Australian Government

The Treasury

Submission to Joint Committee on Corporations and Financial Services

Inquiry into Access for Small and Medium Business to Finance

16 February 2011

CONTENTS

Executive Summary

Small and medium sized enterprises (SMEs[1]) make a significant contribution to employment, productivity, and value added in the Australian economy. According to the Australian Bureau of Statistics (ABS), businesses with less than 200 employees accounted for 58 per cent of total value added by industry in 2008-09.[2] The SME sector also plays an important role in generating jobs across Australia, accounting for 71 per cent of total employment in the economy as at 30 June 2009.[3]

SMEs fund their activities from a variety of sources, including internal funding, owner equity, venture capital, secured and unsecured intermediated credit, and bank bills. While larger businesses can issue corporate bonds and equity as alternative sources of finance, small businesses' funding requirements tend to be too small to make such issuance cost-effective. As such, bank credit remains an important funding source for SMEs.

The global financial crisis has resulted in increased concentration in the business lending market in Australia (big and small business). However SMEs continue to have access to a range of lenders and loan products.

SME credit has held up relatively well since the onset of the crisis (better than for large businesses). Finance has generally remained available to creditworthy SMEs.

Finance has become more expensive for small businesses since the onset of the crisis. SME borrowers have been affected by a re-pricing of risk by SME lenders (reflecting higher probabilities of default).

Growth in credit to SMEs in the agricultural sector has generally kept pace with credit growth in other sectors of the economy. A key concern in relation to the agricultural sector is the capacity of SMEs to support borrowing (especially where it is undertake in response to extreme weather events). The submission lists a number of Government programs available to assist agriculture dependent small businesses.

During the financial crisis, the Australian Government assisted banks and other lenders to maintain support for business lending (including through its program of guarantees). It also provided considerable direct support to the SME sector.

On 12 December, the Government announced a new *Competitive and Sustainable Banking Package*. The aim of the measures in this package is to improve choice and bank access to funding. The development of new and existing funding mechanisms is the main way in which the package will improve SME access to funding.

The Government's new $4 billion investment in the residential mortgage-backed securities (RMBS) market has the additional objective of supporting lending to small businesses across Australia, which it started in its second $8 billion investment. The Australian Office of Financial Management (AOFM) estimates that close to 10 percent of funds already invested from the Government's second $8 billion support tranche have been lent to Australian small businesses.

---

[1] See "Defining SMEs" on page 2.

[2] Australian Bureau of Statistics (ABS) Cat. No. 8155.0 – Australian Industry, 2008-09

[3] Australian Bureau of Statistics (ABS) Cat. No. 8155.0 – Australian Industry, 2008-09

Introduction

This submission is structured as follows.

- The first section outlines the trends in SME credit in recent years and details pricing and competition in the market for SME loans.
- The second section focuses on the availability of regional credit and details Government measures aimed at supporting debt-funded SMEs in rural areas.
- The third section deals with the impact of certain prudential requirements and guarantees on lending to SMEs.
- The final section outlines the role for the Government in continuing to support SMEs as the economy further recovers from the financial crisis.

Defining SMEs

There is no single universally accepted definition of a small or medium-sized enterprise. A variety of definitions are used by industry participants. These are generally based on the size of a business's annual turnover, number of its employees, the size of its borrowings, or a combination of these characteristics. In addition, there is no clear distinction between what constitutes a small business and what constitutes a medium-sized business.

The Australian Tax Office defines a small business as an individual, partnership, trust or company with an aggregate annual turnover of less than $2 million, whereas a medium to large business is, in most cases, defined as an entity with annual total income of greater than $10 million. The Australian Bureau of Statistics defines micro, small, and medium businesses as those with 0 to 4, 5 to 19, and 20 to 199 employees, respectively.

Two key indicators of the ability of SMEs to access finance are the stock of outstanding credit provided to SMEs and the flow of new credit to SMEs. RBA credit data categorises businesses based on the volume of credit outstanding. A key distinction is between business with less than $2 million credit outstanding and businesses with $2 million or more credit outstanding. Generally, the RBA refers to businesses with greater than $2 million outstanding as large businesses, and those with less than $2 million as small businesses.

In its submission to the Senate Economics References Committee's Inquiry into Access of Small Business to Finance, the RBA noted that it is difficult to identify loans to businesses of a given size from available data. Further, because it is possible for a firm with 5 to 19 employees to have an annual total income of more than $10 million, or for a firm with 20 to 199 employees to have aggregate debt exposures of less than $2 million, it becomes difficult to establish whether a given business is either small or medium sized, based purely on the data.

