Chapter 6

Structural change in the market for small business finance

Introduction

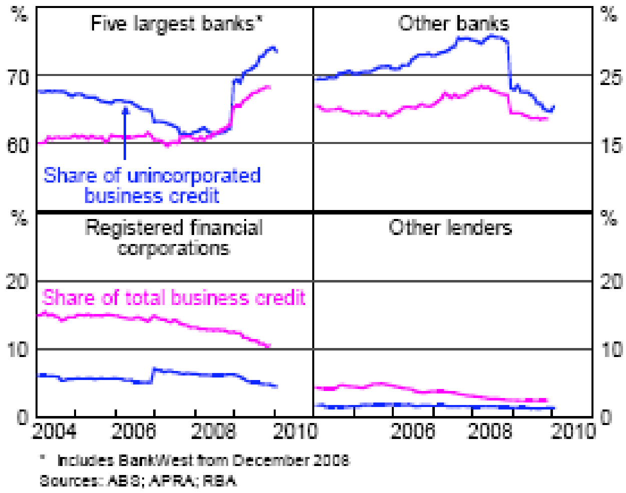
6.1 The Australian banking market is dominated by four large banks, now accounting for around ¾ of the market. This has resulted from a series of mergers going back more than a century (Charts 6.2 to 6.6).

6.2 The Committee has commented in an earlier report:

> A consequence of these mergers has been a long-run tendency towards increased concentration within the Australian banking industry. There was a temporary reduction in concentration with the deregulation of the 1980s, mostly reflecting the entry of foreign banks and conversion of the larger building societies, but this has now been overwhelmed by the ongoing mergers. As a result the Australian banking market is now, by some criteria, the most concentrated it has been for more than a century…The Australian banking market is now quite concentrated by international standards. This is likely to be one reason it is more profitable, and has wider interest margins, than banks in most comparable countries…[1]

6.3 Since the start of the global financial crisis, Westpac has taken over St George and the Commonwealth Bank has taken over BankWest, further entrenching the dominance of the four majors (Chart 6.1)

Chart 6.1: Lenders' shares of business credit



Source: Reserve Bank of Australia, *Submission 2*, p. 6.

