NARGA

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30 March 2010

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Email: economics.sen@aph.gov.au

Dear Mr Hawkins,

Access of Small Business to Finance

NARGA represents the independent retail grocery sector comprising over 5000 stores employing more than 225,000 people.

The independent grocery sector now comprises less than 20% of the national grocery market, yet provides essential supplies to thousands of regional and remote communities, particularly those considered too small to be of interest to the major supermarket chains, as well as providing competitive pressure to those chains through larger stores in metropolitan and regional centres.

The ongoing viability of the independent network is ***dependent on the competition framework within which they must operate, which include banking competition factors and other factors affecting small business access to finance***.

Even though all political parties express their support for small business, the importance of small business to the Australian economy tends to be underestimated and the political support so often expressed rarely translates to concrete action.

Whilst the market capitalisation of the ASX in 2006 was around $1.4 Trillion (in a $1.0 trillion Australian economy) and funds under management were around $1.3 Trillion, family owned business represented a capital value of around $4.3 Trillion.

It is well recognised that SMEs provide the greater proportion of employment opportunities in Australia as evidenced by the following chart taken from a PriceWaterhouseCoopers study prepared for NARGA:[1]

[1] The economic contribution of small to medium-sized grocery retailers to the Australian economy, with a particular focus on Western Australia, PriceWaterhouseCoopers, June 2007

Characteristics associated with market participants in the grocery industry

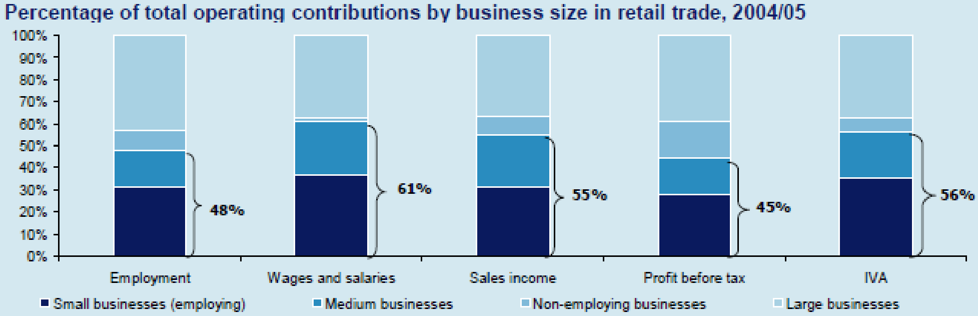
Market Participants	% Turnover	Stores	Turnover	FTEs	FTEs per store
Top 2 – Woolworths & Coles	78-79%	1,493 (24%)	$59 billion	108,833 (43%)	65
Top 4 – Woolworths, Coles, ALDI & Pick 'n Pay (Franklins)	80%	1,683 (27%)			
Independent grocery banner groups – IGA, FoodWorks, Ritchies	18.9%	2,140 (35%)	$15 billion	144,267 (57%)	32
Other independent grocery retailers	1.1%	3,291 (53%)			
TOTAL	**100%**	**6,183**	**$74 billion**	**253,100**	

The same is true for the retail sector as a whole, as is shown below:

Box 4: Contribution to retail trade by business size

The graph below shows the proportion of employment, total wages paid, sales generated, etc. in the retail trade sector according to business size. The percentages in bold indicate the percentage contribution of SMEs (excluding non-employing business) to each variable of interest.

Percentage of total operating contributions by business size in retail trade, 2004/05



Source: ABS Cat. 81550

Large businesses (ie MGRs) account for a sizable contribution to the retail industry, however, cumulatively, SMEs account for a proportionately greater value given their lower market share.

Employing SMEs contribute a greater proportion of wages and salaries and Industry Value-Added (IVA) than the level of employment or profits they generate. This is indicative of the important role that SMEs play in promoting wealth redistribution and local economic prosperity through recirculation of a larger proportion of sales income at a local level.

