Government Minority Report

Introduction

Terms of Reference

On 03 February 2010 the Senate referred the following matter to the Senate Economics Committee for inquiry and report.

The purpose of the inquiry was to investigate and report on the current circumstances of issues surrounding access of small businesses to finance, including:

(a) the costs, terms and conditions of finance and changes to lending policies and practices affecting small businesses;
(b) the importance of reasonable access to funding to support small business expansion and the sector's contribution to employment growth and economic recovery;
(c) the state of competition in small business lending and the impact of the Government's banking guarantees;
(d) opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion;
(e) policies, practices and strategies to enhance access to small business finance that exist in other countries; and
(f) any other related matters.

Members of this minority report note that the Government recognises the important contribution small businesses make to national prosperity and supporting jobs. During the onset of the global financial crisis, most small businesses managed to maintain services and production while retaining staff. Evidence suggested that hours of employees were reduced, but there were relatively few retrenchments.

Nevertheless government members had many reports of difficulties for small business in obtaining finance, even for rollovers of existing loans for firms that had a good credit track record.

We note that the government supported small business in a number of ways during the global financial crisis. This took a number of different forms, including reducing financial pressures, providing up to date information and taking measures to improve the availability of finance through financial intermediaries.

The Government's support for small business

1 Availability of finance

The Government senators recognise that the Treasurer's announcement in October 2009 of an extension to the Government's investment in Australian residential mortgage-backed securities (RMBS), further supports banking competition.

The Government directed the Australian Office of Financial Management (AOFM) to provide a further $8 billion of support to new issuances of high-quality RMBS.

In making this announcement, the Treasurer specified the additional objective of supporting small businesses year. This was highlighted in Treasury's submission to this inquiry:

> "The extension to the RMBS program includes an additional objective of supporting lending to small businesses. Consequently, lenders who seek support under the RMBS program are encouraged to outline how active they are in lending to small business and to allocate part of the proceeds raised under the program to lending to small business. This is one of the factors that the AOFM assesses when deciding whether to support an RMBS deal.
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> To date, AOFM's investment of just under $1 billion of the additional $8 billion has allowed lenders to raise around $4.6 billion in funds. Based on information provided by these lenders to the AOFM, it is expected that over $400 million of these funds will be lent to small businesses."[1]

CEO of smaller lender RESIMAC, Mr Warren McLeland, recently advised the Government that its support for the RMBS market has "been vital to permitting a continual flow of finance to the small business community."[2]

Mr McLeland said that "without such support, there would be literally thousands of Australian small business owners who would have been deprived access to finance." He stated that this included a range of small businesses like those in plumbing, paving, dry cleaning and restaurants.[3]

The company rate will be reduced to 29 per cent in 2013-14 and then cut it further to 28 per cent from the 2014-15 income year.

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[1] Treasury, Submission No. 50, 23 April 2010, pp 15-16

[2] *Treasurer's Economic Note*, 30 May 2010, www.treasurer.gov.au

[3] *Treasurer's Economic Note*, 30 May 2010, www.treasurer.gov.au

2 Small Business Tax Break

The Committee heard that the Government provided direct assistance to small businesses through a special small business tax break. Small businesses were able to claim an additional 50 per cent tax deduction for eligible assets costing $1,000 or more, purchased between 13 December 2008 and the end of 2009, and installed before the end of 2010. The 50 per cent tax break was available to small businesses with an annual turnover of less than $2 million.

This is supported by the Treasury's evidence given in their submission to the inquiry: "The Commonwealth Coordinator General's report on the progress of the Economic Stimulus Plan to 31 December 2009 stated that '$2.4 billion in deductions have been claimed to date under the Small Business and General Business Tax Break.'"[4]

The tax break provided small businesses with an ability to invest in new capital items, such as computer hardware and business vehicles, and to undertake capital improvements to existing machinery and equipment.

3 Tax adjustment to provide cash flow relief during 2009-10

Maintaining cash flow is vital to the viability of small businesses. To help boost cash flow, the Government reduced quarterly pay-as-you-go (PAYG) instalments for small businesses during 2009-10.

This $720 million in cash flow relief for 2009-10 came on top of the boost provided by the Government's discounted December 2008 quarter PAYG instalment, giving a further benefit for small businesses in difficult economic times.

4 Economic Stimulus Plan

Although an economy wide measure, small businesses benefited significantly from the Government's $42 billion Nation Building – Economic Stimulus Plan introduced to support jobs, build infrastructure and invest in long-term economic growth. Around 70 per cent of the stimulus plan is investment in nation-building infrastructure. Tradesmen, other independent contractors and small business suppliers benefited from this investment in local infrastructure.

