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The Secretary  
Senate Standing Committee on Economics  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

Dear Mr Hawkins

## **INQUIRY INTO ACCESS OF SMALL BUSINESS TO FINANCE**

The WA Small Enterprise Network (SEN) is pleased to make a submission to the Senate Economics Committee Inquiry into Access of Small Business to Finance. SEN's comments are made in response to the terms of reference of the inquiry.

### ***About WA Small Enterprise Network***

The WA Small Enterprise Network exists to represent the interests of small businesses in Western Australia. SEN represents a membership of over 300 companies, across all industry sectors, with each member employing between zero and thirty staff.

SEN is supported by the Chamber of Commerce and Industry of Western Australia (CCI), which is the State's leading business association, representing over 5,500 businesses across all business sectors.

### ***The costs, terms and conditions of finance and changes to lending policies and practices affecting small businesses.***

With regard to financial products and borrowing options offered by lending organisations, small businesses are generally limited to the role of price taker. Small businesses acting alone do not have the capacity to negotiate terms or vary the cost structures associated with debt finance. This has resulted in a situation where there is minimal price competition in the small business lending market. A lack of competitive tension in the market leads to there being little variability for loan products marketed towards small business. Put simply, it is difficult for small businesses to 'find a good deal' through lender-based competition. This means that it is small businesses, who have limited cash flow, that are required to pay the highest costs for debt.

SEN is concerned that small businesses are often forced to accept higher rates of interest on loans, lines of credit and short-term credit. Small business advises that it can be difficult to obtain timely funding. This has a tendency to push small business borrowers towards less appropriate, higher cost options such as credit cards and short-term lines of credit backed by non-business equity, such as personal mortgages.

The type of skills and expertise that exist within many small businesses are often not well suited to understanding details of what can be complex loan packages. A large amount of information is often needed to be provided by the applicant, even when applying for relatively small amounts. This has been exacerbated as the major lending institutions have reassessed their credit criteria subsequent to the global financial crisis.

For small businesses, it can often be difficult to meet the requirements imposed by lenders and subsequently confirm finance approval. It can also be difficult for small businesses to understand the compliance requirements imposed by lenders and provide appropriate information. If a loan application is refused, it can be difficult for the applicant to understand the reasons for the rejection, and discover what they can do to improve the likelihood of acceptance at a future date.

Cash flow is critical to small businesses, with many operating with a relatively small amount of working capital available to cushion the impact of cash flow interruptions. In recent times larger customers of small businesses have sought to extend payment term; effectively treating that business as an additional short-term provider of credit. Such changes can have negative implications for small businesses, who do not necessarily have the capacity to operate without payment within regular terms. Where these customers also seek a discount for early settlement, the problem can be exacerbated.

This creates risk that small businesses then need to seek bridging finance which is often very costly and creates further cost implications for the financial position of their company.

SEN considers that the level of compliance should be commensurate with the risk, and that lending process should be streamlined where possible to allow small business to access finance within a reasonable timeframe and at a reasonable cost.

***The importance of reasonable access to funding to support small business expansion and the sector's contribution to employment growth and economic recovery.***

Approximately 80 per cent of businesses in Western Australia are small businesses. It is estimated that the small business sector in Western Australia accounts for over half of all private sector, non-agricultural employment. Other estimates also show that small businesses employ around a third of the State's labour force.<sup>1</sup>

Small business is critical in ensuring that both the broader business sector and local communities are able to access a wide range of goods and services on a daily basis. Small business can be considered as the engine room of the Western Australian economy.

SEN considers that the small business sector strongly represents the heart of Australia's entrepreneurs and innovators. It is important that a regulatory framework be established that encourages these activities to ensure that benefits can be derived from the

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<sup>1</sup> <http://www.smallbusiness.wa.gov.au/small-business-statistics/>

implementation of new business ideas and opportunities. It is critical that these innovators be able to gain access to finance to help transition their creative ideas into marketable business products and solutions.