RBA data on interest rates for small businesses is sourced directly from banks. Each bank has a slightly different definition of small business. The definitions used by market research companies to gauge small business confidence and expectations also vary. For example, the Australian Chamber of Commerce and Industry defines small and medium businesses as those with fewer than 20, and 20 to 99 employees, respectively, for its Small Business Survey. The National Australia Bank's SME Survey defines SMEs by using three bands of annual turnover; $2 to 3 million, $3 to 5 million, and $5 to 10 million for the lower, middle, and upper sized SMEs, respectively.

For this reason, both in this submission and more generally, the definition of a SME will often depend upon the context in which the term is used. In most instances, where the term SME is used in this submission, it means a business that would fit either the RBA definition (an entity with outstanding debt obligations of less than $2 million) or the ABS definition (an entity with less than 200 employees).

Finance and Credit Options Available to SMEs

Financing Options for SMEs

Small and medium businesses fund their activities from a variety of sources, including:

- internal funding – earnings generated from the previous operations of the business (often referred to as retained earnings);
- owner's equity – using additional equity investments from either current owners or new shareholders (including from venture capitalists); and
- intermediated credit – lending from financial institution through secured or unsecured loans, overdrafts or bills[4].

Although data on this issue is not conclusive, it is clear that bank intermediated credit is a significant funding source for SMEs. A CPA[5] survey of 500 Australian businesses with fewer than 20 employees found that a third had used a secured loan for funding at some stage in the previous 12 months, while 12.2 per cent had used an unsecured loan. Overdrafts (29.5 per cent), leasing (22.5 per cent) and cash injection from family or friends (17.6 per cent) were also significant financing sources.

- Around 62 per cent of respondents also used business credit cards for funding purposes, although this may be for cash flow management purposes rather than longer term funding.

Larger businesses can often access a number of additional financing options, including issuing bonds and raising capital through the share market. However, SMEs' funding requirements tend to be too small to make such wholesale issuance of debt or equity cost-effective.

Market for SME lending

Prior to the global financial crisis major banks provided the majority of business finance, with other banks and non-bank lenders taking lesser, but nevertheless substantial, roles[6]. Since the crisis, the major banks' share of total outstanding business lending has increased from around 60 per cent to around 70 per cent. There has also been a significant fall in the market shares of smaller lenders. This reflects a number of factors, including dislocation in funding markets and weaker conditions in foreign lenders' home economies that temporarily forced them to scale back lending.

---

[4] A commercial bill is a promise to pay a face value on a maturity date in the near future, generally 30 to 180 days. The bill is purchased at a discount to its face value, the difference between purchase price and face value represents the return on the bill to the purchaser. By issuing a commercial bill a business has access to the purchase price immediately and must pay the face value at the maturity date.

[5] Source: CPA Australia's Asia Pacific Small Business Survey 2010.

[6] Source: Treasury submission to the Senate Inquiry into Banking Competition, page 9. Separate data on market shares in SME lending is not available.

Nonetheless, there continues to be a significant range of institutions offering SME lending products (Table 1).

Table 1: Number of business loan products and providers

Loan type	Providers	Products
Residentially-secured variable business loans	32	44
Residentially-secured business overdrafts	30	44
Commercially-secured variable business loans	32	38
Commercially-secured business overdrafts	29	38
Residentially-secured 5-year fixed loans	30	33

Source: Cannex

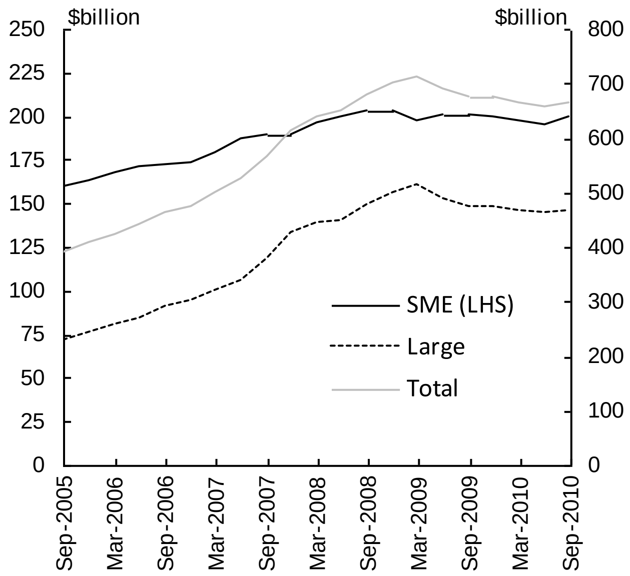
Trends in SME credit

Stock of Credit

The stock of SME credit[7] outstanding has been relatively stable since the beginning of the global financial crisis. Since mid-2008 it has fluctuated around the $200 billion mark (Chart 1). The stock of outstanding SME credit has been more stable than the stock of large business credit in the period since the global financial crisis.

