environment, than it was two years ago when rates were higher. The margins are higher, the fees have increased, even with more reporting and increased security' Another member went so far as to say that the banks had taken advantage of the situation and repriced risk that had previously been underpriced.

The banks may argue (reasonably) that this was due to the change in risk profile brought about from the GFC, however one member had a differing view to this point, claiming that the tight credit conditions allowed the banks to re-evaluate lending criteria, which in some instances highlighted that fact that they had lent to SMEs that never should have had finance in the first place. A Victorian public practitioner believes that the banks simply used situation to improve their positions 'I think that this has been a good opportunity for the banks to restructure loans, and if they had any gaps in terms of their security requirements, to make sure they tightened all those up. So I think that in the end it gave them an opportunity to clean their act up at a time when the customer was at their mercy, and would sign just about anything, especially if they needed any increase in facilities or additional funding.'

Whatever the reasons for increases in cost of funding, one of the more important outcomes from the increase in costs is the impact on cash flow. Feedback from our members suggests that with many SMEs already struggling from a reduce level of demand and tight cashflow, in an environment where finance has been difficult to access and/or service, their focus has shifted to assess alternative ways to finance their needs. This is a direct result of the current credit market conditions. As the Chair of the Queensland SME Committee concedes 'We are talking about access and access is not just the banks having money. The reality is if you put up the price of the drawdown, make it half a percent, if you put up the registration fee, if you put up the other charges for investigating and evaluating the business, if you have more in holding fees then that puts up the cost of finance. They have ratcheted up the physical margin of the loans, and they have gone security heavy, so now people just look at this picture and say equity is cheaper. It's cheaper to put my own money in, ask shareholders or frankly, just don't bother with the growth. So that's what has happened.'

Another member confirms that their bank have ratcheted up the equity requirement post GFC 'Subsequent to the GFC [although the facilities had been approved pre GFC], they are now requesting that we fund some of the construction from equity, despite the fact that they would have security threefold of the value of the construction value.'

A Queensland member provides insight into how increases in equity requirements are becoming common place to manufacturers out of necessity: 'If you are a manufacturer in this country and rely on work in progress (WIP), there is no one in this country that is financing WIP. So these businesses are faced with the task of building up equity to fund WIP and then hopefully finance under factoring for 30 days – most WIP is 90 days plus.'

Various members confirmed the view that tighter credit conditions are impacting the working capital of many SMEs. It was suggested that in some instances, the banks were actually dictating what terms and conditions the business is to impose on their suppliers. The Chair of the Queensland SME Committee states: 'We saw a $15 million increase in working capital needs in four months because between insurance companies and the banks they tightened all of our supplier's terms and therefore our creditors days went from 47 to 28. They said if you don't do it then we won't supply, it's as simple as that.' The member at the same round table adds: 'and our debtors days went from 47 to 62' Such dramatic shift in operational trading terms, at a time when many were unable to find finance, can only exacerbate cash flow issues, particularly with SMEs who are often undercapitalised anyway.

However not all the conversations were ‘doom and gloom’. A interesting perspective was provided by a representative of a large logistics/transport company. He shared with the Brisbane round table how his employer was supporting customers who have cash flow issues: ‘What I have seen is twofold, businesses struggling for working capital [even though they were highly capitalised] and businesses struggling for growth or tangible capital. I worked with our customers more to fund working capital, through the provision of more generous credit terms or extension of credit limits.’

The member went on to say ‘We had a lot of customers come back to us and say that they were cutting costs. I think some businesses have been a bit slower in this area and are only just now getting around to it. A couple things happened. A couple of customers came to us seeking help to shorten lead times in transit. Transit time is a big player in inventories. So, by shortening their lead times and shorten their transit times they were able to decrease their inventories and reduce their warehouse costs - that was mostly the east coast customers.

The east to west coast customers actually extended their lead times. They reduced their warehousing capacity by extending lead times through the utilisation of slower modes – the result was for most they gained two weeks free warehousing. So they could put half their warehouse into containers and instead of putting it on a train [which takes about two weeks], they put it on a boat to Perth, which takes about four weeks to Perth. The other thing we did was offer free warehousing at both ends and that was our way of increasing market share, as the smaller transport companies did not have the capacity to do so. This enabled them to either do away completely with the third party warehousing provider, or downsize their own in-house warehouse. In summary, we assisted our customers cutting costs, providing warehousing, inventory management and providing improved working capital (and hence cash flow) through increased credit limits and extended credit terms.’