5 Assistance from the Tax Office

As part of the May Budget, the Government provided $100 million over four years to the Australian Tax Office to assist small businesses and other taxpayers experiencing financial distress to remain viable and in the tax system. To assist small businesses that are having difficulty meeting their tax obligations, the Tax Office's Small Business Assistance Program works with individual small businesses to help them meet their obligations

[4] Treasury, Submission No. 50, 23 April 2010, p. 17

In addition, small businesses with short-term cash flow problems were permitted to have the due date of their quarterly or annual tax activity statement payments (e.g. PAYG and GST instalments) extended for up to two months.

6 Small business advice and support

The Government invested $42 million to enhance small business advisory services. The service was provided through the existing Business Enterprise Centres on matters such as developing business plans, preparing applications for finance and cash flow.

The Small Business Support Line, launched by the Government on 3 September 2009, provides initial advice to small business owners and puts them in touch with specialist advisers on matters such as obtaining finance, cash flow management, retail leasing, diagnostic services, promotion and marketing advice, and personal stress/hardship counselling. Support Line advisers link into the nationwide network of Business Enterprise Centres and other small business advisory services around Australia.

The existing Small Business Credit Complaints clearing house has been integrated as part of the service. Issues are referred to the Australian Bankers Association for a response.

Reserve Bank of Australia

We note the Reserve Bank of Australia's submission to the Committee:

> "Lending to small businesses has been little changed over 2009, after growing steadily over prior years. The slowdown reflects both reduced demand from small businesses and a general tightening in banks' lending standards. Small businesses in most industries have been able to access funding throughout the financial crisis, **albeit on less favourable terms than previously.**
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> Since late 2008, the interest rates on small business lending have been below their averages over the past decade, as the large net reduction in the cash rate has more than offset the increases in banks' lending spreads. Fees have risen, but for most businesses they are only a small part of the overall cost of a loan.
>
> Competition in the small business lending market has eased from the strong levels just prior to the onset of the financial crisis, **but should recover as the economy continues to strengthen.**"[5]

According to the RBA, "Small business borrowers have faced lower loan-to-valuation ratios, stricter collateral requirements and higher interest coverage ratios."[6]

This is consistent with Australia and the world experiencing the worst global financial crisis in 50 years.

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[5] Reserve Bank of Australia, *Submission 2*, p. 1.

[6] Reserve Bank of Australia, *Submission 2*, p. 3.

International Regulation

In asking questions of the **National Australia Bank (NAB)**, Senator Pratt raised the issue of the significance of international Basel II Capital adequacy rules. She expressed her concern that these rules encourage banks to favour residential mortgage lending over business lending. She sought information as to how significant those rules are in the situation that small businesses currently face.[7]

Mr Joseph Healy, Group Executive, Business Banking, NAB, responded: "As I mentioned, Basel II makes it more attractive for banks to lend for household mortgages than to business. If you look at the amount of lending into the household sector over the last twelve months, as opposed to the business sector, that will give you an answer to that question. I do not believe it is necessarily a question of one or the other..."[8]

Reduced Competition

Senator Pratt expressed her concern in relation to the major banks understanding the nature of farming businesses with the **National Farmers' Federation**:

> "Clearly the more the banking sector understands the nature of farming businesses, the better it can be at lending. It does appear here that we are risk of losing a specialist service, resulting in further consolidation to the four big banks from the loss of expertise, and emphasis on it at the ANZ."[9]

In his opening statement, Mr Peter Anderson, Chief Executive, **Australian Chamber of Commerce and Industry**, in his opening statement before the committee commented: "It is also worth noting that just a couple of weeks ago, on 8 April, the Australian Bankers Association, in responding to a report by the Australia Institute, said in a public statement that close to 60% of banking fees are not paid by households but by businesses – in other words, we have seen, and our submission points to, the fattening of margins by retail banks at the expense of small business lending. It is not just margins in terms of repricing credit; it is margins in terms of a range of other fees and costs imposed on customers."[10]

This view was partly shared by Mr Steven Munchenberg, Chief Executive Officer, **Australian Bankers Association**:

> "...However, we are aware that there has been a number of concerns expressed for some time now about both access to finance from the banks but also the price that small businesses are paying for that finance. In the

[7] Public Hearing, Canberra, 10 May 2010, p. E27

[8] Mr Joseph Healy, NAB, Public Hearing, Canberra, 10 May 2010, p. E27

[9] Senator Louise Pratt, Public Hearing, Canberra, 10 May 2010, p. E70

[10] Mr Peter Anderson, Chief Executive, Australian Chamber of Commerce Industry, Public Hearing, Canberra, 10 May 2010, p.E9

> large part we think these concerns are based in changes that banks have reasonably and prudently made in their approach to lending through the course of the global financial crisis,.....Nonetheless, the banks have stood by their small business customers and, indeed, have picked up a lot of customers from lenders who are no longer operating because of changes in credit markets."[11]