The total stock of outstanding SME credit is now slightly higher than immediately prior to the crisis[8]. This growth in the stock of outstanding credit may be the result of more loans being provided by banks to SMEs or slower SME repayment rates.

Chart 1: Total business credit



Source: RBA D7 – Bank lending to business. Large businesses are defined as those with more than $2 million credit outstanding.

---

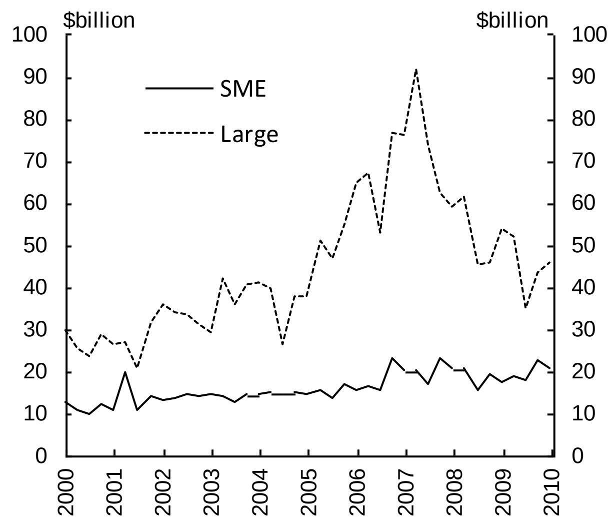
[7] In this section, SME credit is defined as businesses with less than $2 million in credit outstanding.
[8] SME credit outstanding is 6 per cent higher in September 2010 than September 2007.

New Lending

According to RBA data, new lending to SMEs has trended slightly upward since the beginning of the financial crisis in mid-2007 (Chart 2), a continuation of the general trend over the last decade. New SME lending increased from $19.8 billion per quarter in September 2007 to $20.6 billion per quarter in September 2010.

In contrast, the level of new credit to large businesses fell sharply since the financial crisis, as many listed companies actively deleveraged their balance sheets. New credit for large businesses is now only about half the December 2007 peak.

Chart 2: New SME and Large business credit



Source: RBA D7 – Bank lending to business

Drivers of SME Credit Trends

SME credit volumes are the product of both supply side and demand side factors.

On the supply side, economic uncertainty can reduce the risk appetite of lenders. Uncertain economic conditions tend to reduce the credit-worthiness of potential business borrowers and increase impairment expenses for lenders. Lenders have historically responded to such conditions by scaling back lending to marginal borrowers as well as by tightening the terms of lending (through higher pricing or collateral requirements).

Banks have also tightened lending standards in response to the financial crisis. New SME borrowers have been subject to lower loan to valuation ratios and higher collateral requirements, while existing borrowers have also had loans repriced, reflecting reassessments of risk by banks. However there is also some evidence of the major banks in Australia expanding their SME lending programs. For example:

- NAB has continued to extend its business lending facilities, opening up new business banking centres and hiring more business bankers.

- Westpac announced in the second half of 2010 that it had set aside an additional $6 billion for SME lending.

Some smaller lenders have also announced some positive developments in the SME lending market:

- HSBC announced in the second half of 2010 that it would be targeting Australian SMEs, particularly those with turnover between $1-10 million and involved in some sort of international trade.
- Think Tank Property Finance (a specialist SME lender) has stated that its new lending has been growing since early 2010, despite the cost of maintaining higher risk capital levels.

Going forward, improvements in competition and overall economic conditions will not only help to ensure credit continues to be available to SMEs, but will also place downward pricing pressure on small business loans over the course of the recovery.

On the demand side, businesses (both large and small) have, on aggregate over the financial crisis, scaled back their investment plans and increased their deleveraging activity. This could reflect the relatively flat level of SME credit outstanding over the last two years of around $200 billion.