A member working for a mining business also shared how his employer had used alternative financing arrangements to assist with working capital requirements ‘Another thing that we have done has accessed trade finance for our exports – as soon as the stock is on the water, then we receive the funds from the bank. The goods could be on the water for six weeks and then with the customer for another 60 days and then they pay us. This has helped cash flow quite a bit.’

In Sydney, a senior member suggested that SMEs should look towards alternative forms of finance to substitute bank funds that now carry heavy compliance burden and higher cost. The member spoke about funding the business from the debtor book. He believes that this is a viable method of finance, particularly where a SMEs has quality customers on their books. Although the member conceded that most financiers will only finance to a possible maximum of 80% of the value of the debtor book and that this type of finance usually does not come cheap, he made a valid point that for those SMEs who were looking for new facilities, then the barriers to entry on these types of loans are likely to be a lot lower than the financing requirements the banks are demanding.

One Canberra-based member showed real concern for the flow on effects from the tight lending conditions of the banks. In particular, he explained the impact on business as a result of banks now only lending on tangible security: ‘I have had three clients in the last twelve months that have attempted to purchase new businesses, all experienced business owners and they have had to pull out of the purchase as they could not access finance through the banks. The banks cannot quantify goodwill and are concerned that the goodwill will walk with the previous owner.’ He then reflects on possible further impacts to business ‘This then causes older entrepreneurs looking to retire with successful businesses, issues as the banks will not lend against goodwill and therefore they cannot sell their business. How are they going to sell the business?’ A Sydney member elaborated on the possible macroeconomic issue this may cause ‘The fact that SMEs are big employers and if they cannot sell their business they may just have to close their business down, then that’s jobs lost.’

Members agreed that most in this sector were not in a position to move forward with growth. The reasons given varied, however all agreed that the common issue was the uncertainty of the economic environment and the limited ability to access finance to support expansion. One Victorian member confirms ‘Our customers were not in growth mode. If they had plans to grow or invest they stopped. There were very few transactions in the market - people did not want to buy at even bargain prices’.

“Our customers were not in growth mode. If they had plans to grow or invest they stopped”.

A Queensland member observes how this lack of growth has other potential economic outcomes 'With SMEs not growing, the flow on effect is that the order books are stagnant, no growth in GDP, they are not expanding their business, if anything they are contracting their business and this impacts importers, manufacturers, and all businesses associated with SME business and then this becomes a slow stagnated process and it will take a lot to get this rebooted.'

## 8. Conclusion

The round tables on Access of SMEs to Finance has provided an important and interesting insight into the current challenges being faced by SMEs. The participating members have provided valuable contributions that should be considered by all members working within this sector and we thank them for this.

Members participating in the round tables were invited provided concluding comments. The following comments broadly represent the views put across at the round tables:

- 'I think it is returning to normal – the pre GFC conditions were never going to be sustainable set of conditions. We are now in the phase where you need to have very good creditability with the bank. With limited funding from offshore banks available, it's not surprising that there is no money in Australia for easy lending. I am not sure what the answer is, but I suppose what I am saying is that I am not surprised by where we are.'

- 'The banks have been in a state of fear for about two years. The first year they were in a state of fear that they would collapse. Through that fear they started to put a lot of pressure on their clients, in particular the corporates, because that was where a lot of the money was outstanding. The corporates then responded to that by going to the equities market and paying back a significant proportion of the debt. So, when the banks say they have money to lend, that's right as a lot of their book has been repaid. The banks are now concerned that medium size businesses will also repay and this will mean that they will have too much cash. But the flip side to that is that they are too scared to lend because we are now passed the phase of 'everyone chip in' to get past the 'Oh my goodness' moments, to now 'Who's fault was it?''

- 'Most SMEs have looked at it now and said being in a much more conservative debt/equity position makes sense. When tricky stuff comes your way, you don't have as much debt on the books because it is too pricy when the trouble comes.'