1 Senate Economics References Committee, *Report on Bank Mergers*, September 2009, pp 5-6.

Chart 6.2: Commonwealth Bank family tree

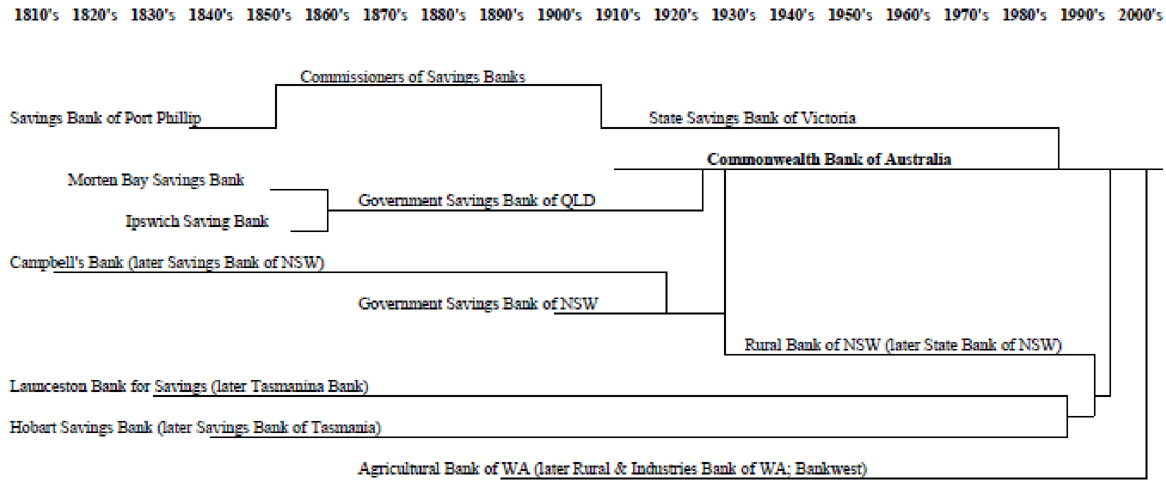


Chart 6.3: ANZ Bank family tree

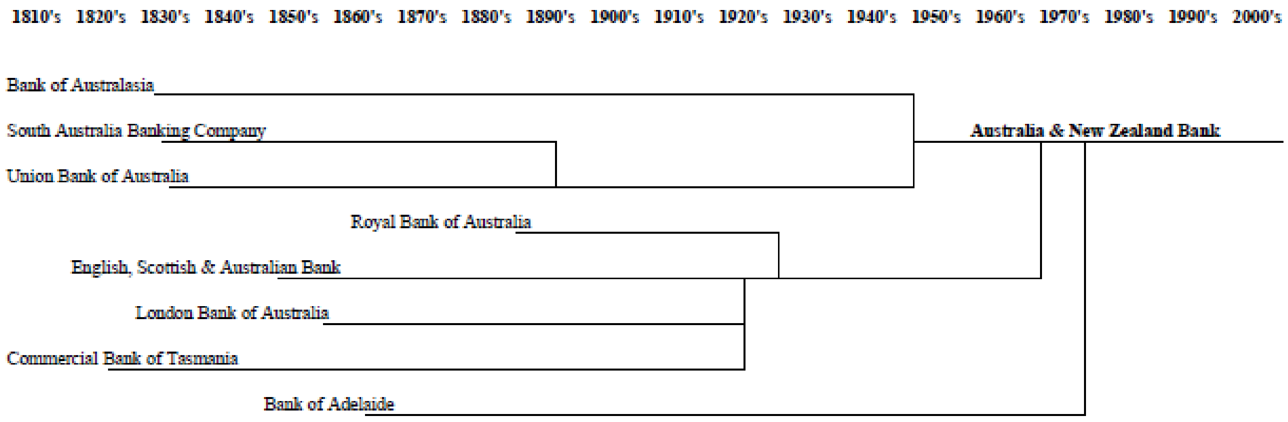


Chart 6.4: National Australia Bank family tree

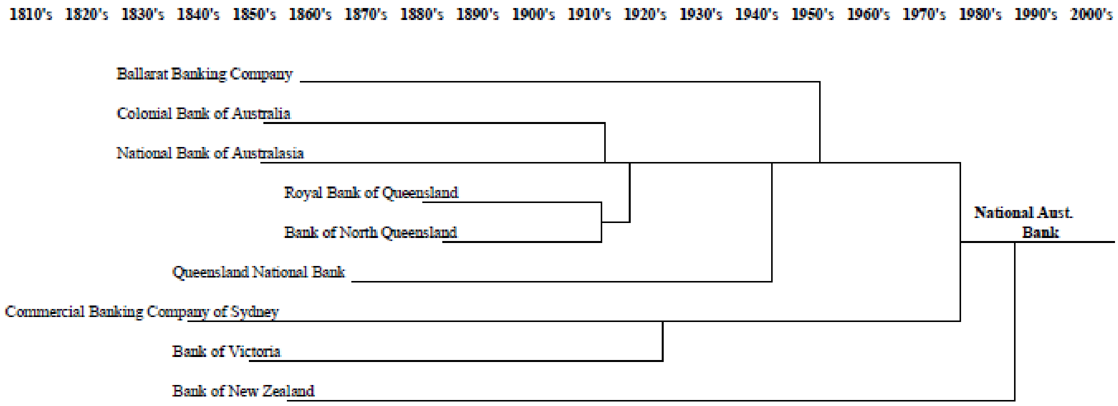
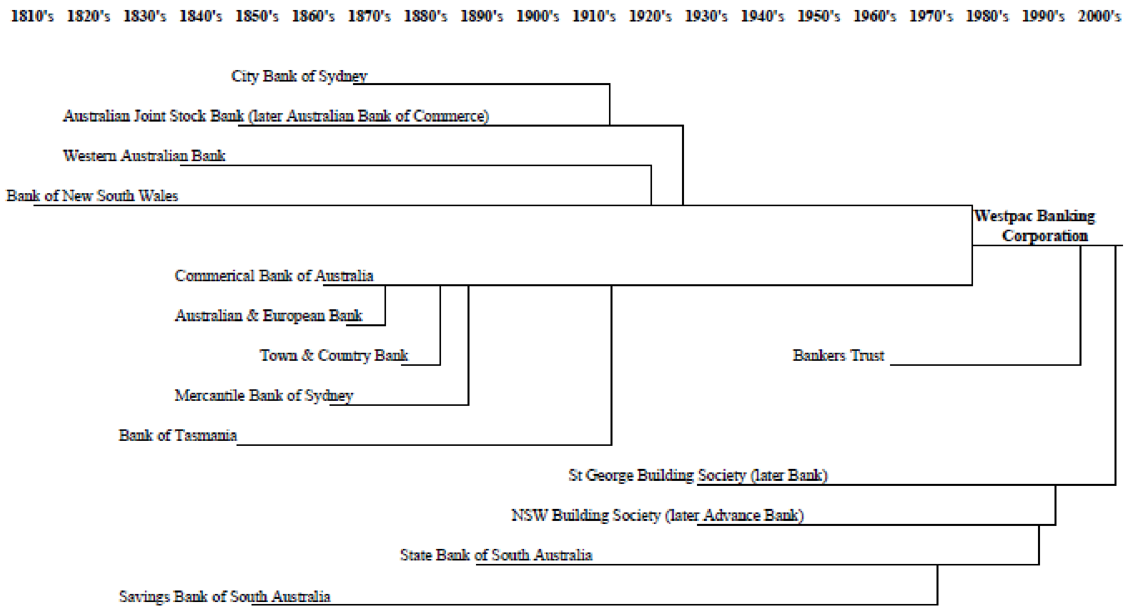


Chart 6.5: Westpac Bank family tree



Implications for small business lending

6.4 As banks become larger they are more able to make large loans to large companies. It has been suggested that this may lead to them being less interested in lending to small business.[2] Overseas studies have found some empirical evidence that larger banks make a smaller proportion of their loans to small business.[3]

6.5 A tendency for mergers between banks may also go some way to explaining the observation that internationally:

> …there is anecdotal and increasingly statistical evidence that Small and Medium Enterprises have not benefited from this financial deepening to the same extent as other borrower groups…[4]

6.6 A cross-country study by World Bank economists concluded that more concentrated banking systems particularly disadvantage smaller businesses:

> Our results indicate that in more concentrated banking markets firms of all sizes face higher financing obstacles and are less likely to receive bank financing. This effect decreases as we move from small to medium and large firms…[5]

6.7 Treasury offered some support to the proposition that larger banks lend more to larger companies (to the extent that 'local' refers to regional banks such as St George and BankWest that have been taken over by national banks):

> Senator EGGLESTON—Do you suppose that the local banks might have a better perception of local economic circumstances and be more prepared to consider propositions because they better understand the local economy?

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2 See the discussion in Group of Ten, *Consolidation in the Financial System*, January 2001, pp 278-286. A related concern often expressed is that foreign banks are less interested than domestic banks in lending to small businesses, although the evidence for this is mixed; see J Hawkins and D Mihaljek, 'The banking industry in the emerging market economies: competition, consolidation and systematic stability: an overview', Bank for International Settlements, *BIS Papers*, no 4, August 2001.

3 This literature is summarised in Group of Ten, *Consolidation in the Financial System*, January 2001, pp 284-5; A Berger, R Demsetz and P Strahan, 'The consolidation of the financial services industry: causes, consequences and implications for the future', *Journal of Banking and Finance*, 1999, vol 23, no 2, pp 135-194; E Carletti, P Hartmann and G Spagnolo, 'Implications of the bank merger wave for competition and stability', *Risk Measurement and Systemic Risk*, CGFS Conference volume, no 2, October 2002, pp 39-42 and Senate Economics References Committee, *Report on Bank Mergers*, September 2009, p. 36.

4 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, provided by NARGA in response to a question on notice, p. 1.

5 T Beck, A Demirgfi-Kunt and V Maksimovic, 'Bank competition, financing obstacles and access to credit', *World Bank Policy Research Working Papers*, no. 2996, March 2003, p. 2.

Mr Murphy—Yes.[6]

6.8 The Australian banks have implicitly agreed, as they have indicated that they are being constrained in their involvement in making loans to large business by their size. While they do not put it in these terms, this suggests that as they become larger they will focus a larger proportion of their attention on very large loans and by implication a smaller proportion of their assets will be in loans for small business. For example, then Westpac CEO David Morgan commented:

> To out it bluntly, the Australian majors need scale…Westpac often finds itself competing against organisations ten times our size. So no one should be too surprised when we do not feature in the 'mega deals'. Size does matter when it comes to lead bank roles and taking on the exposures involved.[7]

6.9 The Reserve Bank also implicitly support this view as they comment:

> The major banks are a particularly important source of debt funding for small businesses…Foreign-owned banks provide only a small share, in part because they do not have a substantial branch network.[8]

6.10 Small business loans make up 12 per cent of St George's loan book but only 5 per cent of the larger bank Westpac's loan portfolio.[9]

6.11 Asked for their view, the Australian Prudential Regulation Authority replied:

> Some historical context may be of use here. In some countries such as the United States and Japan, the current larger banks originated as 'city' banks with a focus on large business lending, while smaller banks started in regional centres and naturally had more focus upon personal and smaller business lending. This is not the historical pattern in Australia. In Australia, the current smaller banks and other ADIs typically originated as home lenders and personal lenders, and the larger commercial banks dominated not only large corporate loans, but small and medium enterprise loans. Based on statistics available to APRA as at end-December 2009, there is no clear pattern that supports the view that large banks concentrate on lending to large business while smaller banks focus on small business. There is considerable variation from bank to bank depending on their business strategy, with some larger banks having a relatively higher share of lending to small business. Regional banks as a group tend to have a relatively high share of small business loans to total loans.[10]

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6 Mr Jim Murphy, Executive Director, Treasury, *Committee Hansard*, 12 March 2009, p 30.

7 David Morgan, 'Changing the game', address to Trans Tasman Business Circle, 26 July 2007. Since this speech was given, some of those larger organisations would have shrunk or closed.

8 Reserve Bank of Australia, *Submission 2*, p. 2.

9 Westpac, *Submission 31*, p. 2.

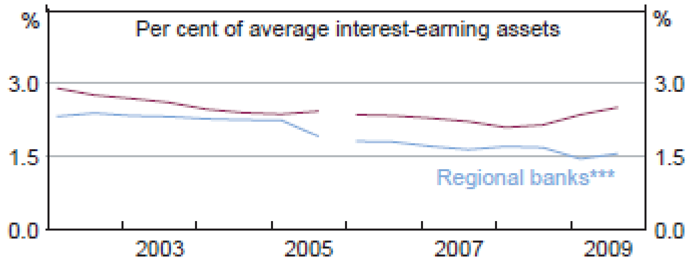
10 APRA, responses to questions on notice.