- The Australian Chamber of Commerce and Industry's (ACCI) November 2010 Small Business Survey noted that small businesses have cut back on investment expenditure.
- A CPA Australia[9] survey found that the main reason for small businesses not seeking new bank finance was that they did not need additional funds or else had adequate internal funds to call upon.

Pricing conditions

SMEs access different types of intermediated credit, including secured and unsecured loans, overdrafts and bills. In examining pricing conditions, the submission uses the indicator rate on residentially-secured small business term loans published by the RBA.

Chart 3 shows the path of this rate between December 2005 and December 2010. The rate rose from 7.5 percentage points to a peak of 10.10 percentage points in July and August 2008. It fell to a low of 7.1 percentage points between April and September 2009. Since September 2009 it has risen to 9 percentage points.

Movements in the indicator rate have generally followed a similar path to movements in the official cash rate. However Chart 4 shows that the margin between the indicator rate and the official cash rate has widened since the onset of the financial crisis.

Chart 4 depicts the relationship between the RBA's indicator rate on residentially-secured small business term loans, its indicator rate on banks' standard variable home loans and the official cash rate.

It shows that the margins between the official cash rate and the interest rates charged on small business loans and home loans have increased since the onset of the financial crisis. It also shows that the margin on small business loans has increased by a greater amount than the margin on home loans.

Drivers of SME interest rates

The funding costs of lenders are an important driver of SME interest rates. As outlined in the RBA's submission to the Senate Economics References Committee's Inquiry into Competition within the Australian Banking sector[10], the cost of funding sources, such as

---

[9] Asia Pacific Small Business Survey 2010

[10] Source: RBA submission to the Senate Inquiry into banking Competition, 30 November 2010.

deposits and long-term wholesale debt, has risen significantly since the financial crisis compared to the official cash rate. However, it is also clear that major bank net interest margins are as high as they were in 2004, and as high as they were pre-crisis. Major bank impairments are also much lower than originally anticipated.

Lenders' perceptions of the risk associated with a loan are also significant drivers. Just as the risk appetites of the banks' wholesale funders have decreased since the financial crisis, so too have the risk appetites of lenders themselves.

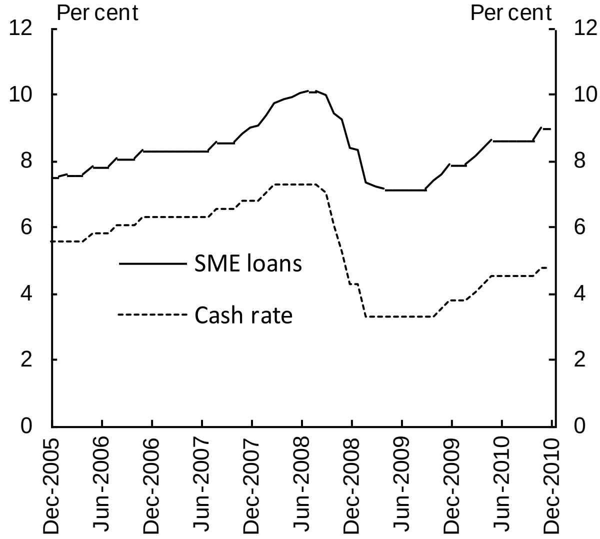
While the Australian economy performed well during the financial crisis, it is likely that loans were re-priced by lenders to reflect the higher probability of default on SME loans.

While many loans to SMEs are secured by residential property, banks take into account several factors, in addition to the type of collateral used, when pricing a loan. The average probability of default on small business loans is around 2.4 per cent. This compares to residential mortgages, whose probability of default is less than half that, at around 1.1 per cent. Further, once a borrower has defaulted, banks stand to lose different amounts on different loans. The loss given default on loans to small business is approximately 30 per cent of the loan's value. This figure is around 20 per cent for housing loans.

In addition to the above factors, factors such as a bank's funding mix, lending portfolio, and corporate strategy may affect prices given on various loans. This could explain the increased spread between residentially secured small business loans and housing loans.