- 'Some of my clients are looking to stay in business only until they can sell and retire – there is no longer joy in running a small business – too much regulation, not enough return. They cannot get good staff to run the business. It is too much hassle and therefore they are not expanding. Most just want to cut back.'

From these views, it is apparent that the times have changed for SMEs and that a 'new normal' is probably going to be what they will have to work with.

| It is apparent that the times have changed for SMEs and that a 'new normal' is probably going to be what they will have to work with. |
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# APPENDIX B

## Codes of conduct on small business banking – comparison between jurisdictions

The following compares the concepts raised in the final report of the inquiry into *Access of Small Business to Finance* and whether those concepts are covered in the existing ABA Code of Banking Practice and the small business lending codes of comparable jurisdictions. Where the concept is covered in whole or part, the actual reference from the document is included to assist the reader understand how the concept is covered. Where in CPA Australia's opinion, the concept is not covered in whole or part by the ABA Code of Banking Practice (only), then this is stated in ***bold*** and ***italics***..

| **Concept** (as taken from para 7.11 of the report from the inquiry into *Access of Small Business to Finance*) | **Australia - Code of Banking Practice** | **Australia - Banks and small business working together** (withdrawn upon the release of the Australian Code of Banking Practice in 2004) | **UK – The Lending Code** | **UK – *A Statement of Principles – Banks and micro-enterprises – working together*** | **Canada – Model Code of Conduct for Bank Relations with Small and Medium-Sized Businesses** | **Ireland - Code of conduct for business lending to Small and Medium Enterprises** |
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| **Banks recognise the need for open communications with their SME customers.**<br><br>This includes banks:<br>○ outlining joint responsibilities<br>○ ensuring all information provided about a credit facility is clear and comprehensible<br>○ key items are brought to the attention of the borrower. | - clause 2.1(b)(i) promote better informed decisions on banking services by providing effective disclosure of information<br><br>- clause 2.1(c) – provide general information about the rights and obligations that arise out of the banker and customer relationship<br><br>- clause 10.1 – | - *Overview* - to promote an environment of open communication between banks, their small business clients and advisers<br><br>*Overview* – important elements in developing a positive relationship include the exchange of information between small business and | - para 13 (second dot point) – customers will be given clear information about accounts and services, including terms and conditions<br><br>- para 54 – the information must be provided before the client is bound by contract<br><br>- para 55 – customers should know that an overdraft is payable on | - *Introduction* – the relationship between a bank and a customer is a partnership – it needs careful thought and openness on both sides.<br><br>- 1(a) – the bank will confirm the conditions of any facility in writing<br><br>- 1(c) – banks will co-operate with advisers to explain loan facilities | *Openness – second dot point* – banks will provide customers with documents, including contracts that are written in clear and understandable language<br><br>*Openness – third dot point* – banks recognise the need for open communication with their customers. Banks will outline joint responsibilities | *The Code's objectives – second dot point* – promote fairness and transparency in the treatment of SMEs by banks<br><br>Para 18 – all information provided under the Code is to be clear and comprehensible and that key items are brought to the attention of the borrower<br><br>Para 25 – a bank must issue statements at |

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| | banks will expeditiously provide to you, or any person on request the terms and conditions, full particulars of standard fees and charges and particulars of applicable interest rates<br><br>- clause 10.2(e)(v) – the advisability of you informing the bank promptly when you are in financial difficulty<br><br>- clause 10.2(e) (vi) - the advisability of you reading the terms and conditions<br><br>- Clause 15.1- disclose the existence of any application fee or charge and whether such fee or charge is refundable if the application is rejected | their bank. For small business, this includes providing a bank with a business plan, financial information, comparisons of actual versus budgets, and informing banks as soon as possible on adverse trends. Banks will have available information on terms and conditions – such terms and conditions should be easy to understand and should be available before (or as soon as practicable after, the contract for the banking service is made | demand<br><br>- para 129 – customers should be provided with any product terms and conditions and be encouraged to read them<br><br>- para 130 – all terms should be written in clear and intelligible language | | | regular intervals to the borrower |