This graph also provides a number of insights into the contribution of SMEs (excluding non-employing businesses):

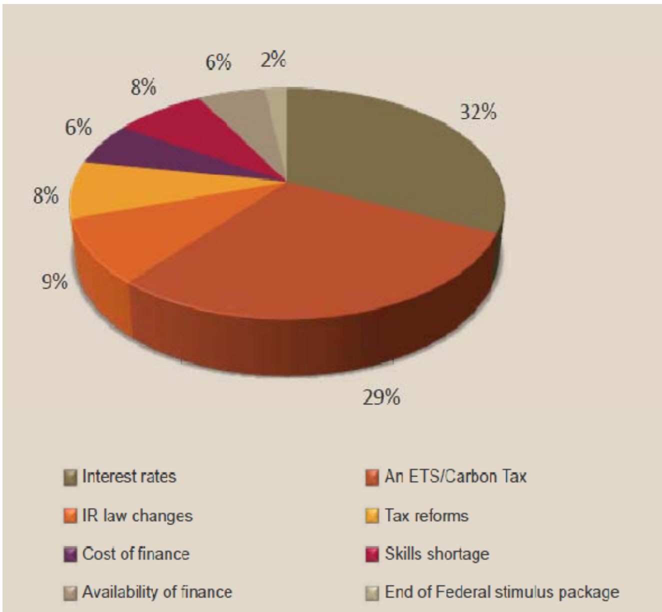
- SMEs employ approximately 48% of all employees and pay approximately 61% of all wages and salaries paid in the retail trade sector, whilst large businesses employ approximately 43% of all employees and pay an even smaller proportion, 38%, of all wages and salaries paid in the retail trade sector
- SMEs generate 45% of retail trade sector profits before tax, only slightly larger than the proportion of sector profits generated by large businesses (39%). This highlights that a greater proportion of sales generated each period are distributed by SMEs in the form of wages, salaries and to local service-providers (eg accountants, lawyers, printers, local papers, etc) than by large businesses. However, large businesses distribute higher profits to shareholders than SMEs deliver to owners for reinvestment
- SMEs generate 55% of sales and 56% of the IVA of the retail trade industry – greater proportions than their employment contribution

It should be noted here that it was employment in the SME sector that held up best during the recent economic downturn.

The contribution to the economy by SMEs is in spite of the reality that the economic 'playing field' is far from level.

A recent survey conducted on behalf of Council of Small Business Organisations of Australia (COSBOA)[2] showed that a significant proportion of SMEs were concerned about the availability of finance and the cost of finance.

ISSUE OF MOST CONCERN TO BUSINESS



Within our membership group we find that those entities that are well established and have equity in real property and/or have an established business history and cash flow have little difficulty in retaining bank support or extending loans. Funding is more difficult to obtain for start ups or for smaller and less 'cashed up' entities.

Whilst access to funds is a problem, the cost of funds is another disadvantage borne by SMEs.

Anthony Sibillin in an AFR Blog dated 17 March 2010 (highlighted in the January 14 issue of BRW) quotes PricewaterhouseCoopers as follows:

'Despite their current round of advertisements professing empathy for the plight of small businesses, the big four banks appear to be using the global financial crisis and the catch-all excuse of 'higher funding costs' to squeeze as much as possible out of them'

'The profit margin on a small business loan could now be as high as 40 per cent, one of Australia's most respected bank watchers, Brian Johnson, says. In comparison, banks sweated an average 13.1 per cent from shareholders' equity in the 2008-09 financial year, PricewaterhouseCoopers calculates.'

It would appear that the banks have not as yet unwound the tight lending criteria established during the global financial crisis with 35% of businesses surveyed in the COSBOA survey saying access to finance was difficult.

[2] Back to Business Survey 2010, COSBOA

Highlighting the problems faced by small business Treasury secretary Ken Henry made the following points during an address to financial services professionals in Canberra on March 15:

- Banks had increased their net interest margins by 0.25% during the financial crisis;
- The banking industry had become more concentrated over this period and, as a result, there is evidence of a diminution of competitive pressure;
- The share of housing finance approvals by the five largest banks has increased from about 60% in 2007 to about 82% in 2009;
- Housing credit had grown a robust 8.2% during 2009 but business credit had shrunk dramatically
- Small business credit has fallen.