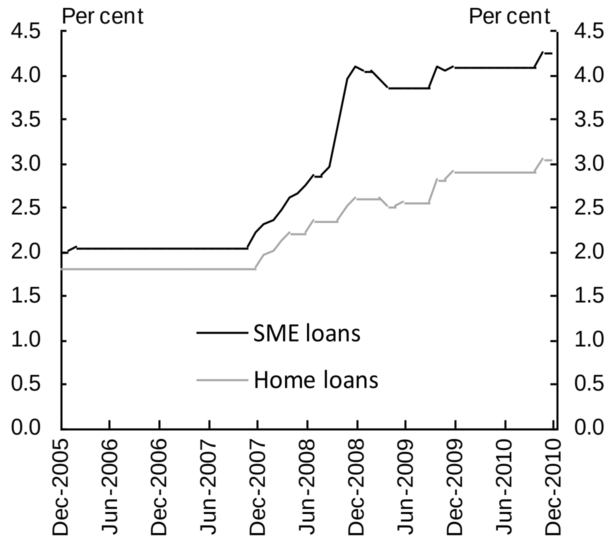
As noted in Treasury's submission to the Senate Inquiry into Competition within the Australian Banking Sector, when analysing developments in loan pricing, it is useful to focus on net interest margins (a profitability metric that measures the difference in basis points between the interest income generated by banks on their assets and amount of interest paid on their liabilities relative to their interest earning assets). While the lending spreads on loans to SMEs have increased since the crisis (chart 4), the major banks' overall interest margins across their lending portfolios have declined steadily since the early 1990s and have roughly halved since the mid 1980s. This trend can be attributed to financial deregulation leading to increased competition in lending, as well as the removal by banks of internal cross-subsidies through the introduction of a user-pays pricing system. However, as discussed above, major bank net interest margins are now as high as they were in 2004.

Chart 3: Small business interest rates[11]



Source: RBA F5 – Interest rates

Chart 4: Spread to the cash rate[12]



Source: RBA F5 – Interest rates

Industry surveys have shown recently that other factors are important when assessing SME business conditions. Interestingly, higher interest rates do not emerge as significant issues in recent surveys by the ACCI and CPA Australia.

- Borrowing costs were not among the top 5 constraints on investment identified in the ACCI survey. SMEs identified the following factors as more important: business taxes and government charges, insufficient retained earnings, and wage and non-wage labour costs.
- In the CPA survey, only 1.3 per cent of respondents claimed to be discouraged by the likelihood of unreasonable terms and conditions.

Trends in regional SME credit

As outlined in the Introduction to this submission, there is no single definition of an SME. This submission uses outstanding credit to the agricultural sector as a proxy for regional credit, which represents the best available indicator of finance available to the sector. In keeping with the RBA definition of small business, the data is based on credit outstanding to individual businesses of less than $2 million.

RBA data indicates that the rate of growth in outstanding bank credit to SMEs in the agricultural sector is similar to the rate of growth in outstanding bank credit to SMEs in other sectors.

Chart 5 indicates that the stock of outstanding credit to SMEs in the agricultural sector increased in nominal terms by around 75 per cent between September 2000 and September 2010. This compares with a nominal increase of around 85 per cent over the same period for SMEs in other sectors.

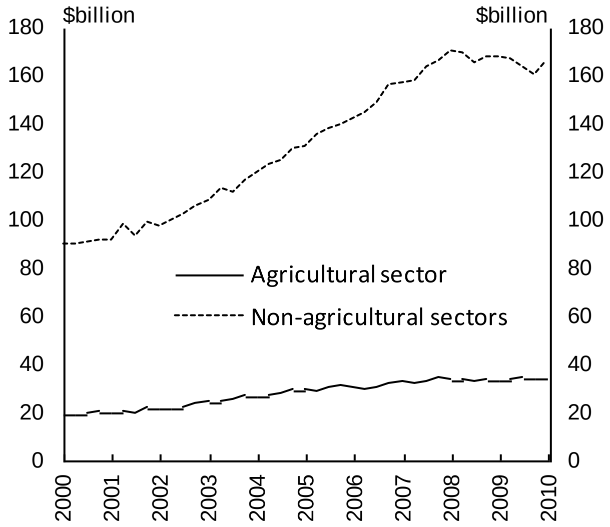
Between June 2007 and September 2010, credit outstanding to SMEs in the agricultural sector increased in nominal terms by around 8 per cent. This compares with a 7 per cent increase in other sectors.

---

[11] SME loans are based on residentially secured variable term loan rates.

[12] SME loans are based on residentially secured variable term loan rates, while home loans are based on an average of the standard variable rates offered by banks.

