31st March 2010

Department of the Senate
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Dear Sir / Madam

Inquiry into Access of Small Business to Finance

The Motor Trades Association Queensland (MTA Queensland) responds to the Senate Economics Committee invitation for submissions to the *Inquiry into Access of Small Business to Finance*. Our responses reflect our membership who constitute a significant link in the automotive value chain and are enunciated below.

Background

By way of background, MTA Queensland is the peak organisation in the State representing the specific interests of 2,500 businesses in the retail, repair and service sector of Australia's automotive industry. It is an industrial association of employers incorporated pursuant to the *Industrial Relations Act* of Queensland.

The Association, comprising 12 separate divisions represents and promotes the issues of the automotive industries to all levels of government and within Queensland's economic structure. There is a high propensity for the automotive value chain to comprise small to medium enterprises.

In Queensland, the automotive trade's value chain post Global Financial Crisis (GFC), generates in excess of an estimated $11 -12 billion annually, directly employing more than 40,000 people and contributes significantly to both Queensland's and the nation's economy.

The Association is the leading automotive training organisation in Queensland offering nationally recognised training, covering all aspects of the retail motor trades industry.

Economic and Financing Context

It would appear from the economic environment in which the automotive industry value chain operates in Queensland, there is a three speed economy.

The first speed economy, comprises the commodities export sectors and is forecast to experience very rapid growth; the second speed, includes industries such as the services sector, banks, construction, transport etc. and is expected to experience robust growth; and

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the third speed, consists of small to medium businesses in the metropolitan suburbs and in the regions that are not direct participants in or have a direct benefit from the commodities export sectors.

The widening economic disparity between the first and second speeds and the third speed particularly for the small businesses in the automotive industry value chain is a significant concern.

It appears important to appreciate, that as the Commonwealth Government phases out its economic stimulus package and the Reserve Bank of Australia (RBA) tightens monetary policy, economic performance is likely to be variable and a number of sectors comprising the second and third speed economies are likely to experience adverse conditions in the near term and many are likely to find recovery difficult to sustain.

These circumstances are likely to have the greatest impact on small and medium businesses. Even in the medium term, economic recovery in Queensland is likely to experience difficulties with the disparities of a three speed economy presenting challenges to both public policy and the business sector.

Business Policy Context

The change in policy settings by the Commonwealth Treasury and the RBA to encourage the private sector to operate corporations and businesses with greater prudential margins and lower debt equity ratios is appreciated by the MTA Queensland. The Australian Prudential Regulatory Authority (APRA) and the RBA have tightened both qualitative (lending guidelines) and quantitative (interest rates) policies.

These initiatives have precipitated through the banking system to the branch level where they translate into a succession of financial restructures for small businesses. These require small businesses to restructure loan collaterals and submit reformed business plans each time the guidelines alter. This imposes a heavy compliance cost on small businesses. Further, the transition period afforded to small businesses to respond to these changes are unreasonable, and in some cases impossible, contributing to business failures.

Submission

Anecdotal data from small businesses in the automotive industry value chain confirm that changing bank lending policies and practices are causing financial uncertainty and hardship. Over the last 12 months as a consequence of the GFC, banking institutions have repriced risk resulting in tighter and prudent lending policies and practices.

For example, the general banking guidelines applying to small businesses prior to the first quarter of 2009, permitted equity in trading stock to contribute to the collaterals for bank finance. By the second quarter of 2009, the guidelines had been restructured and the charge over trading stock was of itself no longer sufficient collateral for bank finance; equity in fixed assets, land and buildings was required to support stock collaterals.

Of greater concern was the devaluation of equity in fixed assets which was reduced for collateral purposes from 80% of independent valuations to 50%. This meant that banks were now holding a far higher collateral coverage with both fixed and

floating charges tying up small business collaterals, making it difficult to source non-bank finance.

In the third quarter of 2009 with unacceptably short advice, the banking sector restructured bank lending guidelines requiring collaterals to comprise business cash flows (profits) as well as assets at valuation. This occurred at a time when economic data showed that Australia had narrowly missed recession, profit margins difficult to maintain and businesses were either downsizing or restructuring with employees moving to job sharing or part-time positions.

In the fourth quarter of 2009, the general bank guidelines changed again to not finance working capital for trading stock, with inventory equity valued at zero for any basket of collaterals. In many instances, business equity in land, buildings and trading stock is unchanged or increased due to revaluations.

Lending policies and guideline restructures were accompanied by simultaneously increased bank fees and borrowing rates above that of residential mortgage holders in the period when the RBA had the cash rate at the emergency level of 3% - the lowest for 49 years. The small business sector finds the costs of compliance with a succession of restructures to the financial guidelines to small business excessive and likely to contribute to business failures.

The rapid changes to the structure of collaterals are unreasonable and the lack of transition time to adjust is also likely to contribute to business failures. The valuations of fixed assets at 50% of equity for collaterals in an inflating market is overly conservative and by limiting access to capital will curb economic growth in the small business sector.
Perhaps the most distressing feature of small business finance is that the higher interest rates compared to home mortgage rates, means that the small business sector is cross subsidising the attractive rates the banking sector is able to offer the real estate market as it competes for mortgage business.

The need for tightened prudential guidelines is appreciated by the small business sector but their implementation at the bank branch level in a generalised form means that all small businesses are classified in the high risk category. This lacks equity.

The banking sector is unfairly rationing capital to the small business sector and this is likely to contribute to the failure of (good) small businesses and a further generation of unemployment particularly in regional economies. Competition between the banking institutions has been of no benefit to small businesses in the automotive industry value chain as these businesses are tied to their lending institutions by mortgages or loans which incur penalties if changed.

Recommendations

1. Policy changes to the lending guidelines facing small business including increased collateral security should be kept to a minimum, as they impose relatively high compliance costs and compliance regimes on small business.

2. If banks are to restructure their lending guidelines to small business, they must provide adequate transition time to allow small business to adjust.

3. Due to the lack of real competition in the small business finance market, the interest rates charged to small businesses should be monitored to ensure they are equitable and policies carefully crafted to ensure that the small sector does not cross subsidise the interests rates to other sectors in particular the home mortgage market.

4. Policy architecture in relation to small business finance should have the competence to recognise the broad diversity of small businesses, so that guidelines based on lowest common denominator risk profiles, do not impose unwarranted high compliance costs on good professionally managed small businesses.

5. As the small business sector makes a significant contribution to the national economy, it would be in the national interest for the Commonwealth Government's policies to ensure that this sector is not starved of the funding required for investment in prudent and productive growth which will contribute to the nation's growth and wealth.

Thank you for your consideration.

Yours sincerely

Richard Payne
Principal Policy Director