Senator Hurley, in raising the issue of competition between banks to Mr Jim Murphy, Executive Director, Markets Group, **Treasury**. "..in terms of competition between banks, is it the smaller banks or the smaller institutions that loan more readily to small business or take the risks?"[12]

Mr Murphy in response stated:

> "There are two aspects of that. One, the large majority of funding for small business will come from the major banks. The second point is that, yes, the fringe players – or non-banks or finance companies – have traditionally lent to the riskier end of small business or the riskier end of business. So to some extent both factors have worked against small business in a downturn; whereas both factors will come back into play to assist small business because all financial institutions are there to make a profit. So, as the economy picks up, they will probably start lending more to small business – this is the majors – and as well as that, drop the price of it, one would hope. Also as the economy picks up, the smaller players will come more into operation and become more available for lending to small business."[13]

"As the economy strengthens, competition for business lending is likely to pick up; there are already some signs of this in the Reserve Bank's liaison with medium and large sized businesses." (See graph below) [14]

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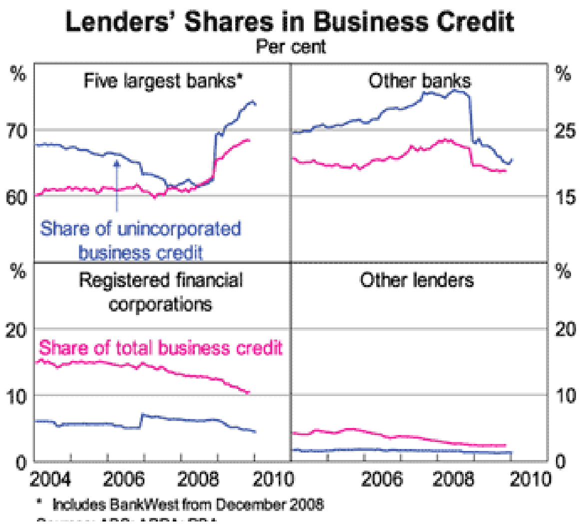
[11] Mr Steven Muchenberg, CEO, Australian Bankers Association, Public Hearing, Sydney, 20 April 2010, p.E1

[12] Senator Annette Hurley, Public Hearing, Canberra, 10 May 2010, p. E4

[13] Mr Jim Murphy, Executive Director, Markets Group Treasury, Public Hearing, Canberra, 10 May 2010, p. E4

[14] Reserve Bank of Australia, *Submission 2*, pp. 5-6



Mr Graham Johnson, General Manager, Industry Technical Services, Supervisory Support Division of the **Australian Prudential Regulation Authority** responded to whether or not small business is being treated differently:

> "I think there are two dimensions to that. One is the demand for credit, particularly after the GFC. Having gone through a period of economic stress like we had, from the evidence available to us, businesses as a whole had less demand for credit. The large end of town, for example, was raising equity and deleveraging, and the smaller end had a fall-off in their approaches to the banks and other lenders for loans.
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> On the supply side, after something like the global financial crisis, the increase in arrears rates and non-performing loans, the authorised deposit-taking institutions and other lenders actually tightened up their lending terms, as would be expected after something like the global financial crisis. The ADIs did things like reducing the maximum loan they would give to particular classes of borrower, they lowered maximum loan to valuation ratios, had higher interest coverage ratios—those sorts of things—to tighten up their terms, with more stringent covenants, and hence there was a drop-off in the available supply. From that point of view, there were two elements—a demand impact and a supply impact. I do not really know which one dominated."[15]

In response to further questioning regarding the ease of obtaining credit prior to the GFC, Mr Johnson responded:

> "I think that is a fair characterisation. Prior to the GFC the spreads on lending were probably the lowest they had been for the statistics that had been collected. There had been 15 years of economic good times, and non-

[15] Mr Graham Johnson, APRA, Public Hearing, Sydney , 12 April 2010, p E57

> performing loans were at historical lows. I think there was a movement towards lending perhaps without the risk based pricing that should have really been there just prior to the GFC hitting, and then there was the correction after that. Our view is that probably we will not go back to the low spreads that we saw just prior to the global financial crisis."[16]

In response to a question from Senator Pratt concerning the permanent tightening on lending based on authentic risk assessment, Mr Johnson commented that:

> "...lending conditions go through a cycle. They tighten when things get like they have been. As things improve and the outlook gets better, the loan to valuation ratios, maximum loan terms and those sorts of things will probably move back to closer to what they were."[17]

Recommendation from Majority Report

6.3 The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provision and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined to 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, on third (set based on international practice) could be presumed to confer market power unless there is strong evidence to the contrary.