| **For those SMEs applying for credit, the banks should make the following information available:** | | | | | | |
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| ○ *directions on how to apply for credit* | - Clauses 10.2(e)(1) and 13.1(a) – account opening procedures<br><br>***Uncertain as to whether these clauses cover credit*** | | | | *Applications for credit – second dot point* – banks will make available directions on how to apply for credit | |
| ○ *an explanation of the requirements needed to obtain bank credit* | ***No mention*** | - *We will have available information on terms and conditions* – banks will have available the required security and guarantees, existing or new, including any minimum values<br><br>- *We will assess an application for financial accomodation in a professional manner* –the document provides a list | - para 49 – Code includes a list factors banks will assess before lending money to microenterprises, including cash flow and business plan<br><br>- para 51 – if a current account is required before lending, this should be explained<br><br>- para 126 – if security is required, bank needs to confirm in writing what | | *Applications for credit – 3rd dot point* – Banks will make an explanation of their requirements needed to obtain bank credit available to each client | |

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| | | of factors that banks will take into account to determine whether a business will be able to meet their financial obligations – eg cash flow forecasts and business plan. Where a decision can not be made, a bank will undertake a range of activities such as notify you of additional information requirements | security is needed and why | | | |
| ○ *an estimate on how long it will take before a credit decision will be made.* | ***No mention*** | | | | *Applications for credit process – 5th dot point* – banks will provide an estimate of how long it will take before a credit decision is made | Para 3 – banks must inform borrowers how long the credit application process is considered likely to take |
| **Each application for credit by an SME should be judged on its own merits** | Clause 25.1 – before offering a credit facility, banks will exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and in | - *We will assess an application for financial accomodation in a professional manner* – document provides a list of factors that | Para 43 – before lending any money, a bank should assess whether the customer has the ability to repay | | *Credit approval – first dot point* – each credit application will be judged on its own merits | *The Code's objectives – first dot point* – The Code is to help facilitate access to credit for sustainable and productive business propositions<br><br>Para 2 – a bank |

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| | determining the client's ability to repay. | banks will take into account to determine whether a business will be able to meet their financial obligations – eg cash flow forecasts and business plan | | | | must consider each application for credit on its own merits<br><br>Para 5 – a bank must have appropriate procedures in place to assess a loan application<br><br>Para 13 – a bank must make each decision to withdraw or amend credit on its merits. |
| **When a credit application is approved, the bank should inform the customer about the terms and conditions of financing**<br><br>This includes information on:<br>○ Default fees, charges and interest rates<br>○ further information needed by the bank both before and after the loan is granted. | - Clause 10.4(a) – where relevant, standard fees and charges will be included in the terms and conditions<br><br>- clause 10.4(b) – where appropriate, the method by which interest is calculated and the frequency of repayment will be included in the terms and conditions<br><br>- Clause 10.4(c) – where relevant, the terms and | - *We will have available information on terms and conditions* – banks will inform clients through the terms and conditions of a number of things including the nature of the fees and charges, interest rate, when the bank intends reviewing the security and security requirements, when the facility will | - para 52 – before entering a contract clients should receive from a bank clear information on whether there are qualifying criteria for accessing an overdraft<br><br>- para 53 – as part of pre-sales information, the customer must be provided details of interest rates to be applied and if relevant, the method for calculating actual interest | -1(a) – The document lists the conditions that will normally be included, including the amount and purpose of the facility<br><br>- 1(d) – the bank will in writing set out what information is required by the bank and when. Examples of information that may be needed include comparisons of forecasts versus actuals, business plans and cash flow | *Credit approval – second dot point* – on approval of a credit application, the bank will inform the customer about the terms and conditions, including documentation needed before the loan is granted | Para 6 – where a new application is approved, a bank must provide the borrower with confirmation of the credit facilities, terms and conditions (including what happens in cases of default), details of fees, charges and interest rates.<br><br>Para 19 – banks must provide information to borrowers outlining terms, conditions, fees and charges, including a general description of collateral policies |

