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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Access for small and medium business to finance

WEDNESDAY, 2 MARCH 2011

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JOINT STATUTORY COMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 2 March 2011

Members: Mr Ripoll (Chairman), Senator Boyce (Deputy Chair), Senators Cormann, Hurley and Stephens and Mr Fletcher, Mr Griffin, Mr Anthony Smith and Ms Smyth

Members in attendance: Senators Boyce and Stephens and Mr Fletcher, Mr Ripoll, Mr Anthony Smith and Ms Smyth

Terms of reference for the inquiry:

To inquire into and report on:

(1) the types of finance and credit options available to small and medium business (SMEs) in Australia;

(2) 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;

(3) credit options available from banks, non-bank lenders and second tier lenders;

(4) the impact of financial institution prudential requirements and banking guarantees on lending costs and practices;

(5) comparison between the credit options available to SMEs located in regional Australia and metropolitan areas;

(6) the impact of lenders' equity and security requirements on the amount of finance available to SMEs;

(7) 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;

(8) the need for any legislative or regulatory change to assist access by SME to finance; and

(9) any other related matters.

WITNESSES

Committee met at 5.09 pm

KREITALS, Mr Jock, Manager Policy, Real Estate Institute of Australia

CHAIRMAN (Mr Ripoll)—I declare open this public hearing of the Joint Committee on Corporations and Financial Services. In doing so I welcome Mr Kreitals. This is the first of a series of public hearings that the committee is holding to inform its inquiry into the access of small and medium business to finance. The committee is to report by 30 April 2011. I remind everyone that witnesses giving evidence to the committee are protected by parliamentary privilege. Any act which may disadvantage a witness on account of their evidence is a breach of privilege and may be treated by the parliament as a contempt. It is also a contempt to give false and misleading evidence to a committee. Witnesses should be aware that if, in the giving of their evidence, they make adverse comment about another individual or organisation, that individual or organisation will be made aware of the comment and given a reasonable opportunity to respond to the committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the ground claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. A request to give a particular answer in camera may also be made at any other time. The committee prefers to hear evidence in public but we may agree to take evidence confidentially. The committee may still publish confidential evidence at a later date but we would consult the witness before doing this. Mr Kreitals, I invite you to make a short opening statement before we go to questions.

Mr Kreitals—Thank you for the opportunity to be part of this process. The REIA welcomes that. The Real Estate Institute of Australia's agents are certainly very much members of the small business community. Our professionals, of which there are about 77,000, work in agencies mostly with fewer than 10 employees and half of these are women.

The REIA submission addressed three aspects of this inquiry: firstly, competition; secondly, the impact of equity and security requirements on the amount of finance available; and, thirdly, the policies and practices that restrict access to finance. To supplement its submission, the REIA referred to a survey of real estate agents across Australia that it conducted last year. I would like to highlight some of the outcomes of that.

Whilst that survey was conducted about the middle of last year, our anecdotal information suggests that little has changed from then. In terms of the term of reference regarding competition in small business lending, our submission detailed the decreases in competition that have occurred in the small business sector. For example, the big four banks increased their share of the market from around 60 per cent in 2004 to around 75 per cent in 2009. This was certainly iterated in the survey response in which respondents indicated that decreases in competition in the finance market were having a debilitating effect on many real estate agencies. It is for these reasons that the REIA made recommendations aimed at improving the availability of finance, addressing the cost of finance for small businesses and increasing competition in that sector.

With regard to the term of reference about the impact of equity and security requirements on the amount of finance, the REIA survey found that four-fifths of respondents believe that the requirements of financial institutions—such as loan to valuation ratios and asset-backing mortgages over personal assets—were more stringent compared with those of the period before

October 2008. Also, two-thirds of the respondents feel that the cost of finance for small businesses relative to official interest rates is more expensive than it was before October 2008.

With regard to the term of reference on policies and practices, respondents to the REIA survey stated in their comments that they feel that the financial sector does not understand the small business sector and, furthermore, tends to group all small businesses in the one basket without any differentiation as to the factors affecting a particular segment or the outlook for that segment. An example of this for the real estate industry is the treatment of rent rolls, which have been used as security against borrowings. A number of the respondents indicated that financial institutions did not recognise rent rolls as an asset despite low vacancies in the rental market and the cash flow stability offered by the rent rolls. Even when rent rolls were considered as an asset, the loan to valuation ratio had changed markedly since the global financial crisis. It had dropped from around 90 per cent before the GFC to around 65 per cent in more recent times.

