

Chapter 1

Introduction

Terms of reference

1.1 On 25 November 2010, the House of Representatives resolved that the Parliamentary Joint Committee on Corporations and Financial Services would inquire, and report by 30 April 2011, into access to finance for small and medium businesses with particular reference to:

- (i) the types of finance and credit options available to small and medium business (SMEs) in Australia;
- (ii) the current levels of choice and competition between lending institutions, but not limited to, credit availability, fees, charges, comparative interest rates and conditions for business finance;
- (iii) credit options available from banks, non-bank lenders and second tier lenders;
- (iv) the impact of financial institution prudential requirements and banking guarantees on lending costs and practices;
- (v) comparison between the credit options available to SMEs located in regional Australia and metropolitan areas;
- (vi) the impact of lenders' equity and security requirements on the amount of finance available to SMEs;
- (vii) policies, practices and strategies that may restrict access to SME finance, and the possible effects this may have on innovation, productivity, growth and job creation;
- (viii) the need for any legislative or regulatory change to assist access by SME to finance; and
- (ix) any other related matters.

Conduct of the inquiry

1.2 The inquiry was advertised in *The Australian* newspaper. Details of the inquiry were placed on the committee's website. The committee invited submissions from a wide range of interested organisations, government departments and authorities, and individuals. The closing date for submissions was 7 February 2011. 19 submissions were received, as listed in Appendix 1.

1.3 Public hearings were held in Canberra and on 11 March 2011 in Sydney. A list of witnesses who gave evidence at the public hearings is at Appendix 2.

1.4 The committee thanks those organisations and individuals that made written submissions, and those who gave evidence at the public hearings.

Note on references

1.5 References to submissions in this report are to individual submissions received by the committee and published on the internet.¹ References to the committee Hansard are to the official Hansard transcript of the public hearings, for which only a proof transcript was available at the time of writing.² Please note that page numbers may vary between the proof and the official Hansard transcripts.

Background

1.6 The health of Australia's financial system and the support of small and medium businesses are two issues of enduring concern to the Australian parliament. The committee acknowledges the work of other parliamentary committees, both past and ongoing, in looking at important issues in relation to SME finance. The House Standing Committee on Economics presented its report 'Competition in the banking and non-banking sectors' in November 2008. The Senate Economics References Committee's June 2010 report 'Access of Small Business to Finance' provided an important backdrop to the current inquiry. That committee is also currently inquiring into competition within the Australian banking sector. As this committee's report will note in chapter 4, competition amongst lenders is important to ensuring affordable finance for SMEs, and the committee notes recent government initiatives in this area.

Definition of SMEs

1.7 Evidence presented to the committee highlights that multiple definitions of small and medium enterprises are used across the finance sector and other regulatory sectors. As Treasury advised, the criteria used to define SMEs can vary between industry participants:

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.³

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- 1 Submissions to the inquiry are available at the following link:
http://www.aph.gov.au/senate/committee/corporations_ctte/sme_finance/submissions.htm
(accessed 27 April 2011).
 - 2 Transcripts of the committee's public hearings can be accessed at the following link:
http://www.aph.gov.au/senate/committee/corporations_ctte/sme_finance/hearings/index.htm
(accessed 27 April 2011).
 - 3 Treasury, *Submission 16*, p. 2.

1.8 The National Australia Bank (NAB) referred to definitions adopted by market researchers DBM Consultants, which define 'microbusiness customers' as businesses with turnover under \$1 million, 'small business customers' as businesses with turnover between \$1 million – \$5 million, and 'medium business customers' as businesses with turnover between \$5 million – \$50 million.⁴ The Commonwealth Bank of Australia (CBA) referenced the definition in the Australian Prudential Regulation Authority's monthly reporting requirements; 'that is, client loan balances less than \$2 million'.⁵

1.9 The definition of SMEs can also vary between members of a banking group. For example, the Westpac Group advised that Westpac defines SMEs as businesses with up to \$1 million in business lending and up to \$2 million in total borrowings, while St George Bank defines SMEs as businesses with lending of up to \$1 million and turnover between \$1 – \$5 million.⁶