6.12 APRA also did not believe their 'large exposure' limits would have the effect of precluding smaller banks lending to large companies:

> APRA has large exposures limits for different classes of counterparty as a percentage of the ADI’s capital base. The maximum for non-Government non-ADI counterparties is 25 per cent of capital; typically, there are limited exposures beyond 10 per cent of capital to this category of borrower. It is unlikely that APRA’s requirements would limit the ability of ADIs to lend to large businesses and thus have the suggested impact on lending to small business. ADIs also have their own limits on exposures to individual borrowers and sectors as part of their internal risk management and these limits are aimed at avoiding a concentration of exposures to individual counterparties, groups, sectors or geographical regions.[11]

6.13 As well as having less enthusiasm for small business lending, there is some evidence that the major banks (the upper line in Chart 6.2) tend to have wider interest margins than do the regional banks.

Chart 6.2: Australian Banks' Net Interest Income



Source: Reserve Bank of Australia, *Financial Stability Review*, March 2010, p. 18.

6.14 Some business groups have also expressed concern that mergers are leading to an overly concentrated banking industry:

> …our marketplace must stay open to new entrants. Secondly, we must show more scepticism about claims that the merger of second and third tier financial institutions will not lessen competition. It does, it has and it will.[12]

> Consultations with small businesses suggest that over and above the lack of credit due to the recent tightening related to the GFC, there is potentially a lack of competition in the market for lending to small businesses.[13]

> When you see…a functioning oligarchy…then obviously it is going to be an issue in terms of the provision of competition…[14]

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11 APRA, responses to questions on notice.

12 Mr Stephen Cartwright, Chief Executive Officer, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 88.

13 Australian Industry Group, *Submission 14*, p. 9.

> The ARA notes widespread concern regarding the lack of competition in the banking sector leading to higher fees and interest rates, standard non-competitive products and a general ignorance and disinterest about the lending requirements of small business.[15]

6.15 Large banks may centralise credit assessment, with adverse consequences:

> …loan applications from Far North Queensland may be assessed in Sydney, where there is no "local" knowledge of regional industries. This has impacted on the ability of rural and other localised industries to obtain funding.[16]

6.16 There is evidence that the ever larger banks are losing credit assessment abilities relevant to small business lending:

> In a recent poll conducted by ACCI during March 2010, 34 per cent of the 215 business respondents reported that their business bankers do not have adequate understanding of their business' cash flows and its ability to service any current or prospective loan obligations.[17]
>
> We have observed over the last decade and a half that there has been a stripping out of trained business lending officers within the banking system in favour of lending for households…It has basically meant the demise of the local bank manager, and that has had an impact on the capacity of banks to assess risk.[18]

6.17 Westpac refers to actions it has taken which might offset this tendency, commenting:

> Westpac commenced a significant investment in grassroots banking in 2009, including bringing back the local Bank Manager and empowering branches to better support local communities. The 18 month program is well progressed - Westpac has created over 1,300 roles which include 530 new Bank Managers and 59 regional managers and will have recruited over 700 new branch staff by mid-year to support our renewed focus on customerfacing representation. Business customer representation has also been increased, with 150 new commercial bankers recruited in 2009 and another 50 are expected to have been recruited by the middle of this year. St George has similarly significantly increased the numbers of its SME relationship managers in the past two years.[19]

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14 Mr Stephen Cartwright, Chief Executive Officer, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 99.

15 Australian Retailers' Association, *Submission 45*, p. 6.

16 Commercial Asset Finance Brokers Association of Australia, *Submission 22*, p. 2.

17 Australian Chamber of Commerce and Industry, *Submission 32*, p. 20.

18 Mr Greg Evans, Director of Economics and Industry Policy, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 10 May 2010, p. 10.

19 Westpac, *Submission 31*, p. 2.

6.18 National Australia Bank has referred to the virtues of:

> …doing business with customers you can see from the local church spire.[20]

6.19 There has been a reduction in competition within specific segments of the finance market. For example, in the equipment leasing space:

> Lenders whose products are no longer available to Equipment Finance Brokers include ABN Amro Ltd, Adelaide Bank, AGC Ltd (independently of Westpac), Bendigo Bank, Colonial State Bank, G E Commercial Finance, Members Equity Bank, Orix Australia Corp, Societe Generale (SG) Aust Ltd and Suncorp Metway Ltd. Each departure from this market removes a particular expertise or product range, leaving fewer options available to Small Business borrowers.[21]

6.20 A specific merger was raised by the Western Australian Farmers' Federation. They oppose the proposed acquisition by ANZ Bank of the deposit and loan books of Landmark Financial Services. Their concern is that:

> Traditionally, lending facilities provided by Landmark incorporate assessment of the value of a farm business in the decision making process. Effectively, if a farmer sells their produce through Landmark, the lender controls the farm cash flow. Purchase of merchandise, insurance and agronomic services through Landmark also provide an income stream to Landmark. These facets of this lender/borrower relationship in some instances will result in lending criteria being more flexible than is the case in a traditional lender/borrower relationship with a banking institution. Interest rates are generally of a higher level to compensate for increased risk in these instances but a lender such as Landmark will in all likelihood extend finance in times of seasonal downturn beyond which a banking institution will …WAFarmers does not believe that this latitude would be continued under normal banking criteria imposed by the ANZ …The very real threat of the proposed acquisition should it proceed will be that the ANZ will cherry pick the loan book of “secure” borrowers, discard those that don’t meet their criteria and retain the deposit book.[22]

Regulated lending

6.21 A possible response is to have regulations mandating minimum proportions of lending to small business:

> I am aware of some South East Asian countries—I think the Philippines—where banks have to put 25 per cent of their loan book into small business.[23]

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20 Mr Joseph Healy, 'Banks, business lending and the economy', 17 February 2010, p. 6, reprinted in NAB, *Submission 44*, attachment 1.

21 Commercial Asset Finance Brokers Association of Australia, *Submission 22*, p. 2.

22 Western Australian Farmers' Federation, *Submission 26*, p. 2.

23 Mr John Cummings, Chairman, NARGA, *Committee Hansard*, 12 April 2010, p. 32.

> …we really need to put in place some sort of structure to ensure that a certain proportion of bank lending continues to go to the small-business sector.[24]

6.22 Professor Sathye doubted this is feasible in Australia:

> The second way could be—of course, it's probably not plausible in Australia in a market economy—to give some sort of mandated target. But that would be interfering in the free market.[25]

Increasing competition from non-bank lenders

6.23 Building societies and credit unions, particularly in regional areas, may be able to provide more competition for the small businesses. They identified as an impediment to their competing that it costs them more to raise funds as many potential customers are under the misapprehension that the mutual organisations do not meet the same prudential standards as the banks:

> But every bit of market research testing we do, and all our dealings with commentators, show us that in particular credit union and building society brands are perceived as less well regulated than the major banks. There is very, very limited understanding of the fact that we have got a harmonised prudential system in Australia. There is very little understanding that on all the risk measures you look at—and it is not just here in Australia but under the Basel Framework globally—the credit union systems have come out as particularly resilient because they are particularly conservative and do not have access to the same kind of risks that internationally operating and complex businesses do, and all the complexity around their balance sheets.[26]

6.24 Abacus suggests allowing building societies and credit unions to style themselves 'mutual banks' may overcome this disadvantage.

Committee view

6.25 In its 2009 report on bank mergers, the Committee supported retention of the 'four pillars' policy. It also recommended that:

> …the Government request the ACCC, APRA and the Reserve Bank to provide a joint annual report to parliament on competition in the retail banking market in Australia, and the provision of affordable banking

24 Mr Frank Sirianni, Consultant, Pharmacy Guild of Australia, *Proof Committee Hansard*, 10 May 2010, p. 47.

25 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 18.

26 Ms Louise Petscher, Chief Executive Officer, Abacus, *Proof Committee Hansard*, 10 May 2010, p. 36.

> facilities to those on low incomes, but taking care not to increase unduly the reporting burden on financial institutions.[27]

6.26 The Committee still holds to these views and also sees value in the annual report addressing the provision of finance for small business.