The REI survey also indicated that three-quarters of respondents thought that access to finance was more difficult than it was before the global financial crisis. This was despite the fact that two-thirds of respondents thought that their financial position was either the same or better than it was 12 months earlier.

CHAIRMAN—Could you give us an indication in terms of financing. You are specifically referring to agents themselves—that is, the finance and the capacity for agents to borrow.

Mr Kreitals—Agents or small business people to borrow money. I am not talking about house buyers.

CHAIRMAN—Or their customers, in particular, in relation to doing business. Obviously a key point would be whether people can borrow to buy homes and therefore create business. There is a fair bit in your submission in relation to competition. In fact your first recommendation is that we do everything we can to increase competition. You say that there has been a decrease in competition in the finance market, which is having a debilitating effect on many agents. Could you give us a better idea of what that means? Where has that competition decreased and why has that come about?

Mr Kreitals—I think that the competition has decreased, as I said in my statement, because the major banks have increased their share of the total market. Before the GFC there were other lenders around. They seem to have vacated the market after the GFC. Certainly there are some indications that they might be coming back. But there was a gap left there.

CHAIRMAN—From your perspective as the industry body, would you determine that that is just a market effect of circumstances at the time and that these are parts of the ups and downs of being in business and that it is not particularly directed at either your sector or any other sector? It is just that fewer people want to be in that market, for whatever reason that might be.

Mr Kreitals—I never suggested that it was targeted at real estate agents. I was just saying that there is a lessening of competition for the availability of finance for small business in general. It is a comment I have got from other industry bodies as well.

CHAIRMAN—There is a fair bit of comment about the place that perhaps pre-GFC—and during and after the GFC was the turning point for the availability of finance—it was just too easy to get money and banks and others perhaps took too much risk and that has now reverted to a more balanced position. Would you agree with that?

Mr Kreitals—Do you say that from a the point of view of a business seeking money or from a person borrowing to buy a house?

CHAIRMAN—Strictly from the business perspective and the lender perspective, there is a fair bit of talk around the place, and certainly in submissions, that there might have been a long period pre-GFC where it was just too easy to borrow and people became accustomed to that. Now things have changed and it has reverted, maybe, to a more balanced position. So where people find themselves today maybe is the right setting. Do you get a sense from your own membership that some of them are saying, 'Yes, it is a bit harder but maybe that is where it ought to be,' in risk versus return type arguments?

Mr Kreitals—Certainly I think it is indicated by my examples that it is harder. I have not heard any comments from our constituency that it was a bit too easy before. If you were saying that there was a blip and we have returned to more normal times it is not a view that our constituents would share.

CHAIRMAN—Maybe these things tend to swing the pendulum too much and it is hard to get it settled right in the middle. Perhaps it was a bit easier, now it is a bit harder and the pendulum has gone too far and we need to bring it back a little bit. From our perspective, a regulatory perspective, I am wondering what we could do to either change any regulation or encourage lenders to be more compliant, to be a bit more generous.

Mr Kreitals—I do not know that I can add further comments. As I said, our guys, with better financial positions than before, are finding it a lot harder currently than they did before.

CHAIRMAN—Is that partly because their assets may not be valued as highly? Is one of the problems you are finding that for agencies and the agents their pool of assets is worth less?

Mr Kreitals—Using rent rolls as an example, I do not think their assets are worth less but the financial institutions are placing a lesser value on them, even though rent rolls are a highly regarded commodity, tradeable between agents. There is no more risk associated with rent. As you well know, the rental market is very tight and getting tighter but the banks' valuation has probably dropped one third.

CHAIRMAN—It would almost seem counterintuitive, that a real estate value might fall in terms of bricks and mortar but a rent roll is cash in.

Mr Kreitals—Yes, it is cash flow.

CHAIRMAN—You would wonder why they would go down that path. Of all the things of value, you would probably value that higher, not lower, because it is cash.

Senator BOYCE—And it is not based on the values of the underlying assets either.

CHAIRMAN—No, it is just whatever rent is the driving factor in any particular area and none of them are going down. Do you have any thoughts or explanation of that? That is something we would like to pursue.

Mr Kreitals—No explanation other than that our members certainly find that hard to explain because their underlying financial situation has not changed.