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| | conditions will include how clients will be notified of changes to the terms and conditions, fees and charges and interest rates<br>- clause 10.4(g) – where relevant, the terms and conditions will include information on repayment details<br>- clause 12 – the bank will make available interest rates and standard fees and charges on credit service products<br>***There is no information in the code on whether the bank should inform the small business on further information needed before a loan is approved or after a loan is approved*** | need to be repaid on demand, the minimum information required at a review and the frequency of such reviews and the need for the client to inform the bank of any problems. | rate.<br>- para 55 – in a facility letter or terms and conditions, customers should be told if an overdraft is repayable on demand<br>- para 132 – customers should be told in the terms and conditions how they will be notified of changes to terms and conditions | forecasts | | |

| **If credit is declined, the bank should inform the customer about:** | | | | | | |
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| ○ *the main reason(s) for the decision* | ***No mention*** | - *We will assess an application for financial accomodation in a professional manner* – bank will provide at the client's request, principal reasons for declining a credit application | - para 56 – if a customer's overdraft request is declined, the bank should explain the main reason why if asked<br>- para 116 – if a customer's loan application is declined, the bank should explain the main reason why if asked | - 1(e) – if asked, a bank will explain the key reasons why a facility has not been offered | *If credit is declined – second dot point* – if an application for credit is declined, the bank will inform the main reason/s for the decision | Para 12 – where an application for credit is declined, the bank must explain clearly to the applicant the reason/s for the decline. |
| ○ *the requirements necessary for the bank to reconsider the application (if applicable)* | ***No mention*** | | | | *If credit is declined – third dot point* – if an application for credit is declined, the bank will inform the applicant the requirements necessary to reconsider the credit application | |
| ○ *information on alternative sources of financing* | ***No mention*** | | | | *If credit is declined – fourth dot point* - If an application for credit is declined, the bank will inform the applicant of alternative sources of finance | |

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| **Sometimes customers will experience significant change. In these circumstances, banks should carefully review the existing arrangement before deciding what action (if any) should be taken** | ***No mention*** | - *We may seek from you additional information and/or an independent review* – if a business is unable to resolve its problems, the bank may request additional information and/or an independent review. If a bank can not continue to provide support, the bank will give an explanation of that decision | - Para 13 – fifth dot point (in part) – banks will act sympathetically and positively when considering a client's financial difficulties<br><br>- Para 137 – the first step when a bank becomes aware of a client's financial difficulties (through their own systems) should be to try to contact the customer to discuss the matter.<br><br>- Para 141 – if a bank becomes aware via their existing systems that a client may be heading towards financial difficulties, the bank should contact the client | | *Changing circumstances in the credit relationship – first dot point* – where a customer experiences a significant change in their business, including financial difficulty, banks will carefully review the existing arrangement before deciding if any action should be taken | |

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| **If there are changes made to the terms, conditions, reporting requirements, fees or lending margins of an existing SME credit facility, banks should inform the customer/s as soon as possible.**<br><br>Banks should provide clients with a minimum of 15 days' notice of such changes (unless there are exceptional circumstances). | - Clause 18.1 - when making changes to a fee or charge or varying the method by which interest is calculated, the bank will provide written notice at least 30 days before the change takes affect<br><br>- clause 18.3 – other variations in terms and conditions will be notified no later than the day on which the variation takes effect<br><br>***For variations in terms and conditions, Australian banks only need to notify the small business on the day on which the variation takes effect, not 15 days prior to the change taking effect.*** | - *We will have available information on terms and conditions* – the terms and conditions will include the manner in which clients will be notified of changes to terms and conditions and interest rates<br><br>- *We will provide notice of variations to terms and conditions* – when there is a variation to a term or condition, interest rate or fee, clients will be provided notice no later than the day on which the variation takes effect.<br><br>- *We will confirm any changes to your contract* - where the bank and customer | - Para 13 – third dot point – (in part) – clients will be informed about changes to the interest rates, charges or terms and conditions<br><br>- Para 62 – within 3 working days of a rate change, banks should inform the public of that change through public notices<br><br>- Para 65 – banks should tell clients personally at least 30 days before increasing an overdraft charge or introducing a new overdraft charge<br><br>- Para 134 –if a change to terms and conditions is to the customer's detriment, the bank should personally inform the client at least 30 days prior to the | | *Changing circumstances in the credit relationship – last three dot points* – if there are changes in the credit relationship, banks will inform customers as soon as possible about the need for on-going additional information and banks will give customers a reasonable opportunity to provide this information.<br><br>Under normal circumstances, banks will provide their customers with a minimum of 15 days notice of any bank actions taken because of a change in the credit relationship.<br><br>Banks must inform clients when changes are made to the terms, conditions, fees or lending margins that are specific to a client's credit relationship. | Para 14 – where a bank decides to withdraw or amend credit facilities, it must notify the borrower promptly of the proposed withdrawal or amendment and the reasons.<br><br>Para 20 - a bank must inform the borrower in advance of making changes to the terms, conditions, fees and charges (but no time frame)<br><br>Para 23 – where a bank changes the interest margin on a credit facility, it must notify affected borrowers promptly of such a change |