6.27 The Committee is concerned that takeovers of regional banks by major banks are not only reducing the number of competitors but are specifically removing those banks most interested in lending to small business. Given the evidence it has seen in other inquiries, most recently into the dairy industry, the Committee is concerned that the existing provisions of the *Trade Practices Act 1974* may be insufficient to prevent further undesirable takeovers in the banking industry.

Recommendation 2

6.28 The Committee reiterates its recommendation that the Government retain the 'four pillars' policy of not allowing a merger between any of the four major banks.

Recommendation 3

6.29 The Committee recommends that a moratorium be placed on approval of any further takeovers in the banking industry for one year, unless the bank being taken over is at imminent risk of failure.

Recommendation 4

6.30 The Committee reiterates its recommendation that the Trade Practices Act be amended to inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

Recommendation 5

6.31 The Committee recommends that the Government request the ACCC, APRA and the Reserve Bank to provide a joint annual report to parliament on competition in the retail banking market in Australia, and the provision of finance to small business, but taking care not to increase unduly the reporting burden on financial institutions.

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27 Senate Economics References Committee, *Report on Bank Mergers*, September 2009, p. 54.

Development bank

6.32 A number of submissions called for some form of 'development bank' to be established to fill perceived gaps in lending by the private banks:

> …the only feasible way forward is to boost competition through the establishment of a government development bank (similar to the old Commonwealth Development Bank) which will enter the market and become a major player in lending to small business. In making loans, the development bank should adopt basic prudential lending practice (such as examining the borrower's budget to ensure that the business activity is likely to generate sufficient return to easily meet interest repayments on the borrowing and obtaining security on other assets where available). However, the bank should do away with unnecessarily onerous conditions (such as requiring tax returns showing significant tax profits in 5 of the last 7 years, for example). The development bank could also set a reasonable margin on loans to small business (say the bank bill rate plus 2% where security is offered or plus 6% where there is inadequate security).[28]
>
> I urge Senators to look at the History of the Commonwealth Development Bank, why it was important to Australia post Depression and how it grew many businesses…[29]
>
> Australia should be following the examples of other nations by establishing a development bank to provide a variety of specialist lending purposes, including lending to small businesses and farmers.[30]
>
> …for small business to continue and survive, a Peoples Development Bank must be established.[31]

6.33 Some of these submitters referred to the German Kreditanstalt fur Wiederaulfbau bank as an example. KfW (whose name means Reconstruction Credit Institute) is a government-owned bank formed in 1948 as part of the Marshall Plan. It is mostly funded by issuing government-guaranteed bonds. It has a specific business unit which provides loans and start-up capital for small business (over the past two decades particularly active in the former East Germany) and is also engaged in securitisation and advisory services.[32]

6.34 One submitter described it as follows:

> In 2007 it had a balance sheet of €354 billion (A$725 billion), making it one of Germany's 10 biggest banks, employing 3,800 staff. The KfW supports the German economy with tailor-made financing, acting as an

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28 Mr Suryan Chandarsegaran, *Submission 3*, p. 3.

29 Mr Ross Wood, *Submission 10*, p. 2.

30 National Civic Council, *Submission 51*, p. 3.

31 Mr Jim McCormack, *Submission 4*, p. 2. See also Mr Peter White, *Submission 8*, p. 1; Mr Philip Osmak, Submission 13, p. 1; Mr Patrick Ariens, *Submission 52*, p. 1.

32 KfW has an English language webpage: http://www.kfw.de/EN_Home/index.jsp.

"equaliser" in providing low-interest, long-term credit, with repayment-free periods for smaller businesses whose sole credit option is the local branch of a major bank… The advantages of this financing system include:

• long-term loans with a maturity of 10 to 20 years;

• favourable interest rates fixed for 10 years, and even 20 years under the SME Programme;

• a particular advantage is that almost all KfW loans can be repaid fully or partially in advance of maturity and free of charge;

• simple application, loan commitment and loan handling through a regular bank.[33]

6.35 Other countries have similar institutions. The Japan Finance Corporation has a unit that lends up to ¥720 million for up to 20 years at fixed rates to small business, including start-ups. The Industrial Bank of Korea is required to make at least 70 per cent of its loans to small business.

6.36 The Commonwealth Development Bank (CDB) was established around 1960 as part of the Commonwealth Bank group. It was wound down from 1996. A submission describes its history as follows:

> The Commonwealth Development Bank…in its 30-year history, it helped establish over 400,000 small and medium-sized enterprises…the CDB was heavily involved in financing farmers who took up holdings in the Ord River project, the Esperance Land Settlements Scheme in Western Australia, the Coleambally and the Heytesbury Scheme in Victoria, to name only a few such projects. … The CDB was staffed by experienced lenders capable of assessing the long-term feasibility of proposals. The staff included specialists in agricultural science, economics, management, accounting, and engineering. They spent much of their time in the field undertaking assessment and investigation work.[34]

6.37 Professor Sathye commented:

> …the third way could be to have a mechanism, a separate development bank, for small businesses. There are issues with that kind of mechanism because of the cost that is involved in running it and, ultimately, to the borrower. I am coming now from experience from home. We had the Small Industries Development Bank of India, which was acting as a refinancing agency. It was basically raising capital in the market and, because it was a government bank, it was in a position to raise the capital at much lower rates and then lend it on to banks. So it was really refinancing the banks. Because the banks were getting a line of credit available to them, exclusively for lending to small businesses, it was freeing up their resources which were otherwise locked up—because they were able to get the

33 National Civic Council, *Submission 51*, pp 4-5.

34 National Civic Council, *Submission 51*, pp 5-6.

> refinance from the banks. That is a mechanism that can be considered. These are the issues that really require a lot of deep thinking.[35]

6.38 It was suggested that competition from the development bank might lead the commercial banks to lift their game in lending to small business:

> …in the area of mortgages and some commercial areas, it would make it more difficult for the commercial banks not to be competitive on loans for mortgages, small business and farmers.[36]

6.39 Advocates suggested a development bank could also fill the gap during recessions:

> It would help keep credit flowing to businesses, farmers and for mortgages, should the commercial banks be forced to restrict lending. Under such a scenario, development bank loans would support investment, support employment, support taxation revenue levels and keep down the welfare bill.[37]

6.40 Treasury warn that unless there is a specific market gap, such as that met by the Export Finance and Insurance Corporation, a development bank can lead to market distortions such as:

> …assisting lenders rather than borrowers, by providing a cheap source of funding that can be lent onwards at normal market rates; stimulating lending to borrowers who would not meet standard credit conditions, and who are not in a position to repay their loans; and/or 'crowding out' existing commercial providers of credit (or depositors and investors if loans are made through a commercial provider), leading to reduced competition.[38]

6.41 Business representatives were also unenthusiastic:

> …it is probably in the best interests of our economy if that type of transformation in the competitive environment is brought about from within the financial institution market itself...rather than from the government getting back into the business of banking.[39]
>
> The creation of a development bank represents a permanent solution to what is not expected to be long-term problem…a development bank is not a market based solution, and may result in funds being rationed to particular sectors of Government interest rather than the most deserving small businesses.[40]

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35 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 18.