Discussion

This recommendation combines a number of issues that are dealt with separately under the TPA; firstly whether a firm has market power which it misuses, secondly whether a firm misuses this market power to price discriminate in an anti-competitive way, and thirdly what role the TPA should play in limiting takeovers which will result in market power.

While related, these concepts may be better addressed as discrete but interconnected topics.

Abuse of market power

- Section 46 in its current form captures those circumstances which the Committee's draft recommendation appears to be targeted towards.

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[16] Mr Graham Johnson, APRA, Public Hearing, Sydney , 12 April 2010, p E58

[17] Mr Graham Johnson, APRA, Public Hearing, Sydney , 12 April 2010, p E61

  - Through amendments made to the TPA in 2007, section 46 currently states that a firm can have a substantial degree of market power even where it does not substantially control the market, and does not have absolute freedom from constraint by the conduct of competitors, and that more than one corporation may have a substantial degree of power in a market.
- It is unclear whether the Committee is recommending the introduction of a trigger point, such as a predetermined market share, to act as a threshold for investigation, or whether the Committee seeks to go further than a trigger by recommending that a market share be determinative of breaches of various provisions of the TPA.
- The ACCC already considers market share when determining whether a corporation has a substantial degree of power in a market. It is not clear on what basis the inclusion of a requirement to do so would alter the assessment of possible breaches of section 46.
- There is a risk that the introduction of explicit consideration of market share may reduce consideration given to other equally or more important factors, and that it may reduce the consideration given to those firms whose market share is below the threshold, despite the possibility that even low market share firms may have market power.
  - Market share as an indicator of market power will vary in each market, for example it is possible a firm may have market power while having a share of the market in the range of 15 per cent, and similarly, a firm may have no market power despite having a share of the market greater than 50 per cent.
- It is also important to note that in addition to market share not necessarily indicating market power, the existence of market power is not an abuse by itself. The firm must take advantage of that power for a prohibited anti-competitive purpose for a breach to occur.

Price discrimination

- In 1993, the Hilmer Committee recommended that section 49 (prohibiting price discrimination) of the TPA be repealed. This recommendation was accepted and section 49 was repealed in 1995.
- The concern was that section 49 generally discouraged competitive prices and so worked against economically efficient outcomes.
  - The Hilmer Committee concluded that price discrimination generally enhances economic efficiency, except in cases which might be dealt with by section 45 (anti-competitive agreements) or section 46 (misuse of market power).

- The Hilmer Committee's recommendation echoed the concerns of previous inquiries, including the Swanson Review in 1976 and the Blunt Review in 1979.
    - The Blunt Committee’s terms of reference required it to explore avenues for improvement of the market position of small businesses. Notwithstanding this, it recommending a repeal of section 49.
- The Dawson Review (2003) supported the findings of the Hilmer Committee and concluded that no changes should be made to the TPA in relation to price discrimination.
    - It noted that the US law governing price discrimination has been widely criticised for being too complex, deterring price competition and promoting price uniformity. While originally directed at large retailers, in practice it has been applied mainly against small businesses who grant discounts in order to compete against large sellers or those engaging in vigorous competition.
    - The Federal Trade Commission now only takes action against price discrimination under the broader competition law.

Mergers

- The existing test already prevents the achievement of market power through merger and acquisition takeovers as proposed in the draft recommendation.
- Section 50 of the TPA prohibits mergers or acquisitions that would have the effect, or likely effect, of substantially lessening competition (SLC) in an Australian market. The ACCC assesses each merger on its merits according to the specific nature of the transaction, the industry and the particular competitive impact likely to result in each case.
- The ACCC and other competition agencies consider market share as just one part of their competition analysis in assessing the likely competition effects of a proposed merger, while also taking into account numerous other considerations such as the closeness of competition between the merger parties, competition from imports, substitutes, the threat of competitive entry, the presence of maverick firms, dynamic characteristics of the market, countervailing power of customers, and vertical integration of the merged firm. Focussing on market share to the exclusion of these other important factors may obscure the true competition effects of a merger.
- Australia’s SLC test for mergers is consistent with merger laws in many other OECD countries including the US, Canada, UK and New Zealand.

Minority Senators' Recommendations

Recommendation 1

The government should continue to explore initiatives to support small business by innovative measures that will assist their general financial viability and facilitate their access to finance.

Recommendation 2

The government should continue to monitor banks' behaviour towards small businesses through its regulatory bodies. The government should also set up its programs targeted to small business to allow for timely feedback on financing and related issues, and ensure that the Minister for Small Business has immediate access to this information.

Recommendation 3

The Government should consider an ongoing assessment of Basel II capital adequacy rules, to ensure that capital requirements are commensurate with real risk.

Senator Annette Hurley
Deputy Chair

Senator Louise Pratt

Senator Doug Cameron