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| | | agree to a change to the terms and conditions, the bank will confirm any changes made or provide a copy of the renegotiated contract as soon as practicable | change<br><br>- Para 135 – where the change to the terms and conditions is not to customer's disadvantage, the change can be made immediately and the client notified within 30 days of change | | | |
| **A bank should not impose unreasonable collateral requirements for providing credit facilities.** | ***No mention*** | | | | | Para 7 – a bank must not impose unreasonable collateral requirements, having regard to the value of the credit being offered |
| **A bank must not impose unreasonable personal guarantee requirements on borrowers** | Clause 28 *Guarantees* (except 28.14, where the principal debtor is a small business) –<br><br>***Clause does not fully cover the concept*** | *We may ask for guarantees* – (does not address concept) | Para 123 – banks should not take an unlimited guarantee from an individual other than to support a customer's liabilities under a merchant agreement. | - 1(a) – banks will always commit to first considering business assets before determining whether personal assets are appropriate as security | | Para 8 – a bank must not impose unreasonable personal guarantee requirements on borrowers. |

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| **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.** | ***No mention*** | | Para 127 – if asked, a bank should tell a client under what circumstances they will agree to release security | | | Para 11 – a bank must promptly at the request of the borrower, return any security held when all facilities for which the security is pledged have been repaid |
| **A bank must have in place procedures for handling of arrears cases.** | Clause 25.2 – banks will assist small business overcome financial difficulties with any credit facility<br><br>***Could have more detail on how banks will manage arrears cases as this is important.*** | - *We may seek from you additional information and/or an independent review* – if a business is unable to resolve its problems, the bank we request additional information and/or an independent review. If a bank can not continue to provide support, the bank will give an explanation of that decision | - para 140 – sets out the potential indicators for a bank of a micro-enterprise going into financial difficulty<br><br>- Para 141 – if a bank becomes aware via their existing systems that a client may be heading towards financial difficulties, the bank should contact the client<br><br>- para 143 – banks should make available to clients straightforward information on their procedures and systems for dealing with clients in financial difficulty | - 2(a) – banks will consider any financial difficulties a business has sympathetically and positively and if a bank has concerns about a business, the bank will let you know in writing and offer to discuss these with the business personally. The bank will after speaking with a business, also seek to agree on terms of their support for the business. The clause includes examples of what may cause concern about a business to their | | *The Code's objectives – third dot point* – the aim of a bank in dealing with arrears cases will be to assist borrowers meet their obligations or otherwise deal with the situation in an orderly and appropriate manner.<br><br>Para 16 – banks must have in place procedures for the handling of arrears cases. |

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| | | | - para 166 – where a bank considers the client’s financial circumstances to be exceptional and unlikely to improve, the bank may consider writing off or not pursuing part or all of the client’s debt – the debt may still a registered as a default with the credit agencies. | banker<br>- 2(b) – the bank may ask for more financial information from a business before actions are considered<br>- 2(c) – the bank may suggest an independent review of a business<br>- 3(b) – banks will support a rescue plan for a business in financial difficulty if the bank believes the plan will succeed<br>- 3(d) – a final decision on not continuing to support to a business is made at a senior level of the bank on the recommendation of the relationship manager | | |