36 National Civic Council, *Submission 51*, p 7.

37 National Civic Council, *Submission 51*, p 7.

38 Treasury, *Submission 50*, p. 21.

39 Mr Peter Anderson, ACCI, *Proof Committee Hansard*, 10 May 2010, p. 13.

40 NSW Business Chamber, responses to questions on notice.

6.42 Unsurprisingly, the banks were not keen on a rival being established:

> There is no compelling case. If the objective is to create greater competition in banking by setting up a major player in banking that is government owned, then the result would be to disproportionally affect small financial institutions, which will erode competition. There have been a number of major problems with government owned banks in Australia recent history, which have required significant investments of taxpayer funds.[41]

6.43 A variant of the development bank idea is to have a refinancier:

> The purpose of that re-financing could be to free up the funds of the banks. So if you have a pie, X amount is allocated to small businesses and the banks will be trying to reduce that pie more and more because it is not profitable. I am an ex-banker. If I have a profitable opportunity available out there in the market, why should I lend to a small business when I can make more money on the other side? One way to handle that is to free up this money. The way to free up the money is to have a re-financing mechanism that can help to push the money to the small business sector. The re-financing that was available with SIDBI, which is the Small Industries Development Bank of India, is exclusively for small businesses. So the banks lend for small businesses and, in turn, go to the SIDBI and take a re-finance from the SIDBI, and SIDBI then provides them with the finance. That channel goes to small businesses only— nothing else—and it frees up the funds of the bank.[42]

6.44 Something similar was suggested by Abacus, the representative body for building societies and credit unions:

> …the government probably needs to investigate whether there is some merit in allocating some funding specifically for small business lending and specifically in regional and rural communities, and we would argue that we are one of the people that are best placed to put in that funding.[43]

Committee view

6.45 The Committee notes the suggestion of a development bank but prefers to increase competition within the existing commercial banks.

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41 Australian Bankers' Association, response to questions on notice.

42 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 19.

43 Mr Mark Degotardi, Head of Public Affairs, Abacus, *Proof Committee Hansard*, 10 May 2010, p. 36.

Postal bank

6.46 Another suggestion was that competition could be increased if Australia Post is given a banking licence. It was noted that their new CEO has extensive banking experience.

6.47 The National Civic Council gave the example of the UK Post Office:

> The UK government has just announced that it is expanding its Post Office into lending more widely…[44]

6.48 One business organisation described it as 'an option that is worthy of examination' but had some reservations:

> …the question I would be asking about the Australia Post model in dealing with business lending: to what extent would they already have relationships with businesses and therefore be close enough to them to be able to make quick, insightful judgments? For me, there would be a question mark about that.[45]

6.49 Another was more enthusiastic:

> Senator XENOPHON—…what about the speculation that Australia Post be turned into a bank? …Would another entrant into the marketplace make a difference from your point of view in terms of making it easier for small businesses?
>
> Mr Cummings—Without a doubt.[46]

6.50 Australia Post certainly has a wide branch network but its officers have no expertise in credit assessment. A model that may work would be for the local post offices to receive applications, make a recommendation based on the knowledge of the local postmaster of the character of the applicant and their view of the viability of the project (eg the local postmaster may have an informed view about whether the existing local pizza outlets seem busy enough that an additional one would also be viable) and then a final decision is made at a regional office staffed by newly hired experienced bankers.

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44 National Civic Council, *Submission 51*, p. 3.

45 Mr Paul Orton, Director, Policy and Advocacy, New South Wales Business Chamber, *Committee Hansard*, 12 April 2010, p. 93.

46 Mr John Cummings, Chairman, NARGA, *Committee Hansard*, 12 April 2010, p. 39.

Banks' service to small businesses

6.51 A number of submissions referred to customer dissatisfaction with banks' services to small businesses, including claims about unreasonable increases in interest rates, poor communication and changes to loan conditions made unilaterally without notice.[47]

6.52 Submissions also referred to onerous lending conditions imposed by banks. For example, ASIC said that small businesses it had consulted referred to the following:

> (i) The family home was usually required as security. Security requirements were also often 'excessive' sometimes exceeding the loan by a factor of 10 or 15 times.
>
> (ii) Applicants without equity in property had to show serviceability by financial statements or cash flow predictions.
>
> (iii) The banks sometimes asked for multiple personal guarantees irrespective of the quality of the business, and blanket guarantees over assets in other entities unrelated to the transaction.
>
> (iv) Applying for a corporate card required a lot of paperwork and the giving of a personal guarantee.[48]

6.53 Particularly critical is the Council of Small Business of Australia, which:

> … has consistently received evidence over the past two years of:
>
> • The withdrawal of pre-approved loans, lines of credit, overdrafts, etc;
>
> • A disproportionate increase in small business loan rates relative to mortgage and corporate loan rates;
>
> • Higher credit assessment hurdles;
>
> • Outright denial of access to credit (in circumstances where credit has previously been available);
>
> • Re-assessment of already agreed loans and terms; and,
>
> • The adoption of inappropriate lending policies (i.e., local managers turning a blind eye to the purpose of a given loan, offering a housing product for a business loan).

6.54 The banks themselves argue that:

> Each proposal from a small business is judged by the bank on its merits. Banks lend money after assessing that a customer has the capacity and

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47 See, for example, the Melbin family, *Submission 5*; Australian Industry Group, *Submission 14*, p. 7; Pharmacy Guild, *Submission 19*; Motor Trades Association of Queensland, Submission 20; COSBOA, *Submission 27a*; NSW Business Chamber, *Submission 33*, pp 7-8 and ASIC, *Submission 17*, p. 4.

48 Australian Securities and Investments Commission, *Submission 17*, p. 3.

> willingness to repay, that they understand the risks they are taking and have the capacity to manage those risks. This is consistent with the need to preserve a sound banking system and a healthy small business sector.[49]
>
> Westpac experienced no material change in the number of complaints from our SME customers throughout the financial crisis. In fact, complaints data for Westpac over 2008 and 2009, which includes complaints regarding access to finance and related matters, details a slight decline in the number of complaints lodged. Of these, over 77 per cent of complaints were resolved at the first point of contact, and nearly 84 per cent were finalised within 5 days.[50]

6.55 There are suggestions that as banks become larger the quality of service to small business may decline, particularly if duplicate branches are closed and local managers moved.[51] A survey by CPA Australia of its members concluded:

> Strong views were expressed by members that the business bankers they deal with are inexperienced and were therefore unlikely to have the necessary skills to appropriately assess credit applications. Members stated that this is adding to the burden on business in securing finance and maintaining finance facilities as they are having to spend extra time providing additional explanations and information on their industry and business which an experienced banker may not normally require. Members also commented that the turnover in business bankers is adding to this burden as this potentially creates a need to re-explain their business to a new person. Regional members expressed concern that bankers in regional areas do not have the authority to assess and authorise loan applications.[52]

6.56 Another perspective was that small businesses would be more satisfied with their interactions with banks if they were better prepared for their dealings with them:

> Every banker and other lender I speak to say most loan applications have totally inadequate financial statements to support their request. This results in most not getting past ‘first base’ or at best, a game of ‘pass the parcel’ over the coming weeks or months between the bank relationship manager, bank credit risk department, the SMB and their external accountant.[53]

6.57 Another submitter felt that banks do not help in this process as:

> 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

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49 Australian Bankers' Association, *Submission 23*, p. 2.

50 Westpac, *Submission 31*, p. 3.

51 Choice's submission to the Committee's inquiry into bank mergers drew on Roy Morgan polling indicating that larger banks consistently have lower customer satisfaction. See *Report on Bank Mergers*, p. 17.