1.10 For the Mutual sector, the 'Mutual Banking Code of Practice' contains two definitions of 'small business':

"Small business" – A business having few than: a) 100 full-time (or equivalent) people if it involves the manufacture of goods, or, b), in any other case, 20 full time (or equivalent) people.⁷

1.11 Definitions used by lenders can be contrasted with definitions adopted by SME representatives. The NSW Business Chamber referred to the Australian Bureau of Statistics' definition of small business as a business employing fewer than 20 employees.⁸ Similarly, CPA Australia advised that its Asia Pacific Small Business Survey 2010 focused on businesses with fewer than 20 employees.⁹ The Australian Chamber of Commerce and Industry (ACCI) advised that its definition of SMEs is based not on the number of employees but the size of the loan:

I suppose for the purpose of our representations here, it is probably more in the order of up to \$2 million. Beyond that, it is probably 'medium-sized business'. That is how we would consider it.¹⁰

1.12 The definition of SMEs also varies across relevant Commonwealth legislation and agencies. 'Small business employer' is defined for the purposes of the *Fair Work Act 2009* and the Small Business Fair Dismissal Code as an employer that

4 National Australia Bank, *Submission 19*, p. 5.

5 Commonwealth Bank of Australia, *Submission 17*, p. 1.

6 The Westpac Group, *Submission 9*, p. 2.

7 Abacus – Australian Mutuals, 'Mutual Banking Code of Practice', January 2010, p. 28.

8 NSW Business Chamber, *Submission 8*, p. 3.

9 CPA Australia, *Submission 10*, p. 3.

10 Mr Greg Evans, Director of Economics and Industry Policy, ACCI, *Proof Hansard*, 2 March 2011, p. 16.

employs fewer than 15 employees.¹¹ By contrast, Treasury advised that for taxation purposes a medium business is 'in most cases, defined as an entity with annual total income of greater than \$10 million',¹² while a separate definition applies to small businesses:

Broadly, a small business entity for taxation purposes is one with an aggregated turnover of less than \$2 million. The aggregated turnover includes the turnover of the small business entity and certain closely related entities.¹³

1.13 The Australian Bureau of Statistics uses employment to define business size. Under the ABS definition, small businesses employ fewer than 20 people, medium businesses 20 to 199 people, and large business 200 or more people.¹⁴

1.14 The Reserve Bank of Australia (RBA) advised that the absence of a uniform definition has prompted the RBA to use 'several measures to delineate small and large businesses and the finance flowing to these sectors.' The measures include whether the SME is an unincorporated enterprise, and the size of the business loan, where the RBA assumes 'that loans of less than \$2 million are generally provided to small businesses'.¹⁵

1.15 Treasury stated that 'there is not a clear distinction between what constitutes a small business and what constitutes a medium-sized business'.¹⁶ Similarly, the RBA also stated that the RBA measures do not distinguish between small and medium-sized enterprises.

No further breakdown of loans about \$2 million is available, and hence, it is not possible to provide any further information on financing to medium-sized businesses.¹⁷

1.16 The Australian Finance Conference (the AFC) raised concerns with the absence of a uniform definition of SMEs:

Much difficulty and confusion in the discussion and development of SME finance policy is caused by imprecision as to what exactly is the subject of consideration.¹⁸

11 *Fair Work Act 2009*, s. 23; Fair Work Australia, *Small Business Fair Dismissal Code*, <http://www.fwa.gov.au/index.cfm?pagename=legislationfwdissmissalcode> (accessed 30 March 2011).

12 Treasury, *Submission 16*, p. 2.

13 Treasury, answer to question on notice, 4 March 2011 (received 29 March 2011).

14 Australian Bureau of Statistics, *Australian industry*, 2008-09, cat.no. 8165.0, [http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/F5105AEC0D3E0B11CA257730001839E5/\\$File/81550_2008-09_1.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/F5105AEC0D3E0B11CA257730001839E5/$File/81550_2008-09_1.pdf) (accessed 19 April 2011).