| **Without prejudicing a bank's regulatory and/or legal obligations and legal rights, a bank must:** | | | | | | *Scope – last paragraph* – nothing in this Code prohibits a bank from acting with all necessary speed in the case of liquidation, fraud etc |
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| ○ *give the borrower reasonable time, to resolve the arrears case* | ***No mention*** | - *We may seek from you additional information and/or an independent review* – if a business is unable to resolve its problems, the bank may request additional information and/or an independent review. If a bank can not continue to provide support, the bank will give an explanation of that decision | - para 146 – bank's should explore a range of options with the client | | | Para 17(a) – without prejudicing a banks legal rights and obligations, a bank must give a borrower reasonable time to resolve an arrears problem |
| ○ *endeavour to agree an approach that will assist the borrower to* | ***No mention*** | | - para 147 – the initial arrangements for repaying an outstanding debt should be in | - *Introduction* – if a micro-enterprise gets into difficulty and the bank becomes aware | | Para 17(b) - without prejudicing a banks legal rights and obligations, a bank will endeavour to agree an approach |

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| *resolve the arrears problem* | | | writing<br>- para 148 – repayment plans may be subject to regular review | of it, the bank will discuss with the customer and advise on what action may be necessary to help the business to return to success. When a bank tells a business about its concerns over the viability of the business, the bank will be as relevant and specific as possible<br>- 2(a) – a business that is in trouble should speak to their bank at it earliest opportunity so that terms for support can be agreed | | that will assist the borrower resolve an arrears problem |
| ○ *advise the borrower of any possible impact of the default on the other accounts held by the borrower* | ***No mention*** | | | - *Introduction* – where the business is not viable as structured, formal insolvency procedures may have to be considered to restructure or wind down the business | | Para 17(c) - without prejudicing a banks legal rights and obligations, a bank must advise the borrower of any possible impact of the default on other accounts held by the borrower |

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| **A bank should explain to borrowers the basis on which interest is calculated.** | - Clause 10.4(b) – terms and conditions will, where appropriate include the method by which interest is calculated and the frequency of debiting or crediting | *We will have available information on terms and conditions* – the terms and conditions will include the method by which interest is calculated | - para 53 – the customer must be provided, where relevant with the method for calculating the actual interest rate<br>- para 59 – for overdrafts, if asked, subscribers should give a full explanation of how interest is worked out | | | Para 22 – a bank must explain to borrowers the basis on which interest is calculated. |
| **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** | ***No mention*** | | - para 162 – if a client does not cooperate with a bank, a repayment plan can not be developed, therefore the bank may proceed with normal debt recovery procedures | - *Introduction* – if the business does not ask for or act on advice or take part in meaningful discussions, the bank may have to take action to protect its own position<br>- 3(c) – if the bank does not consider that a rescue plan will succeed, the bank will explain the reasons why and help the customer consider other options | | Para 15 – Nothing in this Code prohibits a bank from acting with all necessary speed to withdraw credit where there is reasonable suspicion of fraud, etc |

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| | | | | - 3(e) – if after reviewing all the options, appointing an administrator is considered the most appropriate action, the decision will be confirmed within the bank at a senior level | | |
| **Other** | Clause 39.3 – This Code replaces the “*Banks and Small Business Working Together – A Set of Principles’*<br><br>This Code is a mix of principle based clauses and prescriptive clauses.<br><br>Clause 21.2 – prior to granting a foreign currency loan, banks will give you a general written warning on exchange rate risks and the products to manage such risk | These Principles were withdrawn when the new Code of Banking Practice began. It can not however be said that the Principles were incorporated into the Code | This Code is set and monitored by an independent standards board called the Lending Standards Board. The standards of behaviour for deposit services is set by the UK Government’s Financial Services Agency. | This Statement of Principles is followed by all British banks that subscribe to the Lending Code and provides micro-enterprise funding. Should therefore be read in conjunction with the Lending Code. | - *Preamble* - Canada’s chartered banks recognise the important role that small and medium-sized enterprises (SMEs) play in Canada’s economy. The chartered banks also recognise that they have an important and unique role to play in fostering the growth of SMEs in Canada. | Unlike the other codes mentioned in this comparison, this Code is set and regulated by the Irish Financial Services Regulatory Authority |