52 CPA Australia, *Submission 46*, p. 5.

53 Attaché Software, *Submission 15*, p. 1.

> the reasons for the rejection, and discover what they can do to improve the likelihood of acceptance at a future date.[54]

Banks as advisers to small business

6.58 Since the deregulation of the 1980s, there has been concern that banks do not give enough attention to advising small business about appropriate products and amounts of debt, as distinct from just marketing loans to them. A House committee was told that banks regarded providing advice as 'paternalism', but the committee thought this kind of paternalism was appropriate.[55]

A small business loan guarantee

6.59 The NSW Business Chamber raised the possibility of a guarantee of small business loans in Australia for a limited period. The proposal envisages it covering about 75-85 per cent of the amount of the loan, so as not to give rise to excessive moral hazard, limited to loans below a certain size and appropriately priced.[56]

6.60 The Council of Small Business of Australia commented:

> I think there could be a lot of value in it for the community and it would be worth exploring. There are obvious risks associated, but I am quite sure that Treasury has the nous to mitigate those, as long as there is political will to try something different.[57]

6.61 The Council drew an analogy between a prospective agency offering a guarantee and the Australian Business Investment Partnership, known colloquially as 'Ruddbank':[58]

> There was very little talk at the time of the introduction of Ruddbank about the potential benefit that would accrue to small businesses through that particular piece of legislation…[It] actually had enough scope in it to support other funds to support activities such as helping out small businesses. I realise it is quite controversial but, given that I think you would agree that your role is to assess the entire array of options that might exist in support of small businesses going forward, this is one which potentially could be revisited or be in a modified format. So in countries like the UK, China and Singapore they all established particular funds in

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54 WA Small Enterprise Network, *Submission 18*, p. 2.

55 House of Representatives Standing Committee on Industry, Science and Technology, *Small Business in Australia: Challenges, Problems and Opportunities*, 1990, p. 205.

56 NSW Business Chamber, *Submission 33*, pp 12-13.

57 Ms Jaye Radisich, Chief Executive Officer, Council of Small Business of Australia, *Proof Committee Hansard*, 10 May 2010, p. 79.

58 The Senate Standing Committee on Economics released a report on this proposal in May 2009.

recognition of the fact that many of the larger banks simply stop lending or change the goalposts when it came to lending to small businesses.[59]

International experience

6.62 The NSE Business Chamber pointed to guarantee schemes for small business loans in Canada, the United Kingdom and the United States.[60] The Reserve Bank provided comparative information on guarantee schemes (Table 6.1 at end of chapter).

6.63 Some overseas schemes have been the subject of study:

> The empirical evidence presented in this analysis shows that Italy's scheme has reached a measure of effectiveness in reducing SMEs' borrowing cost and easing their financing constraints.[61]
>
> …the UK government initiated a loan guarantee scheme (SFLGS) in 1981. In this paper we use a unique dataset comprised of small firms facing a very real, and binding, credit constraint, to question whether a corrective scheme such as the SFLGS has, in practice, alleviated such constraints by promoting access to debt finance for small credit constrained firms. The results broadly support the view that the SFLGS has fulfilled its primary objective.[62]

World Bank study

6.64 A survey by some World Bank economists made the following observations:

> Many countries around the world have therefore made Partial Credit Guarantee (PCG) funds a central part of their strategy to alleviate SMEs financing constraints. Multi- and bilateral donors have supported the set-up of such schemes around the developing world. These schemes seek to expand lending to SMEs, sometimes focusing on specific regions or sectors through reducing lending risk. Specifically, a PCG fund is a risk transfer and risk diversification mechanism; it lowers the risk to the lender by substituting part of the risk of the counterparty by that of the issuer of the PCG…PCG funds (and full credit guarantee funds) have existed at least since the beginning of the 20th century[63] and have become more popular

59 Ms Jaye Radisich, Chief Executive Officer, Council of Small Business of Australia, *Proof Committee Hansard*, 10 May 2010, p. 74.

60 NSW Business Chamber, *Submission 33*, p. 12.

61 S Zecchini and M Ventura, 'The impact of public guarantees on credit to SMEs', *Small Business Economics*, 2007, p. 204, provided by Professor Milind Sathye in response to a question on notice.

62 M Cowling, 'The role of loan guarantee schemes in alleviating credit rationing in the UK', University of Sussex Institute for Employment Studies working papers, no WP7, February 2007, provided by NARGA in response to a question on notice.

63 Uruguay established a scheme in 1896!

over the past decades. In spite of their recent growth and initial evidence suggesting success of some of these funds, there is a dearth of analysis to systematically inform the process of design of PCG funds, pricing of their guarantees, their regulation, and the implication that PCG fund characteristics have with respect to the prudential regulation of banking portfolios covered by such guarantees.[64]

6.65 Their analysis leads them to conclude:

Our survey shows an important role of government in partial credit guarantee schemes around the world, but mostly limited to funding and management, and much less in credit risk assessment and recovery. This might be for the better, as we also find that where government is involved in credit risk assessment and recovery, default rates are typically higher. Older schemes are also more likely to be government funded and managed and also have higher loan losses, consistent with the notion that the costs and liabilities of a PCG fund become obvious only after some time. We find a surprisingly low incidence of risk-based pricing and limited use of risk management mechanisms.[65]

Reservations

6.66 Treasury do not support such schemes. They note:

The majority of OECD countries have implemented or expanded existing guarantee schemes for small business loans since the onset of the global financial crisis. However, these schemes have generally been unsuccessful in stimulating credit to small businesses. According to the OECD, such guarantee schemes and extensions have not produced the desired results, and 'the stagnation in lending is true even of banks in countries where…credit guarantee schemes exist.[66]

6.67 Treasury points to the following problems with such schemes:

…guarantees of credit do not stimulate demand in the economy, and therefore do not help small businesses generate profits with which to service additional debt; and guarantee schemes can be subject to adverse selection, where the least viable businesses obtain credit guarantees.[67]

6.68 The Reserve Bank characterised the challenge of such schemes as:

64 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, provided by NARGA in response to a question on notice, pp 2-3.

65 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, p. 25.

66 Treasury, *Submission 50*, p. 20.

67 Treasury, *Submission 50*, p. 20.

> Are you going to be able to find small businesses that have viable propositions which a regular financial institution is not going to be willing to lend to?[68]

6.69 Some World Bank economists warn that getting the pricing right in the scheme is crucial:

> Funding of the scheme through proper pricing of the guarantees and limiting government funding to set-up costs might be important in giving the lenders the proper incentives to monitor borrowers, avoid excessive risk taking and thus minimize loan losses.[69]

6.70 Some business organisations are also hesitant:

> My instincts in that area are that there is a warning bell that rings government failure when we talk about governments guaranteeing loans.[70]

> …we were concerned about that, it is not an area that we would comfortably see government providing guarantees for small business lending. Our resolution to that would be more that we have to promote greater competition within the Australian marketplace rather than seeing taxpayers being exposed to small business lending in that regard.[71]

6.71 Professor Sathye commented:

> There are several countries where governments do get involved—the US, the UK, Canada, Korea and Singapore, just to name a few—and government guarantees are provided to small businesses. The issue that arises is the running of that guarantee scheme, the costs that are involved and whether that leads to some kind of a moral hazard or problems arising out of it. The answer to that question will again be that we really need consider it, study it and look at the feasibility and operation of it in an Australian setting.[72]

6.72 The NSW Business Chamber said that the fee in Canada for the guarantee is up to 300 basis points and in the United Kingdom ranges from 150 to 200 basis points.[73] It may be that at this price very few borrowers or lenders would want to use such a scheme.

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68 Dr Guy Debelle, Assistant Governor (Financial Markets), Reserve Bank of Australia, *Committee Hansard*, 12 April 2010, p. 26.

69 T Beck, L Klapper and J Mendoza, 'The typology of partial credit guarantee funds around the world', draft World Bank working paper, March 2008, provided by NARGA in response to a question on notice, p. 6.

70 Dr Peter Burn, Australian Industry Group, *Committee Hansard*, 12 April 2010, p. 48.

71 Mr Greg Evans, ACCI, *Proof Committee Hansard*, 10 May 2010, p. 11.

72 Professor Milind Sathye, *Proof Committee Hansard*, 10 May 2010, p. 18.

73 Mr Micah Green, NSW Business Chamber, *Committee Hansard*, 12 April 2010, p. 94; NSW Business Chamber, responses to questions of notice.