CHAIRMAN—As an association, obviously you are in contact with all of your members and work for their benefit. This is certainly an issue we have identified as a problem, as has your organisation. What is the institute doing in talking to lenders and banks collectively to find solutions for your members? Is there a particular course of action or strategy in dealing with banks and lenders directly?

Mr Kreitals—Early post GFC the then minister for small business did convene one meeting with the Australian Bankers Association to initiate a forum to discuss problems and seek solutions. As it turns out, it was a one-off meeting. Post that meeting, I have had some discussions with the Commonwealth Bank on their approach to housing, but there are no standing ongoing arrangements to seek solutions.

CHAIRMAN—But certainly it is within the realm of your capacity to organise meetings and to pursue these issues. Banks being the providers and your guys being the customers, they would want to look after them in some way. I am just trying to understand whether there is a possibility outside anything we might do for the industry itself to take a hold of this in some specific areas.

Mr Kreitals—From our perspective we would certainly welcome any opportunity to continue the discussions we had with the ABA. I thought they were an ongoing thing but only one meeting was ever convened.

Senator BOYCE—You mention that rent rolls are traded between agents. How do you value them for that purpose.

Mr Kreitals—The valuation would be very much dependent on the size of the roll, which is the number of properties and the cash flow they generate.

Senator BOYCE—So there would be no standard norm within the industry for how you go about that?

Mr Kreitals—There is a norm within the industry which is a multiple of that rent roll—say the rent roll is $100,000 a year, there would be a multiple of the valuation. If you want me to find you an answer for that, rather than give you a wrong one, I will take that on notice.

Senator BOYCE—That would be good. One of the issues which arose while we were beginning to undertake this inquiry was a number of people in the financial sector—accountants, real estate agents and businesses themselves—who were not happy with their current credit options but were concerned about how they might affect their relationship with their current lending institution if they were to speak publicly. Would that apply to any of your members?

Mr Kreitals—I cannot demonstrate that with a concrete example, but it is possible that it is the case.

Senator BOYCE—One of our other terms of reference is to compare the availability of credit options between urban and rural and regional areas. Do you have any evidence from your members in that area?

Mr Kreitals—This may not be answering your question, but if I could go back to the survey: the respondents to the survey were across all states and there was a good mix between metropolitan and non-metropolitan and there was not any difference between whether they were metropolitan or non-metropolitan.

Senator BOYCE—So on the basis of your survey, there is no more difficulty in rural and regional areas. You linked accessing finance and problems with staff employment levels. Could you tease out for us what you mean by that?

Mr Kreitals—If you have that impression, I have created the wrong impression. I did not actually say that there was a relationship between the difficulty of getting funds and the size of the enterprise.

Senator BOYCE—Sorry—that people simply had to lay off staff because they could not get finance for a particular enterprise.

Mr Kreitals—I did not say that either.

Senator BOYCE—I had understood your submission to be saying that. You say that small business finance costs of being penalised by the current lending provisions. What would you like to see happen there?

Mr Kreitals—The reason I say they are being penalised is that we know there is a margin between the cash rate and the current lending rates. The banks will say that is because of the cost of borrowings but the margin that small business borrows at has increased since pre the GST to current times. That is why I say they are being penalised, particularly as I indicated that the risk factors associated with the real estate business have not increased.

Senator BOYCE—Do you see any strong distinctions between real estate agents as small businesses and other small and medium businesses?

Mr Kreitals—As I said in my statement, I do not see any differentiation because one of the criticisms we have is that all small businesses are treated the same, that the banks would say that it is riskier lending now. I do not wish to keep harping back to the rent roll but the risk factor associated with that has not changed, yet the cost of funding for real estate businesses has increased, just as it has for other small businesses, which might have had a riskier future post GFC.

Mr ANTHONY SMITH—You made the point in your submission, which I think goes to the nub of some of the issues, that small businesses tend to be grouped and assessed the same—this lack of differentiation. Are you saying that that has obviously always been the case and with the challenges of the GFC everyone moved to a slightly more difficult position or you saying that that became more pronounced during the GFC—that is, was there any level of differentiation before the banks wiped away what they saw as increased risk?

Mr Kreitals—It had become more pronounced and I say that on the basis that the margin between lending and the cash rate has increased but it has increased right across the board so it has become more pronounced.

