vecci
INVIGORATING BUSINESS

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Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Senators

Re Inquiry into Access of Small Business to Finance

Thank you for the opportunity to respond to the Inquiry into Access of Small Business to Finance.

The Victorian Employers' Chamber of Commerce and Industry (VECCI) is the largest and most influential employer organisation in Victoria and has been providing services to and representing business in Victoria for over 150 years.

We are committed to being the voice for business, representing and championing the interests and concerns of our members, customers and clients in public policy and other business related matters.

VECCI's members, customers and clients come from all sectors of the economy across the State, and vary in size.

VECCI has a significant number of small business operators in its membership and actively supports and advocates on their behalf in regard to a wide range of issues including access to finance.

Please find attached the full submission, including a **confidential** appendix outlining direct member feedback. While the main submission is a public document, Appendix 3 is to remain **confidential.**

Yours sincerely

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Chief Executive Officer

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THE IMPORTANCE OF THE SMALL BUSINESS SECTOR

Small business makes a significant contribution to the economy, employment, exports and production. In Victoria, 96% of all businesses are considered small, employing less than 20 persons.

Small business also makes an important contribution to society and community wellbeing, and provides support for local events and other initiatives. In smaller centers, particularly those in regional and rural Australia, the small business community is vital, providing employment and contributing to liveability.

As a group, the small business community is both disparate and diverse. Small business operates in every region of Australia and across virtually every sector of the economy. In aggregate, small business is the largest employer in Australia contributing half of total private sector employment.

ECONOMIC ENVIRONMENT

In responding to this Inquiry it is important to consider the current economic environment. While signs of global economic stabilisation started to emerge in the middle of 2009, recovery has been, and is expected to continue to be, gradual and uncertain.

While Australia and Victoria avoided a technical recession, and emerged in a significantly better position than many of our trading partners, this by no means diminishes the significance of the downturn and the effect it has had on small business in particular.

Many businesses have faced low profitability and limited cash flow as a result of reduced demand; numerous have been forced to reduce staffing numbers or hours; some have questioned their ongoing viability; while others have been forced to downsize operations or even close. In addition, some businesses have experienced a reduction in asset valuation, together with a return of wage pressure and increasing interest rates.

At this time small business needs access to finance to carry them through periods of limited cash flow and low profitability, and increasingly, for investment and expansion purposes to capitalise on opportunities arising from the economic recovery. The rate of economic recovery is highly dependent on private sector growth, which in turn is dependent on the private sector's ability to access affordable finance.

Our most recent member survey (December Quarter 2009) indicates that despite a recovery in confidence and some growth in sales, many businesses still report difficult trading conditions, including low profitability, exports and investment levels, together with increasing wage pressure.

We acknowledge that the availability of credit has tightened globally and that increasing bank interest rates in part reflect the higher risk faced by lending institutions. We also acknowledge that the major banks in Australia have emerged in a comparatively solid position. While this has in part been a result of good governance practices and lending policies, many have also been assisted by the Government guarantees provided to the larger financial institutions during the Global Finance Crisis.

Recent evidence would suggest that the financial strength of the banking sector is relatively strong. A recent article in the Financial Review ("Big banks cruise to $7.4bn half-year payday", 31 March 2010) indicates that, "Three of Australia's major banks are expected to report collective cash profits of more than $7.4bn for the first half of 2010, ... as bad debts shrink faster than expected and the banks maintain their dominance in writing new mortgages."

INDUSTRY STRUCTURE AND A LACK OF ALTERNATIVE FUNDING SOURCES

There is a serious lack of competition in the banking sector, which undoubtedly presents a significant problem for small business. The lack of competition and lack of alternatives places the small business operator in an inferior bargaining position. This is an ongoing issue, and not one that can be easily resolved. However, every effort must be made to ensure that existing competition is not eroded further.

While the guarantees provided by Government to the major banks is likely to have helped reduce the impact of the financial crisis in Australia, one of the unintended consequences is that it further reduced the competitive strength of the smaller financial institutions, and further strengthened that of the major banks.

While Governments have generated a lot of attention around the mortgage sector and the financial pressure faced by households, there has been comparatively less public attention around access to finance for small business and therefore less pressure put on financial institutions.

The above mentioned article in the Financial Review (Wednesday 31 March 2010), indicates that the difference in the official cash rate and banks' average lending rate to small business is currently at a record high of almost 5 percentage points.

More specifically, data from the Reserve Bank of Australia indicates that after the three successive interest rate hikes over the December quarter of 2009, small businesses were paying a margin of 3.97 percentage points above the cash rate on average for bank finance, compared to a margin of 2.29 percentage points for large businesses and 2.32 percentage points for mortgage customers.