Committee view

6.73 The Committee notes the suggestion of a guarantee for loans to small business but prefers to increase competition within the commercial banks rather than for a government entity to assume the risk.

Table 6.1: Small Business Guarantee Schemes in Selected Countries

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES

	Criteria	Scope	Cost
United States *Small Business Administration (SBA)- 7(a) Loan Program*[1]	*Prior to the crisis* Prior to the crisis, the program generally guaranteed up to 85 per cent of the loss incurred for loans of up to US$150 000, and up to 75 per cent for loans above this threshold (up to a maximum loan value of US$2 million). The exceptions within this program include SBAExpress loans (processed within 3 days), which provide a maximum guarantee of 50 per cent, and the Export Working Capital Loan Program, which guarantees up to 90 per cent (with a maximum guaranteed amount of US$1 million). Loans may be used for a variety of general business purposes including capital purchase and improvements, working capital and debt refinancing under special conditions. Loan maturity is up to 25 years for fixed assets and 10 years for working capital. The 7(a) program applies to small businesses which meet their particular industry's size standards. Generally, manufacturing and mining firms with fewer than 500 employees and non-manufacturing firms with up to US$7 million annual revenues are eligible.	In December 2009 the outstanding guaranteed principal was about US$49 billion. The SBA estimates that, in 2008, it guaranteed about 7 per cent of the value of small business loans (classified as loans less than US$1 million) through this program.[2]	The SBA receives an up-front fee from borrowers of between 2 per cent and 3.75 per cent of the guaranteed portion of the loan. Lenders also pay an annual subscription fee of 0.55 per cent of the outstanding balance of the guaranteed portion of the loan.
United States *Small Business Administration (SBA)- CDC/504 Loan Program*[3]	*Prior to the crisis* This program has provided a full guarantee of debentures issued by non-profit Certified Development Companies (CDCs) to fund loans to SMEs for the purchase of land or construction. The maximum size of an individual guarantee is between US$1.5 million and US$4 million, depending on the loan use and industry.	In December 2009 the outstanding guaranteed principal was about US$24 billion.[4] It is estimated that, in 2008, the SBA guaranteed about 3 per cent of the value of small business loans through this program.	Fees total about 3 per cent of the guaranteed amount.

[1] Small Business Administration, 7(a) Loan Program: http://www.sba.gov/financialassistance/borrowers/guaranteed/7alp/index.html
[2] Small Business Administration (2009), 'The Small Business Economy': http://www.sba.gov/advo/research/sb_econ2009.pdf
[3] Small Business Administration, CDC/504 Loan Program: http://www.sba.gov/financialassistance/borrowers/guaranteed/CDC504lp/index.html
[4] Small Business Administration: http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_bud_lperf_upbreport.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
United States	*Temporary measures for 7(a) and CDC/504 programs* - extended to end-May 2010 unless funds exhausted earlier		
Small Business Administration (SBA)	The maximum guarantee was temporarily raised to 90 per cent for 7(a) loans, except those processed under SBAExpress. SBA's maximum exposure per loan remains at US$1.5 million. The loan criteria and coverage for the CDC/504 program have not been changed.	Since February 2009, the SBA received an additional US$680 million in funding to temporarily provide the higher guarantee levels on 7(a) loans and waive loan fees on 7(a) and CDC/504 programs.[5]	The SBA has temporarily removed the up-front fee for loans with maturity of longer than 12 months. The SBA has temporarily removed some fees on CDC/504 loans.
United Kingdom *Enterprise Finance Guarantee Scheme*[6]	The Enterprise Finance Guarantee (EFG) Scheme was instituted in January 2009, replacing the Small Firms Loan Guarantee (SFLG) Scheme with expanded eligibility.[7] The EFG guarantees a maximum of 75 per cent of the loan amount for loans between £1 000 and £1 million (previously £5 000 to £250 000). Businesses with annual turnover up to £25 million (previously £5.6 million) are eligible. The scheme covers loans repayable between 3 months and 10 years. A relatively wide range of loan uses are guaranteed including investment, working capital and refinancing.	The total value of guarantees between January 2009 and March 2010 was capped at £1.3 billion. The scheme was extended to allow for an additional £500 million of guaranteed loans over the 12 months to March 2011.	Borrowers pay 2 per cent of the outstanding balance of the loan annually.
United Kingdom *Working Capital Scheme*[8]	From March 2009 to 2011, the Government will guarantee up to 50 per cent of credit lines for businesses with annual turnover of up to £500 million.	The maximum amount to be guaranteed between March 2009 and 2011 is £10 billion.	The Government charges a fee based on the both expected and unexpected loss plus an administrative fee.

[5] Small Business Administration (2010), 'SBA Recovery Lending Extended Through May', Media Release 29th March: http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_10-15.pdf
[6] Department of Business, Innovation and Skills, Enterprise Finance Guarantee: http://www.bis.gov.uk/policies/enterprise-and-business-support/access-to-finance/enterprise-finance-guarantee
[7] Department for Business, Enterprise & Regulatory Reform (2008), 'Small Firms Loan Guarantee, Annual Report for Financial Year 2007/08': http://www.bis.gov.uk/files/file47204.pdf
[8] European Commission (2009), 'Working Capital Guarantee Scheme': http://ec.europa.eu/community_law/state_aids/comp-2009/n111-09.pdf; Department for Business, Enterprise and Regulatory Reform (Unknown), 'Working Capital Scheme Factsheet': http://www.cw-chamber.co.uk/UserFiles/File/WorkingCapitalSchemeFactsheet.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
Canada *Small Business Financing Program*[9]	Prior to April 2009, the scheme guaranteed 85 per cent of loans up to CA$250 000. From April onwards, the maximum loan amount has been increased to CA$500 000, of which a maximum of CA$350 000 can be used to purchase or improve equipment and finance leasehold improvements. Loans must be for capital purchases or improvements only, and may not be used to finance things such as working capital or research and development. A maximum of 90 per cent of the project cost may be funded. The maximum loan term is 10 years. Only businesses with annual revenues of CA$5 million or less are eligible. A cap on the Government's obligation applies to each lender. The Government will pay 85 per of the loss on defaulted loans up to the sum of: 90 per cent of the first CA$250 000 in loans registered, 50 per cent of the next CA$250 000, and 12 per cent of all loans in excess of CA$500 000 made from the 1st April 2009 (10 per cent for loans made prior to this date).	The aggregate contingent liability over a five-year window is capped at CA$1.5 billion. For loans made between April 1, 2004, and March 31, 2009, the maximum liability was CA$667.4 million.	Borrowers pay a registration fee of 2 per cent of the amount loaned at origination. An annual administration fee of 1.25 per cent of the amount outstanding is also payable.
Canada *Export Development Canada-Export Guarantee Program*[10]	Provides guarantees on loans to large and small companies for export-related activities and/or foreign investments. From March 2009, the guarantee is available to companies involved in export trade who do not meet the traditional eligibility criteria of CA$5 million in export sales or 15 per cent of total sales derived from exports.[11] The mandate has been temporarily expanded for two years from March 2009 to guarantee domestic activities. The program guarantees 90 per cent of the loan amount for loans up to CA$500 000 and 75 per cent for loans between CA$500 000 and CA$10 million. There is 100 per cent coverage for loans to make direct investments abroad.	Export Development Canada's contingent liability limit across all its programs, including the Export Guarantee Program, was increased from CA$30 billion to CA$45 billion in March 2009.[12]	For loans under CA$500 000 the borrower pays a fee at origination based on their credit worthiness. Loans above CA$500 000 attract an up-front fee of 0.25 per cent of the guaranteed portion of the loan. EDC's guarantee fee is equal to the loan interest spread over the prime rate plus 50 basis points (based on the average quarterly outstanding balance of the loan).[13]