Mr ANTHONY SMITH—Do you see this as the key policy challenge because diversity and small business is obvious and is always going to be a policy challenge so it is a matter of trying to work within that? Do you see it as the major issue?

Mr Kreitals—I am not saying it is the major issue about it certainly is an issue from our perspective.

Mr ANTHONY SMITH—I mean from the perspective of how the banks assess their clients. What you seem to be saying is that when it really came to the crunch, your size or your scope did not seem to matter.

Mr Kreitals—Or what industry you were in.

Mr ANTHONY SMITH—Yes, your strength or your industry. You are a small business and therefore, whether Senator Stephens and I started this business yesterday with two or three clients or whether we had been going for 10 years, that would not have made any difference. That seems to be—

Mr Kreitals—Yes, I would agree with that.

Ms SMYTH—I want to turn back to employment because it was obviously very significant in the context of the GFC. Looking at page 6 of your written submission, I want to understand whether it is your opinion that the observations in the second paragraph on that page are not necessarily applicable to the real estate industry. I understand from the written submission that they are applicable to small business generally and the pressures on employment in the context of funding restrictions is significant in small businesses. If it is not what you have experienced in the real estate industry, that would be of interest.

Mr Kreitals—That paragraph is referring to some other studies.

Ms SMYTH—Small business generally?

Mr Kreitals—Rather than the real estate industry. My apologies if you misunderstood. That was a general comment as evidence of it rather than specific to the real estate industry.

Senator STEPHENS—Going back to your earlier evidence, in your submission where you reiterated what COSBOA has found in terms of lending practices towards small businesses, to what extent can you tell us that the practice of either withdrawing pre-approved loans and lines of credit is a feature of the real estate environment? Can you give us some examples around the issue of reassessment of already agreed loans and terms in the real estate industry?

Mr Kreitals—It is not a question that we asked in our survey. However, at the time of that survey, with what I will refer to as anecdotal evidence, there were certainly instances of people having had pre-approvals from their banks and then going back to their banks and finding that either the loans were no longer available or the terms had changed considerably. I cannot be more definitive and quantify that, but it was the case.

Senator STEPHENS—But it is happening in the real estate industry?

Mr Kreitals—It had happened in the post GFC period.

CHAIRMAN—I have heard anecdotally and I would like to know whether you have heard about this or whether any of your members have spoken to you about being pushed from one type of lending facility—say, an ordinary loan to perhaps an overdraft, or perhaps from an overdraft or credit card, scaling up the costs, fees, charges and interest, still getting the same amounts of money that they need to operate or grow but finding that they cannot do it through a traditional loan with the same lender and having to shift to other types of more risky and expensive lending, say mezzanine finances, that sort of thing.

Mr Kreitals—You said ‘being pushed’. I am not sure that they are being pushed.

CHAIRMAN—Pushed or encouraged?

Mr Kreitals—The reality is that lending has become more difficult and previously you were offered Y dollars and now were being offered only X dollars so you will seek the difference from other sources which generally means using your credit card and higher interest rates.

CHAIRMAN—I understand that and I can understand why people would do. More specifically I am asking where a borrower, after going to their ordinary bank, would tell you, ‘I just went to borrow what I would normally borrow and they said that they could not lend it to me in that form but if I took an overdraft they would give it to me or if I used a credit card they would still give me the amount I needed but in a different form.’ So rather than deciding by their own they will to say, ‘ I cannot get what I want so I will go elsewhere and use other forms.’ I am interested to see whether there are any institutional lenders who would say, ‘We will still give it to you but we are going to make you pay a higher interest rate.’

Mr ANTHONY SMITH—So someone might have accessed the credit line at a certain level and the lender could say, ‘We can no longer provide that but you have a MasterCard with a $10,000 limit which we are prepared to extend it to $100,000.’

CHAIRMAN—Yes, spot on.

Mr Kreitals—I understand that has happened but whether it has been suggested by the banks or whether it is—

CHAIRMAN—No, all I am asking is whether that has been raised with you by your members.

Mr Kreitals—Yes it has.

CHAIRMAN—You are saying that there are instances where your members had said to you that they were being forced from one type of loan to another more expensive loan?

Mr Kreitals—Yes.

CHAIRMAN—You are pretty happy that real estate agents themselves are not being treated differently from anyone else? Do you get the sense that banks are picking on you for any particular reason—a difference in market or anything you do which is different from what everyone else does?