The lack of competition in the financial sector is exacerbated by the lack of venture capital available in the Australian economy, further restricting alternative sources of finance.

There is also concern among businesses over the difficultly in accessing financial support through grants and other government funding. In some cases this may indicate a change or tightening of criteria, but also reflects general member sentiment over the difficulty experienced in finding information regarding available funding, together with the administrative burden involved in applying for funding. An accessible, centralised information source providing up-to-date, standardised information would greatly assist businesses find and compare available funding opportunities.

In addition to general economic conditions, other factors are currently having an impact on accessing finance. The Victorian bushfires of February 2009, the existence of Code Red days, together with the real and perceived risks associated with bushfire prone areas has also contributed to difficulties for small business in accessing finance. Member evidence suggests that some operators in bushfire prone areas are having difficulty accessing finance even for the purposes of upgrades and refurbishments.

In general, members have voiced concern over a number of areas in regard to accessing finance. These include; the administrative difficulties and costs involved in changing banks, the general lack of alternative options for sourcing finance, a lack of transparency over requirements and timelines in accessing finance leading to delays in investment and lost revenue, a lack of timely notification of changes to financial products/services, and an increase in the cost of finance even for low risk customers with excellent payment history.

MEMBER RESEARCH

A recent member survey canvassed investment intensions over the coming year, intended funding sources and major barriers to new investment.

More than one quarter of small business members (those with less than 20 employees) indicated that both the availability of capital, and the cost of capital, represent a **major barrier** to new investment. In particular, concern over the cost of capital has risen significantly when compared to results in the same quarter in the previous year.

In addition, 21% of respondents indicated that **changes to bank lending practices** in the last six months have affected capital investment plans, while 24% believe such changes have affected access to finance for operational purposes.

The survey questions were originally asked in March 2009 and have been repeated again in March 2010. In some cases the responses are quite similar. However this is not surprising. In March 2009 many businesses were feeling the full effect of the Global Financial Crisis. While conditions have started to improve, in many ways investment and financial considerations remain unchanged.

A summary of results for small business members are provided below, while the full results are set out in *Appendix 1*:

- 35% of respondents are planning on undertaking new capital investment in the next 12 months.
- Of those intending to undertake new investment, 52% intend to invest in plant and equipment, 37% in buildings and structure, and 11% in other investment.
- 19% intend to use equity finance (down from 30% in March 2009).
- 23% intend to use debt finance (down from 26% in March 2009).
- 29% intend to use a combination of equity and debt finance (up from 23% in March 2009), and
- 9% intend to use other sources (e.g. cash reserves and overseas joint venture)
- The major barriers to new investment from the point of view of their own business included:
    - Lack of demand (27%), down from 38% in March 2009.
    - **Availability of capital (27%),** down from 29% in March 2009.
    - **Cost of capital (26%),** up from 17% in March 2009.
- 21% of all respondents considered that changes to bank lending practices in the last six months have affected their capital investment plans for the next 12 months, while 24% believed such changes have affected access to finance for operational purposes (including bank overdraft/ line of credit).

THE NATURE OF SMALL BUSINESS

Small business owners range in age and experience, and may include a young entrepreneur, someone nearing retirement that has used their superannuation to purchase a 'lifestyle' business, a family member who has years of experience in a family-owned business, as well as someone with extensive experience in many industries. Anecdotal evidence suggests that many small business owners have limited financial expertise and a varying degree of business training.

This range in both age and experience has many implications, including the ability of the owner to secure access to finance.

Small business operators are often busy engaged in day-to-day operations, dealing with the needs and demands of customers, often in a very competitive environment. It is often the case that small business owners spend the majority of their time working 'in the business', leaving little time to work 'on the business'. As a result, activities such as business analysis and long term strategic planning often fall down the list of priorities.

In addition, small businesses with few tangible assets are likely to struggle to provide sufficient evidence to satisfy the criteria for lending. In particular those who are self employed and/or those who receive irregular income flows may find it particularly difficult. Operators in the service sector can also face similar difficulties especially where intellectual property is their primary asset.

An important sector of small business includes new start ups. While often deemed to carry higher risk, new start ups make a significant contribution to the economy, generating new ideas, products and services.

We acknowledge that there is an onus on business owners to ensure their business plans and accounts are in good condition. It is good business practice to implement business planning procedures, risk management strategies and quality accounting practices.

However, in practice there is significant variation in the ability of small business to ensure this. Not only do business owners have a variety of experience and training, many also face significant pressure from resource, skill and time constraints.

There is a need for further assistance to business owners, in order to overcome any lack of knowledge or experience in terms of preparing business planning and financial management documents and processes.