[9] Industry Canada (2009), 'Canada Small Business Financing Act Annual Report 2008-2009': http://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/h_la02973.html
[10] Export Development Canada, Export Guarantee Program: http://www.edc.ca/english/financing_export_guarantee.htm
[11] Export Development Canada, Domestic Powers: http://www.edc.ca/english/domestic_finance.htm
[12] Export Development Act: http://laws.justice.gc.ca/en/E-20/FullText.html
[13] Export Development Canada, Solutions for Bankers: http://www.edc.ca/english/docs/FI_detailed_e.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
Canada *Business Development Bank- Operating Line of Credit Guarantee*[14]	This scheme, introduced in June 2009, fully guarantees increases in existing lines of credit provided by financial institutions to businesses. It applies to expansions in lines of credit of between 25 and 40 per cent when the line of credit is between CA$400 000 and CA$40 million. The line of credit must be secured against short term assets such as accounts receivable and inventory. The guarantee is provided for 12 months and can be renewed annually.	The maximum contingent liability is unclear. It has been allocated CA$100 million of capital.[15] Announced in June 2009, the duration of the program has not been declared.	A fee of 0.25 per cent of the guaranteed amount paid at the time of set-up and renewal.
Japan *Credit Guarantee System and Credit Insurance System*[16]	Guarantees 80 per cent of the loan amount under the Credit Guarantee System.[17] Depending on the particular guarantee, the loan value may be up to ¥80 million to ¥400 million. Businesses must be classified as SMEs according to employee numbers and capitalisation to be eligible. The size cut-offs depend on the industry, but at most a firm may have up to ¥300 million capitalisation or less than 300 employees.	At end-March 2009, outstanding guaranteed liabilities amounted to around ¥33 trillion, accounting for approximately 13 per cent of all loans to SMEs according to the Government-owned institutions' own records.[17]	Borrowers pay a fee of between 0.5 per cent and 2.2 per cent of the loan amount depending on credit risk.
Japan *Securitisation Guarantee*[18]	The scheme provides guarantees of up to 70 per cent on unsecured loans to SMEs for the purpose of securitization as well as guarantees for securitized instruments.	Between July 2004 and March 2009, the value of loans under the guarantee scheme was ¥94.3 billion.[19]	N/A

[14] Business Development Bank of Canada, Operating Line of Credit Guarantee: http://www.bdc.ca/en/about/federal_budget/bcap/olcg2.htm
[15] Business Development Bank of Canada (2009), 'Government of Canada Announces $450 Million in New Funding for BDC to Assist Canadian Businesses', Media Release 15th June: http://www.bdc.ca/en/about/mediaroom/news_releases/2009/20090615.htm
[16] Credit Guarantee Corporation (2009), 'Credit Guarantee System in Japan 2009': http://www.zenshinhoren.or.jp/pdf/English_Annual_Report.pdf
[17] Japanese Finance Corporation (2009), 'Credit Insurance Programs': http://www.c.jfc.go.jp/eng/pdf/AR_2009_02_c.pdf
[18] Japanese Finance Corporation (2009), 'Securitization Support Programs': http://www.c.jfc.go.jp/eng/pdf/AR_2009_03_b.pdf
[19] Japanese Finance Corporation (2009), 'Securitization Support Programs': http://www.c.jfc.go.jp/eng/pdf/AR_2009_02_b.pdf

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
Singapore *Loan Insurance Scheme (LIS)*[20]	*Prior to the crisis* Scheme to help companies secure trade financing lines by assisting them to insure against insolvency risks by commercial insurers. The Government subsidises a portion of the insurance premium for commercial insurers to cover against default. The insurer covers 75 per cent of the loan amount. There is no specified maximum for loan values, although loan amounts above SGD1 million may be vetoed by the insurer. The maximum repayment term is 1 year. The loan must be secured against working capital. The scheme is open to companies of any size meeting local shareholding or business presence requirements.	Over the year to December 2009, the Singapore Government's Special Risk Sharing Initiative and enhanced financing schemes supported about SGD8 billion in lending. The Government expects their schemes will support up to SGD8.4 billion in new lending to end-January 2011. The amounts attributable to the Loan Insurance Scheme are not available.[21]	Borrower pays 0.45 per cent of the loan value at origination.
Singapore *Loan Insurance Scheme Plus*[20]	*Temporary measures*- Extended to end-January 2011 In February 2009 the Government introduced LIS Plus to aid access to larger tranches of trade financing lines. The Government directly guarantees loans beyond the capacity of current LIS insurers. It applies the same criteria as the LIS (above), but caps the loan size at SGD15 million.		Borrower pays 1 per cent of the loan value at origination.

[20] International Enterprise (IE) Singapore (2010), 'Loan Insurance Scheme': http://www.iesingapore.gov.sg/wps/wcm/connect/de008f80410f477dbe10bf3ad8984e19/Capital_20091231_LISV3.pdf?MOD=AJPERES

[21] Standards, Productivity and Innovation Board (SPRING) Singapore (2009), 'Government Extends Financing Schemes For One More Year At Revised Terms In Tandem With Economic Recovery', Media Release 28th December: http://www.spring.gov.sg/NewsEvents/PR/2009/Pages/MTI-Media-Release-Government-Extends-Financing-Schemes-For-One-More-Year-At-Revised-Terms-20091228.aspx

SMALL BUSINESS LOAN GUARANTEE SCHEMES IN SELECTED COUNTRIES (Continued)

	Criteria	Scope	Cost
European Investment Fund (EIF) *SME Guarantee Facility*[22]	The EIF provides capped guarantees partially covering portfolios of financing to SMEs. Financial intermediaries interested in applying for a guarantee must be established and operating in one of the EU member states; Norway; Iceland; Liechtenstein; Croatia; FYR Macedonia; Montenegro; Serbia or Turkey. The facility is comprised of four business lines, known as 'windows': *(1) The Loan Guarantee* - The EIF will guarantee up to 50 per cent of a financial institution's commitment on loans made to businesses with fewer than 250 employees and less than EUR50 million annual turnover or EUR43 million in balance sheet value. There does not appear to be a limit on the loan amount. The loan maturity must be at least 12 months. *(2) The Micro-Credit Guarantee* – The EIF will guarantee up to 75 per cent of financial institution's commitment on loans to businesses with fewer than 10 employees and less than EUR2 million in annual turnover or balance sheet value are eligible. Loans up to EUR25 000 with a maturity of at least 6 months are covered. *(3) The Equity Guarantee* - Covers mezzanine financing and equity investments in SMEs in the seed and start-up phases. The maximum equity investment amount covered is EUR500 000. The EIF will guarantee up to 50 per cent of a financial institution's commitment. *(4) Securitisation* - Guarantees are provided to support securitisation of SME financing instruments. Loans must have a maturity of at least 12 months. The EIF will guarantee up to 50 per cent of the first loss tranche, and up to 100 per cent of other guaranteed tranches. The intermediary is required use a portion of the resources made available through securitisation to finance SMEs.	As at December 2008, the net guarantee portfolio under mandate activity amounted to EUR8.5 billion (corresponding to a maximum first loss liability of EUR0.5 billion).[23]	There are no guarantee fees (except for the securitisation window). However EIF may charge the institution a fee calculated on amounts committed but not utilised under the Loan and Micro-Credit windows.

[22] European Investment Fund, CIP SME Guarantee Facility: http://www.eif.europa.eu/guarantees/cip_portfolio_guarantees/index.htm
[23] European Investment Fund (2009), 'EIF Annual Report 2008': http://www.eif.europa.eu/attachments/about/agm_2009/EIF_AnnualReport_2008.pdf