Chart 5: Agricultural SME credit



Source: RBA D7 – Bank lending to business

In assessing rural SME access to finance, it is important to consider the reasons for rural borrowing. As noted in the final report of the Senate Economics References Committee's June 2010 inquiry into the Access of Small Business to Finance, there has been a substantial increase in the amount of finance provided to support working capital, rather than land purchases, in the face of severe weather conditions, which reduce rural cash flows.

Some submissions to this inquiry indicated that rural debt outstanding has increased substantially over the past decade. For example, the National Farmers' Federation noted in its submission that 'rural debt has escalated by over 85 per cent since 2002-03 due to drought conditions, placing the agriculture sector at considerable exposure to increasing credit cost'.

Lenders take into account the ability of a borrower to service a debt, as well as the level of collateral, when deciding whether to approve a loan. Consequently, it is necessary that businesses in rural and other sectors have sufficient cash flows to service any loan, as well as sufficient assets to act as collateral. This acts as protection for both borrowers and lenders, and prevents debt levels from escalating to the point where the business must be foreclosed in order to repay the loan.

Cash flows to rural sector businesses can often be volatile, particularly as a result of extreme weather events, such as droughts and floods. The Government assists farms and agriculture-dependent small businesses to respond to the negative impacts of such conditions, including in managing their interest burden during periods of reduced income.

- Farmers and agriculture-dependent small businesses experiencing drought may be able to access interest rate subsidies of 50 per cent of the interest on loans for the first year of an Exceptional Circumstances declaration, and 80 per cent for second and subsequent years. These subsidies provide recipients with up to $100,000 per year, and up to $500,000 over 5 years.

- Affected farmers may also access professional advice and financial planning assistance that helps them develop business plans and identify ways to improve their farm management practices.

On 10 January 2011 the Australian Government announced the availability of a Disaster Income Recovery Subsidy to employees, small businesses and farmers who have lost income as a direct result of extreme weather events since November 2010. This subsidy provides a fortnightly payment of up to the maximum rate of existing Newstart Allowance[13] for a period of 13 weeks, and will be available to those affected that are not currently receiving, or are not eligible for, any other form of income support payment.

- These payments will help SMEs to maintain cash flows, employment, as well as repayments on credit obligations.

In summary, finance remains available to creditworthy SMEs in rural areas. Further, the Government is supporting leveraged SMEs to afford debt obligations as they fall due, through a period of reduced cash flows.

Impact of prudential requirements and guarantees on small business lending

Prudential requirements for SME lending

Prudential regulations may impact on the price and availability of lending to the SME sector. One of the issues identified by the Committee is whether Australia's prudential framework unfairly discriminates against SME loans compared with home lending (especially where small business loans are secured against residential property).

Residentially secured loans have become an increasingly important source of small business finance since these products were first offered in the mid 1990s and it now represents the majority of SME intermediated loans[14].

The purpose of prudential regulation is to protect bank depositors and maintain financial stability. The Australian Prudential Regulation Authority (APRA) is responsible for administering Australia's prudential framework. Minimum capital requirements are a core component of prudential regulation. In 2008 Australia adopted the Basel II framework. This is based on risk-weighted capital requirements. The amount of capital required for different types of loans varies in line with differences in the amount of risk they involve. The amount of risk involved in a loan is a function of the probability of default by the borrower and the expected recovery value of any collateral provided to the lender. Depending on the institution involved, this can be calculated using a standardised approach or through internal ratings based approaches (the latter are used by the major banks).

The risk weighting attached to a loan secured against a residential mortgage can vary between 35 per cent and 100 per cent. The actual risk weighting will depend on the type of loan, the loan to value ratio and whether or not it is covered by mortgage insurance. APRA has advised that small business loans can, and often do, have the same risk weighting as a comparable home loan. Overall however, small business loans will tend to have higher risk weightings because these loans are characterised by higher default rates. This applies regardless of similarities in collateral.

As noted previously, the probability of default on SME loans is approximately double that of a residential home loan, and upon default, banks also stand to lose about 50 per cent more on these loans relative to residential mortgages. SME loans on average, therefore, have a higher underlying risk.

---

[13] A Centrelink program providing income support to the unemployed who are looking for work.
[14] Treasury Submission to the Senate Inquiry into Small Businesses Access to Finance, page 5.

Prudential capital requirements ensure that banks hold capital proportionate to a loan's riskiness. Banks hold capital to cover losses on loans in excess of the loan's expected loss. As banks hold capital with the intent of earning a return, banks are likely to need to hold more capital against SME loans, relative to residential mortgages.