Mr Kreitals—I certainly do not think that real estate agents are being picked on.

CHAIRMAN—Treated differently might be a better way to describe it.

Mr Kreitals—Certainly immediately post GFC and partly as a result of the government's stimulus package, turnover in the real estate sector increased compared to what it had been for the previous 12 to 18 months. The assessment of that was not taken into account by the banks—they were being treated like everybody else. They were not being picked on but the underlying strength of the industry at that stage was not being taken into account either.

CHAIRMAN—In relation to rent rolls, I am assuming there are not too many other assets held by real estate agents that could be used as collateral equity or something else with banks. Is that right?

Mr Kreitals—It depends on the structure of the business. Some have their own offices. I used the instance of rent rolls because, as someone else remarked, they were cash—they were liquid—and that does not change with valuations.

CHAIRMAN—Mr Kreitals, is there anything else you would like to add?

Mr Kreitals—No, thank you.

CHAIRMAN—We thank you very much. The committee secretary will inform you of any proceedings from here.

[5.41 pm]

EVANS, Mr Greg, Director of Economics and Industry Policy, Australian Chamber of Commerce and Industry

CHAIRMAN—Good afternoon. I will ask you to make a short opening statement and then we will ask some questions.

Mr Evans—We have provided a submission, which outlines the substance of the issues we want to represent. I want to refer to the wider circumstances of small business to give some context to why we believe access to finance is a particular issue. The results of our last small business survey show a continuing chasm between the performance of large business and small business. Most of the growth indicators of small business, in areas such as sales, profitability, investment and employment, declined and are in fact in contractionary territory compared with the more favourable circumstances of large business. What that points to, in particular, is that because of a sustained period of low profitability for small business their retained earnings or cash available is at a fairly low level; therefore, they are at a far more concerning level in terms of being able to fund working capital requirements, let alone capital expansion plans. Coming out of the GFC we saw that large companies were able to raise equity but small businesses found it much more difficult because, at the end of the day, the only finance they can generally raise is through their lenders. They are the circumstances we are finding in our survey feedback with regard to small business and, indeed, access to finance still ranks as one of the major constraints that we find in our survey—second only, generally, to difficulties in accessing skilled labour.

CHAIRMAN—Is that more a case of just being a factual course of events, that a large business enterprise can raise equity finance whereas a small business usually cannot? It is no particular reflection on banks or lenders; it is just the market as it exists. I am trying to establish the difference. There was a change—we had the global financial crisis. There was a tightening of requirements and a limited access to finance. I am very interested in your view in terms of what your members are saying. The big change was the tighter restrictions. Was it fair or unfair? Was small business more than capable of accessing that finance and then prevented? I would use the example of ‘The pendulum swung’. How far too far did it swing, in your view?

Mr Evans—We believe it has swung. The feedback from our surveys is that small business is finding it more difficult than they did prior to the global financial crisis, and they still nominate access to finance as a constraint in terms of capital expansion but, as I said, also their capacity to deal with working capital requirements. What we have also found is that in cost to finance, not only just access but also cost to finance, banks are clearly taking a much closer look at the serviceability and collateral provision provided by small business. The lending criteria are much tighter and interest charges have increased for small business.

CHAIRMAN—Would you agree with the CPA submission that says that pre-GFC it was just too easy to get credit and this has rebalanced it in a way. Maybe the setting now is where it should always have been. Under the pendulum concept the pendulum was way too far one way and it was too easy. That was certainly their view. Is that your view that it was too easy?

Mr Evans—I am not sure that is necessarily the circumstance for Australia. I believe that in the banking system, internationally, that might be the case. There are probably pockets of industry in Australia where the banks have felt that they lent too much and their exposure was too high such as in commercial property. We are just talking about the mainstream Australian small business that has necessarily had a good trading record, has a track record and may well have been established for many years or, indeed, decades. They found that the lending noose had tightened around them as well.

Mr ANTHONY SMITH—Irrespective of the fact that their business was still performing strongly, they were just lumped in with a general typing.

Mr Evans—That is our view. We believe that the lending skills within banks have actually deteriorated probably over a longer period. There are very specific lending skills associated with lending for corporates. The availability of information is a lot more transparent. That is a specialist area on its own. Whereas lending for housing is relatively simple and straightforward. But to actually get a business finance professional, someone that understands local market conditions and the like, is that much more difficult. Finding someone who actually understands a set of accounts, who is probably not necessarily prepared to an ASIC-compliant level, is that much more difficult. We believe some of those skills have deteriorated in the banking system. It probably came about when banks started cutting costs and made their branch network money shops rather than necessarily having a skilled business lender in them.