The small business sector will play a key role in ensuring Australia's economy continues to grow, and avoids the economic risks associated with the aftermath of the global financial crisis. It is important that confidence is maintained in this sector, and that businesses have access to sufficient working capital to allow them to operate effectively.

Recent increases in interest rates on lending products, even above the official increases imposed by the Reserve Bank of Australia (RBA), have threatened both the confidence and the capability of small business to trade out of a potentially recessionary environment. It is imperative that small business are provided the opportunity to access reasonably priced debt, where the provision of that debt does not represent an unreasonable risk to the lender.

SEN understands that banks are now scrutinising applications for finance more thoroughly than has been the case in previous years. Underpinning these requirements is a strong view on the part of the banks that risk has been underpriced in the past.

The question is whether market or company risk is now 'overpriced', particularly in the small business sector. Many small and medium enterprises are now finding it difficult to access finance, while those who can have not necessarily benefited from reduced borrowing costs that have come with the cuts that were made to official interest rates by the RBA during 2009.

SEN is concerned that high borrowing costs, combined with general difficulties in obtaining finance, remain a constraint on business, many of which have to manage through generally weaker economic conditions than have been experienced in WA for many years.

#### *CCI Survey of Business Expectations – March 2010*

The Chamber of Commerce and Industry of WA, in its *Survey of Business Expectations* for the March 2010 quarter, surveyed its membership to determine the key issues affecting business.

The data indicated that in the small business sector, more than a quarter of all respondents rated borrowing costs as one of the top three issues affecting them. This was a higher result than that indicated across all sizes of business, which indicates that small businesses may be potentially suffering disproportionately in terms of the cost and availability of finance.

Concerns about global economic growth was also rated as one of the top three business concerns by over 30 per cent of all respondents, which may indicate that there may continue to be considerable demand for debt finance to support small businesses through the global downturn in the short to medium term.

The greatest concern for small businesses was wage costs, with 62 per cent of respondents including this as one of their top three business concerns. Increasing wage costs will put further pressure on a business' ability to generate cash to fund wages. Where cash flow shortages occur, businesses may need to supplement this cash with debt. If debt is difficult to obtain, it will exacerbate the problems associated with wage costs, and may have negative implications for the business to be able to operate viably and continue to provide employment opportunities.

### *CCI Survey of Business Expectations – December 2008*

The Chamber of Commerce and Industry of WA, in its *Survey of Business Expectations* for the December 2008 quarter, surveyed its membership to better understand the impact that a growing difficulty in accessing finance was having on business.

The results of this survey showed that some 35 per cent of respondents indicated that the global financial crisis had a negative effect on their ability to access finance, while a further 29 per cent of respondents also reported an adverse effect upon the cost of borrowing.

Over 34 per cent of small and medium sized businesses reported that the global financial crisis had negatively affected their ability to access finance. Similarly, over 30 per cent of small businesses and 25 per cent of medium sized businesses respectively also believed that the global financial crisis had an adverse impact upon the cost of borrowing.

This survey found that a range of measures were adopted by businesses in order to cope with the worsening economic conditions arising from the global financial crisis. The most common strategy adopted by businesses was to delay investment decisions, with this approach being used by around 53 per cent of businesses. Implementing a hiring freeze was the next most popular option, with around 35 per cent of all respondents putting recruitment activity on hold. Other commonly used strategies to deal with the worsening economic conditions included using an overdraft facility and drawing down on retained earnings (20 per cent), and lowering production (11 per cent), while 17 per cent of respondents reported laying off staff.

### *ACCI Small Business Survey*

In February 2010, the Australian Chamber of Commerce and Industry (ACCI) released Issue 42 of its *Small Business Survey*. This survey provided an assessment of the constraints that exist for small business investment. The survey found that 'charges by lending institutions', which incorporates bank lending fees and interest costs, had risen from a rank of eighth in the previous survey to second, in terms of the concerns held by small business. This result highlights the negative impact that high borrowing costs are having across the small business sector and the impact that it can have on the propensity of business to invest. It is possible that this limit on the availability of debt could lessen the ability of businesses to make capital investments and help build the Australian economy's productive capacity.