SME loan guarantees

Since the onset of the financial crisis, a number of OECD countries have implemented or expanded guarantee schemes for small business loans. However, these schemes have generally been unsuccessful in stimulating credit to small businesses. According to the OECD, such guarantee schemes and extensions have not produced the desired results, and 'the stagnation in lending is true even of banks in countries where credit guarantee schemes exist.'

For example, despite the UK's pre-existing Small Firms Loan Guarantee being replaced by an expanded loan program, known as the Enterprise Finance Guarantee, business credit growth in the UK fell from levels in the order of 20 per cent to below zero following the onset of the crisis.

There are a number of constraints that may account for the general lack of success such small business guarantee schemes have had in stimulating credit.

- Where declines in small business credit are the result of declines in demand for finance, rather than a tightening of supply, a guarantee is unlikely to effectively stimulate credit flows. This occurs in the event of poor business conditions, where there is less certainty regarding the return on debt-funded capital investments.

- Small business guarantees of credit do not stimulate demand in the economy, and therefore do not help small businesses generate profits with which to service additional debt.

- Small business guarantee schemes can be subject to adverse selection, where the least viable businesses obtain credit guarantees. This may lead to a higher probability of default for guaranteed loans, resulting in taxpayers bearing the associated costs. For example, the UK's Enterprise Finance Guarantee resulted in a substantial cost to UK taxpayers, with the cost of defaults from the Small Firms Loan Guarantee scheme exceeding £68 million in 2007-08, out of total new lending of £207 million over the same period. This is before administration costs are taken into account.

- Finally, small business guarantee schemes may crowd out commercial private lenders, lessening competition, and not achieving the desired effect of prudent and efficiently priced provision of private credit.

The final report of the Senate Economics References Committee's 2010 inquiry into Access of Small Business to Finance noted that measures to increase the level of competition in the lending market would be more beneficial for access to finance, than through the imposition of measures such as a Government guarantee of small business loans.

Wholesale funding and deposit guarantees

Under the Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme), the Government provided a guarantee for authorised deposit taking institutions' (ADIs') wholesale debt and large deposit obligations, for a fee. The Guarantee Scheme closed to new issuance of wholesale liabilities and additional deposit funds on 31 March 2010. However liabilities will continue to be covered under the Scheme for up to 67 months after this date.

The Guarantee Scheme has been critical in helping to support competition across all sectors of the banking market, including SME lending. It has supported the entire banking sector, by offering wholesale funding certainty to more than 150 Australian ADIs, including 14 Australian banks, 11 building societies, 110 credit unions, and 9 foreign bank subsidiaries.

The Guarantee Scheme allowed a broad range of institutions to raise funds in wholesale markets, and to continue to lend to Australian businesses. For example, as at 9 April 2010, non-major domestic banks hold $65.2 billion in guaranteed liabilities. Without the Guarantee Scheme, the supply of credit to Australian householder and businesses would have declined substantially.

This certainty was further supported by the availability of free insurance of deposits of up to $1 million through the Financial Claims Scheme (FCS) to all ADIs. As deposits make up a larger portion of smaller institutions' funding requirements than for larger institutions[15], this free guarantee particularly benefited mid-tier and smaller ADIs. Following the introduction of the FCS, deposits at these smaller institutions grew at a faster rate than the major banks' deposits. The Government's Competitive and Sustainable Banking package confirmed the FCS as a permanent feature of Australia's financial system.

Need for regulatory or legislative change

In addition to supporting the capacity of the financial sector to maintain credit to business and households, the Government provided direct support to SMEs throughout the global financial crisis. While not all of these were directly targeted at access to finance, many of these measures are likely to have assisted small businesses' to sustain their operations and cash flows. The Government assisted small businesses through:

- direct investment of up to $20 billion in the residential mortgage-backed securities (RMBS) market. This policy has enabled smaller lenders to lend at competitive interest rates and maintain a higher level of lending and market share than would otherwise have been possible. An explicit objective of this policy has been to facilitate small business lending, with commitments from lenders indicating an additional $1.4 billion of credit has been provided for small business lending;

- with a network of small business advisory services, a small business support line, a one-stop-shop website, and assistance for small businesses to get on-line;

- through the Small Business and General Business Tax Break, and, supporting access to financing for innovation by investing in Australia's venture capital market through the Innovation Investment Fund, which was allocated $224.7 million over 5 years in the 2006-07 Budget. In August 2009, a further $64 million was invested through the Innovation Investment Follow on Fund (IIFF) to support venture capital during the downturn;

- by providing cash flow relief to eligible small businesses by reducing their pay as you go (PAYG) instalment obligations. The PAYG instalment reductions provided around 1.7 million eligible taxpayers with cash flow relief during the global financial crisis by ensuring that their PAYG instalments more closely approximated their actual end of year income tax liability. This meant that small businesses and other eligible taxpayers had the use of what would otherwise be overpaid tax collections of around $440 million in 2008-09 and $720 million in 2009-10;

---

[15] See for example, RBA's submission to the Senate Inquiry on Banking Competition.