CHAIRMAN—Obviously ACCI is a large organisation with a lot of members and a large base. You would be representing those views, I am assuming, to lenders directly, to individual banks and to banking associations and so forth. I am just wondering: what sort of feedback and what is the interaction between lenders and the body?

Mr Evans—We do have meetings and have in the past met with the Australian Bankers Association. I suppose in the immediate aftermath of the GFC they said, ‘We’ve got the money. It’s just that we don’t have the demand for it.’ There is no problem actually accessing the finance; it is just that no small business is coming and asking for it or very limited numbers are. We understand that argument but we also believe that, given the widespread perception as well that it is difficult to obtain finance, many small businesses stopped approaching their banks. One reason is they did not want their loan facilities re-rated and end up paying a higher margin. The more they can stay away from the bank the better.

CHAIRMAN—There is an argument that they knew it would be an issue if they approached their bank for refinance that revaluations and new conditions would apply and it might make life very difficult for them.

Mr Evans—They would be poring over their revenue projections and the like and trying to pare them back. I think that was a legitimate concern.

Mr ANTHONY SMITH—The chair has got you into some territory that I think is worth exploring a bit further. Let me ask you this question, given your experience and the breadth of your organisation, and it follows on from the previous witness: what is your feeling of the international experience in this area over the last few years, notwithstanding the fact that some jurisdictions would have been much worse because the effect of the GFC was much worse?

Generally who does this better around the world? I think some of your recommendations touch on this but as a matter of policy who is dealing with some of these issues better and what are the drivers of that? Are they, for instance, some of the factors you just mentioned about bank personnel and attitudes?

Mr Evans—I think the advantages in different markets in the key Western economies are probably as a result of greater levels of competition in the banking sector as compared with here. I think that is what we found with respect to small business lending access. It was the narrowing of competition which diminished the opportunity for small business. Talking internationally, I think there were some specific policy responses in different jurisdictions that existed even before the GFC, but certainly they were enhanced after the GFC and that was government guarantees and the like for small business financing because they realised it was obviously going to have a major macro-economic effect if small business could not borrow money. I have seen it written that just about every OECD country except New Zealand and Australia actually has a scheme whereby the government will guarantee to some extent small business lending. As an organisation that would not be our first policy response because of the hazard associated with such a scheme. In our recommendations, as you will see, we think that is something the government should at least put on the policy agenda for discussion and examination to see whether it is plausible. The other point we make is that should only be temporary in the aftermath of the GFC. To some extent, as time goes by and hopefully greater levels of competition come back into the marketplace as more non-bank lenders and some of the foreign banks come back in, we would hope those sorts of initiatives probably are not required.

Ms SMYTH—Returning to the point you made previously about assessments of risk and holding small business up to tests that are slightly unrealistic for the kinds of sets of accounts they present, is there a means by which we can usefully provide a lesser form of the ASIC equivalent that currently exists so that there is some sort of benchmark for use by those assessing risk and doing financial due diligence in the financial sector?

Mr Evans—Perhaps, but I guess we would not want to impose a regulatory solution on that. One of the problems is that most small business proprietors, as you will appreciate, are just flat out running their business let alone dealing with compliance associated with even seeking a routine loan. Most small businesses basically find going to their bank a major chore in having to provide all the relevant information in terms of cash flow projections and the like. In some respects, this is an area where small business probably could improve and that is more the extent to which they can improve their own accounting systems and the like.

Ms SMYTH—I suppose I was not thinking of it so much from the point of view of enforcing something on small business but of using some sort of standard template that could be applied by those providing finance, which might limit the extent to which they wanted to make excessive inquiries and unnecessarily burden small business. It would be just a guide, if you like.

Mr Evans—I understand that. Some of the lenders actually do that, but I think this was a bigger problem than that. It was more of a systemic problem that banks did not want any more exposure to particular risks and therefore were not going to lend more.

Ms SMYTH—In any circumstance.

Mr Evans—Yes, especially, for example, if commercial property was collateral.

Ms SMYTH—Yes, of course.