The Australian Chamber of Commerce and Industry has also expressed concerns about small business access to finance, agreeing with Joseph Healy of NAB that the focus on home lending at the expense of productive lending to business will come at an economic cost.[3]

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

A review of current bank interest rates as regularly advertised in national dailies shows a substantial difference in the rates being charged to home owners as opposed to businesses. This is in spite of the fact that business loans are often secured through mortgages on private property suggesting that the risk profile is not all that different.

We suggest that, in cases where such security is provided, any interest rate differential needs to be justified.

There are other factors which make the categorisation by banks of loans secured by mortgages on private property a 'business' loan. Such loans escape the controls imposed by consumer credit rules at state and federal levels.

Access to bank finance is particularly important to SMEs as they do not generally have access to other sources of finance available to larger entities which can tap equity markets through the ASX or access funds available through non-retail bank channels. In many cases such sources of funds are cheaper than those available to SMEs, putting smaller businesses at a competitive disadvantage. Note that the larger businesses also have the ability to access funds from banks at preferential rates, again at a competitive disadvantage to small businesses.

Lack of real competition between banks also means that SMEs are disadvantaged in the credit / debit card payment system, bearing a disproportionate burden of the system costs through higher transaction and transfer fees. These higher costs reduce the ability of SMEs to compete with larger competitors.

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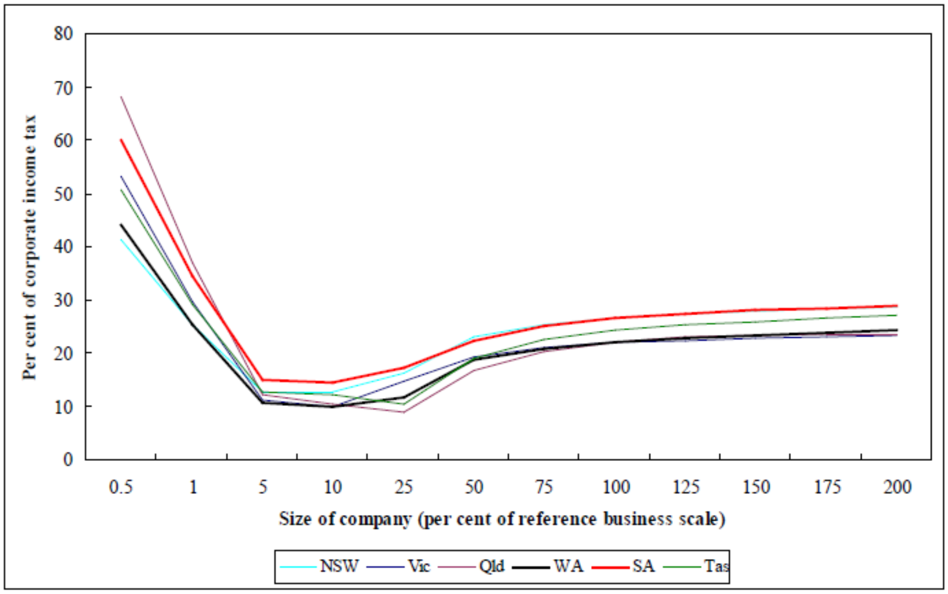
[3] AFR March 3, 2010

Whilst this Inquiry is focusing on the availability of funds to small business – the inflow of capital – a related issue is the outflow of funds. One factor we would like to highlight is the use of businesses as a 'cash cow' by governments at all levels – a factor that impacts small business disproportionately.

A recent report by the Institute of Public Affairs[4] shows that state government imposts have a disproportionate impact on small business.

State tax liability as proportion of corporate income tax, 2009



As at 31 December 2009. Based on state business tax liabilities borne by a reference business. Including payroll tax, land tax, land transfer duty, insurance duty, motor vehicle duty and motor vehicle registration fee. WA taxes include Metropolitan Regional Improvement Tax (MRIT). Including workers' compensation premiums.
Source: IPA State Business Tax Calculator.

The higher impact of state taxes and charges on small business shown in the above graph is mainly due to the fact that many state charges are flat – they do not take the size of the business into account.

As far as state charges are concerned it is evident that when charges to business are compared with charges for similar services paid by individuals or households, businesses tend to have to pay more than do households for the same service.