Anecdotal evidence suggests that many businesses tend to limit their use of financial advisers to tax returns from their accountant. The cost of more advanced advice and the pressing demand of everyday operations, often limits the extent to which businesses access advanced financial advice (e.g. investment assessment, business planning, risk management, and marketing and growth strategies).

Government assistance to small operators should be provided through a flexible, tailored, user-driven approach, such as further access to business mentors or subsidised financial management assistance through industry associations and accredited service providers. Additional recommendations resulting from VECCI's experience in delivering various business programs can be found in Appendix 2.

RECOMMENDATIONS

In summary there are a number of recommendations which we believe would assist improve access to finance for small business. These include:

- Efforts to improve competition in the financial sector in order to increase to the number of alternatives available to small business, and place downward pressure on the cost of finance. As a minimum requirement, efforts must be made to ensure that existing competition is not eroded further.
- In line with the current consideration by Federal Government to ban exit fees that banks charge when households switch mortgages, we recommend a reduction in administrative and cost related barriers for small business to switch lending providers.
- Greater transparency on the part of lending institutions regarding the required documentation and expected timeframes for approval of funding. Further to this, we recommend improvements in the administrative process, together with sufficient time provided to customers following a change to bank lending products.
- Employees at lending institutions would benefit from greater training on the needs of small business, together with enhanced specialist skills in small business credit assessment.
- Further assistance to business owners to overcome any lack of knowledge or experience in preparing business planning and financial documentation and processes. Assistance should be provided through a flexible, tailored, user-driven approach, such as further access to business mentors, or subsidised financial management assistance provided through industry based service providers, including industry associations and other accredited providers.
- A centralised, standardised and accessible source of up-to-date information outlining all Government grants available, including clear uniform information on criteria, funding levels and timelines.

APPENDIX 1: MEMBER SURVEY RESULTS

The following questions were included in the March quarter 2010 VECCI - Commonwealth Bank Survey of Business Trends and Prospects.

The results below include small business members only, and represent the views of 215 respondents.

Are you planning on undertaking any new capital investment in the next 12 months?

	March 2010	March 2009
Yes	35 %	33 %
No	65 %	67 %

If yes: What type of capital investment do you plan to undertake?

	March 2010	March 2009
Plant and equipment	52%	56%
Building and structures	37%	42%
Other	11%	3%

What will be the major source of funds used to undertake this new investment?

	March 2010	March 2009
Equity finance	19%	30%
Debt finance	23%	26%
Combination	29%	23%
Other	9%	3%
Not applicable	20%	18%

From the point of view of your own business, what do you consider to be the major barriers to new investment? (* includes multiple responses)

	March 2010	March 2009
Lack of demand	27%	38%
Availability of capital	27%	29%
Cost of capital	26%	17%
Recent investment	14%	18%
Existing capacity	14%	16%
Low ROI	10%	13%
Other priorities	15%	13%
Tax bias	13%	10%
Planning system	6%	6%
Other	7%	0%

Do you consider changes to bank lending practices in the last six months have affected your:

(a) Capital investment plans for the next 12 months?

	March 2010	March 2009
Yes	21%	20%
No	78%	80%

b) Access to finance for operational purposes (e.g. bank overdraft/ line of credit)?

	March 2010	March 2009
Yes	24%	24%
No	76%	77%

APPENDIX 2: SUMMARY OF EXPERIENCE ACCUMULATED FROM VECCI BUSINESS CONSULTANTS

As a result of experience by VECCI business consultants working in the Drought Business Transitioning Program together with assistance provided to businesses following the Victorian bushfires through the VECCI Business Relief Fund, we present a number of general recommendations highlighting areas of need and potential improvements for any future program(s) to assist small business.

These include:

- A need to provide assistance to businesses to assess their viability and adopt more systematic business planning processes including business reviews, workforce management, marketing and communication strategies, target market assessment, growth strategies, succession planning and risk management.
- Such assistance would be best provided by industry associations and other providers, who have established and trusted links with small business.
- While workshops have a role to play in the educational process, evidence suggests that these should be complemented by a personalised, user-friendly service. Such a service should offer tailored assistance, in a flexible manner and could include the use of a business mentor or a comprehensive financial advisor/business planner. Such a service allows assistance to be provided in a manner and at a time and venue that suits the business owner, and is therefore more likely to be taken up. This is particularly true where the issues covered are confidential or personal in nature.
- Such a service should include a combination of both day-to-day operational activities, as well as high level strategic action.
- In addition, readily available business tools such as SWOT analysis, a viability checklist or calculator, business environment analysis, investment analysis and payback periods (including technology and innovations), and financial planning templates would assist greatly. While many such tools are already provided by Governments and financial institutions, the use of these could be further enhanced if provided through industry associations and other accredited providers.