CHAIRMAN—Is that coming back? Is that pendulum swinging back towards the availability of credit and, let us say, a more 'normalised' environment?

Mr Evans—Yes. The Reserve Bank does make those comments, but we are not necessarily seeing that reflected yet. I think only this week we saw business credit, and it is still fairly flat; it actually deteriorated over the quarter. The empirical evidence suggests that it has not necessarily improved a lot.

CHAIRMAN—You talk in your submission, as do others, about the diminishing competition in retail banking and the detrimental impact it is having on borrowers. When we look at it in terms of data and the number of lenders that are available for, say, residential secured business overdrafts or other forms of lending, there appears to be—at least on paper—a fair bit of choice. There could always be more, I suppose, but in terms of rates, conditions and other requirements and the number of products and providers—30 credit providers, 18 banking groups, 53 different products—there seems to be a range there. When you talk about competition, what are you specifically referring to?

Mr Evans—I am not sure of that table you are referring to. Are you talking about lending for residential mortgages?

CHAIRMAN—All different types of lending on choice and competition, whether it is residentially secured business overdrafts or specifically other forms—for example, variable business loans. For variable business loans to small business there are 33 providers, 25 banking groups and 52 different products, with quite a range of rates, terms and amounts. There appears, at least on paper, to be a fair variety. Maybe on paper it just shows a picture and does not tell you what is happening on the ground. I would certainly be interested in what you think about what it happening on the ground.

Mr Evans—At the end of the day, small business lending is still the game of the big four banks, with two or three regional players. A lot of those fringe players probably are not really providing the necessary level of competitive pressure in the marketplace. Some of the foreign bank lenders did actually exit the market, not because of circumstances in Australia but because their parent company's circumstances. They were much more active in the marketplace, especially for small business. It is those sorts of players that we will be seeking to see return, as well as a lot of players in the commercial leasing market. They are the players that made the difference and provided the competitive stick to the big four.

CHAIRMAN—Continuing on that theme, you have alerted me to an idea. As we all understand, small business is busy just trying to operate. They do not really have the time to go out there and research and find out all the different products that are available. Maybe part of the advantage of the big four is that they are the ones that are visible and that people go to. Is there a possibility here that people just do not know what is available out there and therefore do not look, so there is reduced competition from the fact that they just do not know rather than that it is not available?

Mr Evans—That may be the case. With respect to small business, if you want to operate a flexible overdraft, for example, it is really only the major trading banks that can probably provide that facility. If you are providing security for the operation of an overdraft, you cannot go and get a fully drawn advance from another institution. So you are really lumped in with one institution for most of your banking. You might use a credit union for transactions, but in terms of business simplification it is always better to try to deal with one provider when you can.

CHAIRMAN—Hence the advantage of the big four in what services they can provide. It just makes sense in terms of the limitations that are on small business in going out there and seeking out a competitive product.

Mr Evans—The big four are in there and obviously have a market presence and that is the first port of call for most.

Mr FLETCHER—The first question I want to ask is about the comment you make in your submission about SMEs in some cases using credit cards as a source of business finance. Can you give a quick overview of the different, I suppose, non-traditional sources of finance that SMEs might use? If credit cards is one are there others?

Mr Evans—Credit cards is the mechanism which has become more popular lately. You would have noticed that a number of lenders are actually marketing themselves as a business finance mechanism. Of late that has become much more popular due to the more relaxed security requirements that need to be provided. That would be the key alternative type of financing. Another way is plant and equipment purchases. Small business does not necessarily have to be loyal to its original bank for leasing because the lender takes, as you know, the security over the plant or equipment. That has been another alternative source of financing. There is evidence of other forms of financing such as factoring and the like, which have been around for a long time, and there may be some evidence that those opportunities have been taken up more than they were in the past.

Mr FLETCHER—Presumably one of the issues of credit cards is that the interest rate you are paying on them is twice what you might normally expect for a business loan?

Mr Evans—That is right especially if you leave any amount outstanding. Many of them offer free credit for 55 days or whatever. Used wisely that is perhaps not necessarily a bad form of finance.

Mr FLETCHER—What about the role of a residential mortgage being used as a means to finance the home owners business?

Mr Evans—Providing the residence as a security for a small business loan is quite commonplace in the small business community. There are various levels of reluctance amongst proprietors to actually do that, to put everything on the line, including their family home. In many circumstances it is necessary if you want to have a loan size of any particular significance.