Examples include:

- Land transfer duty
- Motor vehicle registration and taxes
- Water rates
- Insurance duty

At the local government level small businesses pay disproportionately higher rates and are subject to a wide range of business related charges not levied on households or individuals.

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[4] State Business Tax Calculator Fact Sheets, Bearing the Burden, The Size and Impact of State Government Business Taxes – IPA December 2009

The practice of skewing state and local government taxes and charges away from individuals or households and towards business translates into an indirect tax on individuals levied through the cost of the goods and services they purchase.

Not only is such a tax hidden, it is less than optimally efficient. It also unnecessarily burdens business and further distorts the competitive environment.

We have in the past highlighted the problem of market concentration in the retail grocery sector and how that concentration gives the major chains a degree of market power that distorts the market for the supply of groceries. We have also raised market concentration concerns in relation to the retail leasing market. Both of these factors result in proportionately higher costs for small businesses in the retail grocery sector and in retailing generally.

Taking these factors together with small business restricted access to funds, higher cost of funds and higher EFTPOS/Credit card costs (in part due to market concentration in the banking sector) and we have a situation where small business in Australia does not appear to be getting the 'fair go' it deserves nor the support of government that is always being promised.

Clearly the current regulatory environment is not generally supportive of small business. For example, the Trade Practices Act 1974 (the TPA) in its current form and as administered by the ACCC has not been able to prevent concentration in key markets. Nor has it been able to address the cost distortions that result from such a level of concentration.

Without change this situation is not going to improve. Current trends towards more concentrated markets and greater SME disadvantage will continue.

One glaring difference between the TPA and equivalent regulatory regimes in other major economies is the absence of a prohibition of price discrimination. Price discrimination clauses in trade practices regimes prohibit the charges of different prices for providing the same goods or services to different clients.

The UK Competition Act 1998 expresses this principle quite clearly.

The Act prohibits agreements which:

> *'(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage'*

It is clear that small business is currently at significant competitive disadvantage – and the reintroduction of a price discrimination clause in the TPA would help address this.

To illustrate this point we quote from a book [5]written by Wright Patman on the US Robinson-Patman Act which added price discrimination clauses to the body of trade practices law in the USA:

- *'If we had to provide a single statement as to the economic tests of an objectionable price discrimination, we would have to say that it is a discrimination that has a substantial tendency to divide the market shares in ways different from the division that would take place if efficiency were the sole determinant of this question' (p.54)*

- *Summing up the adverse tendencies of discriminatory selling, then we can say that the general tendency is to give larger sellers an advantage over smaller competing sellers and,*

[5] Complete Guide to the Robinson-Patman Act, Wright Patman, Prentice Hall 1963

again generally, to give larger buyers an unearned advantage over smaller competing buyers.' (p.55)

- *'Price discrimination favouring preferred buyers presents a danger to the competitive enterprise system which is inconsistent with the policy of the price discrimination statute. Firms can abuse their superior market position and engage in discriminatory practices that eliminate small suppliers and small retailers from the competitive scene (Conclusion of the House Committee on the Judiciary)' (p.206)*

- *'Congress...has found that the effects of price discrimination are substantially to lessen competition and to tend to create monopolies. In other words, Congress has found the practice of price discrimination to be anticompetitive – and it has done that on each occasion when it studied the details of the factual information about the practice of price discrimination. These legislative findings have been made despite arguments by the advocates of price discrimination that it is a form of competition and that the Robinson-Patman Act and other similar legislation are antidiscriminatory. Reaffirmation by the Congress of its earlier findings on these matters would help make more effective our antitrust legislation against price discrimination.' (p.207-8)*

The symptoms are clear. So is the remedy.

We would suggest that the problem of access to funds currently experienced by small business is part of a wider pattern of disadvantage affecting SMEs and has as its basis the lack of a proper regulatory framework that supports competition.

It is clear that, in spite of the constant affirmations of support for small business from all parts of the political spectrum, Australia there is still much to be done before small business feels the benefit of that support.

Please contact us should you require further details.

Yours sincerely

Ken Henrick
Chief Executive Officer