15 RBA, *Submission 3*, p. 1.

16 Treasury, *Submission 16*, p. 2.

17 RBA, *Submission 3*, pp. 1–2.

1.17 However, this concern did not appear to be necessarily widely shared. In response to questions on this issue, ACCI noted that lenders' procedures can differ depending on whether the applicant is considered a small business but did not comment on whether the multiple definitions had a positive or negative outcome.¹⁹ Treasury advised that it does not consider that the absence of a settled definition poses regulatory problems.²⁰ Westpac Group linked the flexibility to define SMEs with increased lending competition: 'Westpac and St George's different approach to the SME market is part of the Westpac Group's multi-branded strategy.'²¹

1.18 The committee is aware that industry-specific definitions can serve regulatory and policy purposes. In the United States, the Small Business Administration delivers small business support programs, including guidelines for government contracting.²² It maintains different small business size standards for each industry sector, some based on annual receipts and some on numbers of employees. These standards are used to tailor program eligibility to the structure of each business sector.

Committee view

1.19 Evidence before the committee does not indicate that the absence of a uniform definition of SMEs directly restricts SME's access to finance. However, the committee considers that the SME sector would benefit from consistent, sector-wide definitions of 'micro', 'small' and 'medium' business. Consistent definitions would assist analysis of the health of the SME sector and encourage greater use of the analysis by SME stakeholders. A shared understanding of micro, small and medium business would also promote more informed policy and practice and solutions tailored to the challenges faced by each kind of SME.

1.20 For the purposes of this report, the committee notes the definitions used by each submitter to the inquiry.

Recommendation 1

1.21 The committee recommends that the Government assess the value of developing uniform definitions of 'micro', 'small' and 'medium' business to be applied for data gathering, policy development and analysis by Commonwealth and state agencies.

18 AFC, *Submission 15*, p. 3.

19 Mr Evans, ACCI, *Proof Hansard*, 2 March 2011, p. 16.

20 Mr Ian Beckett, Principal Adviser, Financial Systems Division, Treasury, *Proof Hansard*, 4 March 2011, p. 43.

21 The Westpac Group, *Submission 9*, p. 2.

22 US Small Business Administration, Size standards, <http://www.sba.gov/content/size-standards> (accessed 21 April 2011).

The importance of access to finance for SMEs

1.22 Small and medium businesses are a fundamental part of Australia's economy. The Australian Bureau of Statistics has calculated that at 30 June 2009 SMEs provided employment for approximately 7.1 million people.²³ For the 2008-09 financial year, SMEs also provided 58% of industry value added; that is, businesses' contribution to the gross domestic product.²⁴

1.23 The relevance of SMEs to the Australian economy was noted in submissions to the inquiry. For example, Treasury advised that:

Small and medium sized enterprises (SMEs) make a significant contribution to employment, productivity, and value added in the Australian economy.²⁵

1.24 Several submissions also argued that a strong SME sector is a vital component of a robust economy.²⁶ Views put to the committee are reflected in ACCI's statement that:

a healthy small business sector is the key in ensuring the durability and sustainability of private sector-led growth, creating jobs and introducing innovation and productivity growth in the Australian economy.²⁷

1.25 Against this background, the committee was informed that SMEs have limited funding options and place considerable reliance on debt funding. The RBA advised that:

Businesses use a combination of debt and equity to fund their operations. Compared with large companies, smaller businesses tend to make greater use of debt funding and less use of equity funding; the latter is generally limited to the personal capital of the owners. Small businesses rely mainly on loans from banks and other financial institutions for their debt funding, as it is difficult and costly for them to raise funds directly from debt capital markets. Most lending to small businesses is secured against residential property.²⁸

23 Australian Bureau of Statistics, 'Employment by business size', Australian Industry, cat. No. 8155.0.

24 Australian Bureau of Statistics, 'Industry value added by business size (private sector)', Australian Industry, cat. No. 8155.0.

25 Treasury, *Submission 16*, p. 1.

26 ACCI, *Submission 6*, p. 6; National Australia Bank, *Submission 19*, p. 5; NSW Business Chamber, *Submission 8*, p. 1; Real Estate Institute of Australia, *Submission 7*, p. 2; Urban Taskforce Australia Ltd, *Submission 1*, p. 2.

