30 March 2010

John Hawkins, Committee Secretary
Senate Standing Committee on Economics
Department of the Senate
Parliament House
Canberra ACT 2600

Dear Mr Hawkins

Inquiry into the Access of Small Business to Finance

Business Switch Pty Ltd welcomes the opportunity to provide its views on the current issues surrounding access of small businesses to finance. In particular, our focus is on Australians starting a business and the ability of start ups to access debt funding.

Business Switch (www.business-switch.com.au) is Australia's leading, full-service business start up company. Our sole focus is to help Australians successfully start up in business. Our services reduce the cost and time taken for Australians to get a new business operational, while also providing new enterprises with the support of an expert team throughout the start up process.

Business Switch has the following concerns about the access of start up businesses to finance. These concerns are based on the experiences of our team and events reported to us by our clients.

Overall, there has been a significant reduction in the availability of start up loans from banks and other financial institutions. This appears to be due to three reasons.

1. Loan–to-value ratio changes have hit start up businesses hard

The global financial crisis has changed loan-to-value (LVR) ratios unfavourably. Before the global financial crisis a person starting a business may have been able to borrow 100% using property and other assets acting as security. Today, banks have become much tighter in their lending practices, with LVRs of 80% or less quite common. For Australians starting a business this has resulted in lower levels of debt approved by financial institutions.

<u>Any further tightening of LVRs will have a corresponding impact on the ability of start up businesses to raise finance using existing assets.</u>

2. Merging of banks results in reduction of options to access debt funding

Australia's banking sector has become a small pond containing a few big fish. With just five main domestic banks there is less competition on interest rates and a lower total lending capacity.

The implications of this circumstance are not limited to just choice. One consequence of Australia's smaller banking pond is that individuals who have borrowed from one bank are running up against portfolio restrictions when they try to borrow from another bank in the same group.

For example, clients of Business Switch have been declined loans by Westpac because they have already borrowed from St.George, now owned by Westpac. This was not due to being too highly geared. Rather, the bank, as a single entity, was unwilling to add additional exposure. Similar cases have also arisen with Commonwealth Bank's ownership of BankWest.

A sign of the lack of competition is that Australia's four major banks – ANZ, CBA, NAB and Westpac – are the most profitable in the world. They delivered the highest combined returns to shareholders in 2008, according to a February 2009 survey by Boston Consulting Group.

The Reserve Bank of Australia forecasts that the major banks' returns to shareholders will be near all-time highs in 2010.

While we respect the commercial imperative of financial institutions, Business Switch warns that continued merging of banking enterprises will further limit options for start up enterprises to access capital in Australia.

3. Reduction in number of offshore financial institutions operating in Australia

The global financial crisis has also caused a number of offshore funding sources to remove or limit their lending activities in Australia.

Societe General and Toronto Dominion Bank have left the Australian lending market. While other funders have cut out lending arms which directly impact start up businesses. For example, in recent years, Suncorp Metway and All Commercial have withdrawn from the equipment finance sector. As key financiers in this marketplace, this has been a serious body blow to start up businesses looking to fund business machinery and vehicles

This restriction of options has impacted on the start up entrepreneur's ability to source competitive alternative funding.

Business Switch would like to see greater encouragement of foreign capital invested in the start up sector – either as debt or equity.

So, in the current environment, where do people starting a business seek debt funding?

a) Australians with an asset base starting a business

Australians with assets, such as property, can still leverage their assets though with much more difficulty and almost certainly on much more restrictive and less attractive terms than previously, for reasons as outlined earlier.

However, it is also worth noting that fewer and fewer start up founders have assets – primarily the family home – to offer as collateral. Research shows that Australians, as a whole have, have declining equity in their homes with overall household gearing levels reaching all time highs of around 30% in 2010.

Younger entrepreneurs in particular are less likely to own a home. According to Reserve Bank of Australia data released in November 2009, home ownership for buyers under 35 has fallen over the past 15 years, A likely reason is that average Australian house prices in capital cities are around five times the average Australian disposable household income, making Australian homes the least affordable since the mid-1990s.

Higher property prices are stifling the ability of younger entrepreneurs to launch businesses.

b) Australians with no asset base starting a business

People starting a business in Australia without an asset base are economic outcasts. Business Switch sees many sound business propositions that 'die' simply due to the inability to access debt funding.

Banks publically say they are interested in helping Australians to start a business. However, this appears limited to opening a business bank account and selling ancillary services. Evidence from our clients clearly suggests banks will not lend to any start up business unless it has an asset that can be provided as security.

It's a sad fact that the only time many financial institutions show an interest in lending money to a small business is after the enterprise has a decent track record of trading for a number of years. This is well after the tough start up period when finance is most needed.

<u>While we understand the commercial imperative of banks to focus on established businesses, this strategy crimps the aspirations of individuals wanting to start a business and, in turn, the potential growth of the Australian economy.</u>

What resources are available to people starting a business? Many turn to credit cards!

The sharp reduction in the availability of business bank loans and the lack of debt funding options to people with no assets means many people starting a business have no other option than to finance their start up with credit cards.

Credit card interest rates for customers with an established relationship with their bank are currently in the region of 20% per annum, around double the rates of small business loans at approximately 9–11% per annum.

These high interest rates certainly put Australians starting a business at a competitive disadvantage to established businesses, which are often able to access business loans. By default, high rates end up stymieing competition.

<u>While offering one of the few sources of debt funding for a start up, 20% and higher credit card interest rates often threaten the very survival of the fledgling business it is funding. However, for many Australians starting a business credit cards are their only source of debt funding.</u>

Banks love credit cards

Banks that do not feel the squeeze of competition do not need to take risks to earn substantial returns. In Australia, that means start up and small businesses end up losing out.

Credit cards are a very profitable business for banks. The total for outstanding charge and credit card balances at the end of January 2010 was $46.2 billion. With competition diminished it is difficult to see what incentives banks have to change to offer other forms of less expensive credit to people starting a business.

In fact, the opposite is occurring with banks finding new ways of making credit cards more profitable. Westpac, for instance has flagged it will begin applying interest to interest charges and fees on credit-card accounts. In more competitive markets such as the UK and Canada, lenders do not charge interest on interest.

This situation is damaging our economy

Business Switch believes this situation is untenable. Small businesses are vital players in Australia's economy representing 96% of all businesses and contributing around 39% of private industry value-add.

Being forced to borrow at higher rates discourages small business formation. It means only the start up businesses that can yield profits able to cover a credit card finance rate of 20% can survive. Borrowing at high rates also reduces the amount of debt an entrepreneur can afford to service and stunts the growth rates of start up businesses.

A solution is at hand

Business Switch asks, if Australian banks are prepared to provide customers with on-going lines of credit via a credit card which is frequently used for non-income producing purchases, couldn't the same credit history be parlayed into giving customers starting a business an interest rate closer to business loan terms of 9-11%?

Surely investing in a start up business is a safer, more positive investment than open credit provided for holidays, gifts and fashion accessories.

It seems likely that the risk factors are lower and the opportunity of building client loyalty over the long term with a growing business must represent some potential to financial institutions.

The benefits to the Australian economy make it at least worthy of investigation.

In closing, Business Switch supports the intent of the Senate Standing Committee on Economics to understand the issues relating to small business access to finance. We encourage the Senate to work towards solutions that include start up businesses and help young businesses achieve a fairer deal in Australia.

Yours sincerely,

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