This survey also indicated that 'insufficient retained earnings' was the fourth greatest concern for small business. Understandably, this is linked to borrowing costs, as insufficient retained earnings is likely to require businesses to seek debt funding as an alternative source of capital.

### ***The state of competition in small business lending and the impact of the Government's banking guarantees.***

SEN considers that the best outcomes in terms of small business lending can be achieved where there is a market that promotes competition and provides opportunities for product innovation.

Currently, there appears to be relatively little differentiation in the products offered to small business across the banking and lending sector. There also appears to be relatively little price competition across the major lenders.

The role of government should be to establish a regulatory framework that encourages competition. This can come from existing participants, while also not restricting new market entrants who may be able to offer new and innovative product offerings.

SEN encourages government to ensure that the regulatory framework for banking and lending products is not limiting competition in the market, and thus limiting the product choices available to small business.

***Opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion.***

SEN considers that government should establish policies that encourage greater use of alternative funding sources beyond traditional bank lending. For instance, policies that encourage venture capitalism, angel funding, and philanthropy should be considered.

Stimulating investment from alternative sources should establish greater competitive tension for funding in the market, build new investment and income streams for potential investors, and provide new avenues for small businesses to pursue in terms of gaining access to capital, both for long-term and short-term purposes.

***Any other related matters.***

*Small Business Statistical Data*

SEN considers that further work should be undertaken in terms of collecting and collating statistical data about small businesses, most likely through the Australian Bureau of Statistics. While small business is a critical aspect of the economy, it is often difficult to obtain meaningful and representative information about this sector because of the lack of data collected and analysed. Additional official data would assist industry, representative groups, and government to better understand the status of small business in Australia.

*State Payroll Tax*

State taxation can limit the growth of small business as well as directly impacting their financial viability. In Western Australia, payroll tax acts as a strong disincentive to growth and increases the cost base of many small businesses.

Payroll tax generated revenue of \$2.2 billion for the Western Australian State Government in 2008-09, an increase from \$1.9 billion earned during 2007-08, which itself was 20 per cent higher than in 2006-07. Revenue generated from State payroll tax is more than double what it was in 2000-01. Western Australia recently overtook New South Wales to become the highest payroll taxing State (in per capita terms) in Australia.

Payroll tax has become an increasing burden on small businesses, with many now caught in the payroll tax net. This has largely come about as a direct consequence of rising wages and an exemption threshold that has not changed since 2004, as opposed to being driven by growth in raw employment numbers. SEN does not consider it appropriate that so many small businesses should be forced to incur the additional costs that payroll tax creates.

Based on earnings data, a business in Western Australia would only be able to employ 11 full-time workers on average wages of \$67,000 per annum before being liable for payroll tax. By contrast, when the exemption threshold was last adjusted in 2003, a business could employ 15 staff before it became liable for payroll tax.

The burden of payroll tax on small business means that less cash is available for productive purposes. The tax is essentially a tax on growth, and also means that Western Australian business may need to seek greater debt funding than those in other States as there is a greater proportion of business income being taken up by State taxes.

#### *Land Tax*

Small businesses are increasingly at risk from the growing costs that are associated with land tax as a result of escalating land values. The process by which land tax assessments are made in Western Australia is often unclear to small business, although the growing costs associated with assessments are considerable. SEN recommends that a review of the process for land tax assessments in WA, to ensure that extreme tax increases do not occur in the future, as has been the case in recent years.

SEN considers that land tax provisions in WA should be simplified and that less individual thresholds should be applied. This would increase the level of certainty for small business, and reduce the risk that can arise from large tax liabilities as a result of changes in land valuations.

#### **Conclusion**

SEN appreciates this opportunity to respond to the Senate Economics Committee's Inquiry into Access of Small Business to Finance. I would be pleased to provide further information on this submission and can be contacted on (08) 9365 7688 or email [andrew.canion@cciwa.com](mailto:andrew.canion@cciwa.com).

Yours sincerely



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