27 ACCI, *Submission 6*, p. 6.

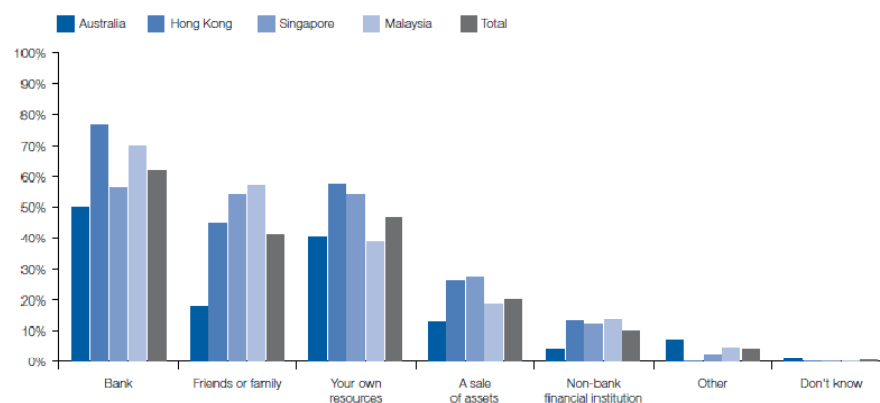
28 RBA, *Submission 3*, p. 1.

1.26 Treasury shared this view, stating that debt funding from banks is essential for SME business:

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.²⁹

1.27 CPA Australia reported that for the Australian businesses surveyed as part of the Asia Pacific Small Business Survey 2010 (the Asia Pacific Survey), 'the most important source of finance was from a bank'. The data provided indicated that for the Australian respondents bank lending was the primary source of funding followed by internal resources.³⁰

Figure 1.1: CPA Australia, Asia Pacific Small Business Survey 2010, 'Source of additional funds'



Question 3-4: And from which of the following sources were those 'required additional funds' obtained?
(Multiple response) (Australia n=128, Hong Kong n=85, Malaysia n=96, Singapore n=85)

1.28 It was put to the committee that access to finance, particularly debt funding, is a key part of a strong SME sector. For example, ACCI stated that SMEs 'rely heavily on intermediated finance from financial institutions for their working capital, new capital expenditure...as well as opportunities for overall expansion.'³¹ Similarly, CPA Australia reported that the two main reasons for SMEs in Australia to seek finance are increasing business expenses (30.5 per cent) and business growth (28.1 per cent), with the third being business survival (27.3 per cent).³²

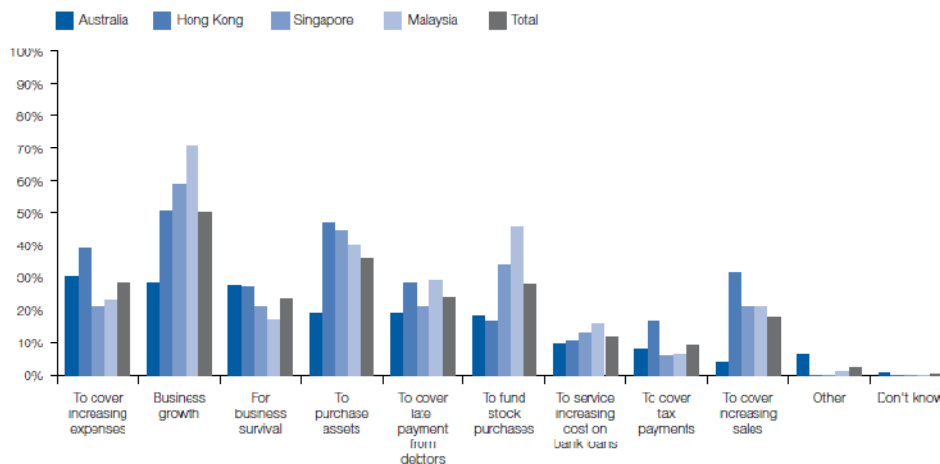
29 Treasury, *Submission 16*, p. 1.

