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Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

By on-line submission through https://senate.aph.gov.au website

Dear Sir / Madam,

Submission to Inquiry into Access of Small Business to Finance

I am a solicitor working in a law firm in regional Victoria, as well as being a registered tax agent. I have worked as a solicitor for over 12 years, 11 of which have been in country Victoria.

Over the past 2 years, I have observed a significant reduction in the access of small business to finance.

In my submission, I shall respond to the 6 matters raised in the inquiry's investigation.

Paragraph (a) the costs, etc of finance

Over the past 2 years, there has been a significant reduction in the availability of finance to small businesses due to:

1) The reduction in the number of available lenders following the Global Financial Crisis ("GFC"), as many lenders have either ceased business altogether in Australia or ceased lending to small business;
2) The GFC (caused partly by lax lending standards where funds were lent to private borrowers without the means to repay) has caused an over-reaction away from borrowers perceived to be "high risk" such as many small businesses.

Even for small businesses who can find a private lender or bank willing to lend to them, the terms and conditions of finance are much stricter, as well as the lending policies and practices imposed on small businesses. The cost of finance is also much dearer due to the reduction in competition caused by the GFC.

Paragraph (b) the importance of reasonable access, etc.

In my view, reasonable access to funding to support small business expansion is vital to the continued well-being of the Australian economy. Small business is Australia's main employer and the best driver of growth. Unlike government and large business, small businesses have to be efficient and well-run to survive. The capital invested in small business is thus likely to be more efficiently utilised to employ the maximum number of people.

The need to maximise employment in Australia is vital for the personal and social well-being of all Australians.

From the government's point of view, maximising employment will boost income tax revenue and reduce expenditure on social security, both of which will help reduce the current government deficit and increase the amount of any future surpluses.

Paragraph (c) competition and the government guarantee

As mentioned above, there is now significantly less competition in the area of small business lending.

The Government's banking guarantee helped reduce competition by providing an advantage (primarily to the main 4 trading banks) by providing them with a large inflow of domestic deposits at the expense of the non-bank sector.

The non-bank finance sector had been a major lender to small business but as their retail deposits were being transferred to the banks, it placed pressure on these lenders to reduce their exposure to small business loans and in some cases caused the closure of these lenders.

The Government bank guarantee has now (thankfully) been removed, but the damage has been done. Smaller banks such as BankWest (which had been targeting small business) have been sold to larger banks (like the Commonwealth Bank). There has not been any major growth in non-bank lending. Hence, the market is now dominated by the main 4 trading banks. Through the GFC, they have been able to maintain multi-billion dollar profits, and this is only likely to continue in the future due to their oligopolic control of the small business finance sector.

Paragraph (d) opportunities & obstacles, etc

There are real obstacles in the current marketplace to re-introduce proper competition into the small business finance sector so as to reduce the cost of small business finance and moderate the terms and conditions of such lending.

There are significant cost and market barriers preventing a large enough small business lender from entering the market, advertising their offering and compelling the major banks (through competition) to offer finance to small business on better terms.

It may be possible for governments to legislate to require the banks to offer such finance and mandate easy terms. However, I do not believe such a course of action is healthy for either the banks or small business in the long run. The legislation will either be so lax that it is ignored by the banks, or so strict and prescriptive that basic prudential lending practice would be ignored and money is lent to unsound businesses who will not be able to repay the loans, leading to a new GFC.

I submit that the only feasible way forward is to boost competition through the establishment of a government development bank (similar to the old Commonwealth Development Bank) which will enter the market and become a major player in lending to small business.

In making loans, the development bank should adopt basic prudential lending practice (such as examining the borrower's budget to ensure that the business activity is likely to generate sufficient return to easily meet interest repayments on the borrowing and obtaining security on other assets where available). However, the bank should do away with unnecessarily onerous conditions (such as requiring tax returns showing significant tax profits in 5 of the last 7 years, for example). The development bank could also set a reasonable margin on loans to small business (say the bank bill rate plus 2% where security is offered or plus 6% where there is inadequate security).

I offer the above examples merely as suggestions. I submit that proper practices and terms should be introduced to ensure that small business have access to loan capital at reasonable rates.

By being a "trend setter" in this area, the development bank would compel the other banks to follow suit in order to be competitive. The development bank could reduce its lending activities once proper small business finance levels are restored, and ramp up its lending activities where the commercial banks fail to properly fund small business. The end result would be better and cheaper loan finance to small business, increased jobs throughout the economy, greater sustainable growth and ultimately a better government economic position through lower social security and increased money collected through income tax.

Provided basic prudential requirements are observed, the loans made to the various small businesses should be repaid in full over time. Whilst the loans are outstanding, the interest earned by the government on the money will be helpful in meeting the government's own interest payments and the excess can be applied as the government sees fit.

Whilst it could be argued that the development bank would "crowd out" the private banks who would want to borrow this capital to lend for other projects, this may not be a bad thing (particularly in the short term).

Instead of borrowings being used to continue supporting unsustainably high property prices, I submit that it would be better for these borrowings to be invested properly with small business so as to generate real employment and growth in the "real" economy, rather than in the "paper" economy of property investment.

Paragraph (e) other countries

I am not sufficiently familiar with the position in other countries to deal with the problem of enhancing access to small business finance. Accordingly, I cannot comment on this point at this stage.

Paragraph (f) any other related matters

I submit that the Federal Government should establish a government-owned development bank to provide finance to small business at reasonable cost and on reasonable terms.

Yours faithfully,

Suryan Chandrasegaran