- the Small Business Assistance Program, administered by the Australian Taxation Office (ATO), which helped small businesses support to help small business understand their tax obligations and entitlements, establish good record keeping practices and manage cash flow effectively. The ATO also enabled small businesses with an activity statement debt to apply for a General Interest Charge (GIC) free payment arrangement between 1 June 2009 and 30 June 2010. Small businesses were also able to request a deferral of payment on eligible activity statements; and

- supporting cash flowing into small businesses, through the Government's guarantee of on-time payments for new small business contracts (up to $1 million) with Government departments.

These measures are further detailed in Treasury's submission to the Senate Economic References Committee's Inquiry into the Access of Small Business to Finance.

The Government has committed to continue to support SMEs through:

- providing a cut to the company tax rate to 29 per cent in 2012-13 for small businesses (those with turnover of less than $2 million), in advance of the cut proposed for large business;

- enabling an instant write-off for any new business asset costing up to $5,000 from 2012-13. This will include the 70 per cent of small businesses not run through a company that will not benefit from the tax cut;

- simplified depreciation arrangements, by combining pools of depreciating assets into a single depreciation pool; and,

- providing a 45 per cent refundable credit on R&D investments for firms with an annual turnover of less than $20 million.

On 12 December 2010, the Government announced a package of reforms aimed at boosting lending market competition. This package consisted of three broad streams of reform: empowering consumers; helping smaller lenders put more competitive pressure on larger banks; and providing a sustainable flow of credit to households and businesses. While some of these measures are relevant to consumers, others should boost competition in SME lending markets by improving access to funding. These measures include:

- Treasury actively facilitating the efforts of mutual credit unions and building societies to develop aggregated structures to pool together and raise cheaper funding;

- Confirming the Financial Claims Scheme as a permanent feature of Australia's financial system. Deposits covered under the Financial Claims Scheme are an important source of funding for our regional banks, credit unions and building societies, making this an important measure to support the capacity of smaller lenders to access funds for cheaper loans to compete with larger banks;

- The Government will invest a further $4 billion in AAA-rated RMBS to continue to support this market which smaller lenders rely on to put competitive pressure on larger banks. This will include the continued additional objective of supporting lending to small business, and will not be available to support the major banks. The Government's investment in RMBS has seen an estimated $1.4 billion worth of small business loans written since the end of 2008;

  – Small lender RESIMAC said this support for the securitisation market has 'been vital to permitting a continual flow of finance to the small business community'.

RESIMAC said that 'without such support, there would be literally thousands of Australian small business owners who would have been deprived access to finance'.

- The Treasury and AOFM will continue working with our financial regulators to develop the market for smaller lender bullet RMBS, including support where required from the Government's new $4 billion tranche of investment in the RMBS market. Bullet issuances can be structured to be eligible for inclusion in certain bond market indices, such as the UBS Composite Bond Index. This additional structural demand and diversification of investors has the potential to make RMBS more reliable and cost effective; and,

- The Government will amend the Banking Act 1959 to allow Australian banks, credit unions and building societies to issue covered bonds, to secure the long-term safety and sustainability of our financial system so it can continue to provide reasonably priced credit to Australian households and small businesses.

The Government has also put in place a number of measures aimed at helping households and businesses with their cash flows in response to the adverse weather events of late 2010 and early 2011. In addition to Exceptional Circumstances payments and Disaster Income Recovery Subsidy outlined above, the Government has also announced $1.03 million in supplementary Emergency Relief funding to be administered by the Department of Families, Housing, Community Services and Indigenous Affairs. This will be distributed to 82 existing community services organisations across Queensland. The Government will also activate a one off Australian Government Disaster Recovery Payment of $1,000 per eligible adult and $400 per eligible child to those adversely affected by a major disaster. These combined measures will help small and medium sized business owners who are facing a period of reduced cash flows.