30 CPA Australia, *Submission 10*, p. 4.

31 ACCI, *Submission 6*, p. iii.

32 CPA Australia, *Submission 10*, p. 3.

Figure 1.2: CPA Australia, Asia Pacific Small Business Survey 2010, 'Reasons for seeking additional funds'³³



Question 3-5: And which of the following best describe the reasons for the 'required extra funds'? (Multiple response) (Australia n=128, Hong Kong n=85, Malaysia n=96, Singapore n=85)

1.29 The NAB also linked business lending to business growth, stating that SMEs 'need financial support to grow and thrive. Good quality business lending is critical to a healthy and robust Australian economy.'³⁴

1.30 Conversely, difficulties accessing finance were cited as contributing to poor SME performance. For example, ACCI submitted that 'while the economy begins to recover, more businesses are reporting the negative impact of difficulties in obtaining finance on their investment plans as well as their normal operating expenses.'³⁵ ACCI provided data from Victoria University's 2010 small business survey which found that inadequate access to finance was considered a major obstacle to growth by 16 per cent, and a moderate obstacle by a further 18 per cent, of the 284 businesses surveyed. Similarly, the NSW Business Chamber stated:

Small businesses will struggle to grow without access to finance. Their lower margins and smaller size means that it is more difficult for them to save; and funding expansions, riding economic downturns, and maintaining the ongoing viability of a small business typically all require access to finance.³⁶

33 CPA Australia, *The CPA Australia Asia-Pacific small business survey 2010: Australia, Hong Kong, Malaysia and Singapore*, 'Figure 4: Reasons for seeking additional funds', p. 12, as cited in CPA Australia, *Submission 10*, p. 4.

34 NAB, *Submission 19*, p. 1.

35 ACCI, *Submission 6*, p. 9.

36 NSW Business Chamber, *Submission 8*, p. 4.

1.31 The Victoria University survey also noted adverse impacts on business productivity, with 30 per cent of respondents indicating that the business had 'passed up' business opportunities due to difficulties accessing finance.³⁷

1.32 Evidence presented to the committee also highlighted a connection between access to finance and employment. CPA Australia advised that:

[A] global survey conducted on behalf of CPA Australia, the Association of Certified Chartered Accountants (United Kingdom) and the Certified General Accountants Association of Canada in 2009...found, not surprisingly, that employment by SMEs is sensitive to the supply of finance. The survey found that SMEs facing tough credit conditions, and SMEs facing severe cash flow problems, are almost three times as likely to lay off staff as those SMEs not so affected.³⁸

1.33 Several submissions also stated that SMEs are turning to less appropriate forms of finance due to difficulties obtaining business loans. For example, CPA Australia and the Lismore and District Financial Counselling Service reported that SMEs are sourcing finance from credit cards or family members due to difficulties accessing business loans.³⁹ CPA Australia advised that the Asia Pacific survey found that 62.6 per cent of Australian small businesses used credit cards as a source of finance.⁴⁰ ACCI stated that over-reliance on credit card funding can increase business costs:

Heavy reliance on credit card finance also means that business owners are paying more than double the interest rate charges for credit card finance than a residentially-secured business loan, which puts significant pressure on small business.⁴¹

Committee view

1.34 The SME sector is vitally important to the Australian economy. The number of previous inquiries into small business finance is a testament to the need to ensure that SMEs have access to finance to support productivity, growth and innovation. As the main source of finance for SMEs, access to debt funding from lending institutions is an essential part of a healthy, robust SME sector. A properly functioning market economy requires the support of policies that facilitate lending from financial institutions. However, as will be explored, it is equally important for there to be a balanced approach to lending, one that is neither overly restrictive nor imprudent regarding the risks associated with lending.

37 ACCI, *Submission 6*, p. 11.

38 CPA Australia, *Submission 10*, p. 9.

39 CPA Australia, *Submission 10*, pp 3–4, p.6; Lismore and District Financial Counselling Service Inc., *Submission 2*, p. 1.

40 CPA Australia, *Submission 10*, p. 5.

41 ACCI, *Submission 6*, p. 10.