Mr FLETCHER—What about the use of superannuation balances as a form of financing? I suppose I am thinking particularly of where people buy their business premises through their super fund.

Mr Evans—I am not sure that you can actually use those as collateral for security for a loan. The other point is that a lot of small businesses actually do not have very high superannuation fund balances in any case.

Mr FLETCHER—What is the role of brokers in the provision of business finance? In other words, mortgage brokers seem to me to have become an increasingly important part of the distribution chain for home finance. Is there an analogous group of people or businesses out there providing broking services for business finance?

Mr Evans—Yes, there is. That is mostly manifested through the small business relationship with their accountant. Quite often the accountant may have a link through to different lenders, particularly for leasing and the like; that type of financing. If you have an overdraft requirement or a requirement for a fully drawn advance they can provide that service as well.

Mr FLETCHER—I certainly had complaints from constituents that that sort of financing has tightened up very sharply in the last couple of years. Is that consistent with information from your members?

Mr Evans—They are necessarily sourcing money from areas that are non traditional. It is just that they might have a relationship with different banks. Some of the smaller banks were quite aggressive a couple of years ago to actually develop relationships with accountants as a distribution point because they do not have the branch network to do that.

Mr FLETCHER—Was the exit of Bankwest as St George, as independent players, a particular trigger point for the withdrawal of the availability of finance to small businesses?

Mr Evans—We believe so. St George were actually quite strong in terms of their lending support for, especially, small businesses. We believe it was due to another competitor who left the market that was probably detrimental to small business.

Mr FLETCHER—You have recommended that the RBA or another agency should conduct a quarterly credit condition survey. To understand that in a bit more detail, is that based upon a concern that there is not a sufficient amount of objective data available right now?

Mr Evans—I think we found that after the GFC it was hard to get a handle on what actual credit conditions were like. We looked at some of the international experience. The Federal Reserve conducts a loan officer survey. The Bank of England does and the Bank of Canada conduct mostly quarterly surveys. The Federal Reserve has been doing it for decades so they can get a pretty good handle on it. It actually aimed at the loan officer—where are you lending, where are you knocking back credit, why are you doing that? They publish the reports on their website so it gives a pretty good snapshot of the state of the economy in terms of lending. It is information that we think is deficient at the moment. The Reserve Bank has information but not to that level of detail. It is more based on their own business liaison and feedback.

Mr FLETCHER—Is it broken down by segment—residential, small business, large business, et cetera?

Mr Evans—We have only looked at it from a business point of view. I am not sure where it is disaggregated into mortgages and the like. I do not know.

Mr FLETCHER—I am just asking the precedence that you are looking at, the Federal Reserve and so on, is that a report on credit conditions and lending availability generally or does it then break it down by segments by segmenting business as opposed to other types of lending.

Mr Evans—It certainly deals with business. I am not sure what other finance they look at.

Mr FLETCHER—I understand. Thank you.

Senator BOYCE—Going back to that quarterly report, we have already had comments that small and medium businesses are pretty busy people. They are not going to be users of this data. Who do you see as the people who would use this report?

Mr Evans—I think it would be important for policy makers. Treasury, the RBA and other policy makers find it hard to get this information. We have our own survey work and we try and get that information as well. Quite often those bodies come to us and ask us about credit conditions. I think even in those countries it is probably voluntary but their financial institutions want to cooperate.

Senator BOYCE—I thought I remembered reading recently that NFF and Canstar were looking at doing a business loan calculator in the way they do shares and other interest rates. Are you aware of that?

Mr Evans—I am not sure about that. One of our state member, the New South Wales business chamber, actually do that with Canstar as well.

Senator BOYCE—I thought it was NFF.

Mr Evans—They may do it as well.

Senator BOYCE—I think they are to launch it shortly. The question I started with earlier was that a number of accounting bodies and a number of small business people were more than happy to tell me off the record about their experiences trying to get loans and the length of time it took them to get loans. They were concerned about what saying that publicly would do to their relationship with the banks or their other lenders. Would you like to comment on that?

Mr Evans—On whether it would in fact damage their relationships?

Senator BOYCE—Are you aware of this reluctance?

Mr Evans—We are. We are approached for our war stories by the media on a regular basis. It is always difficult to get people to appear in those, not necessarily because of the retaliation by the banks—

Senator BOYCE—Perhaps concern?

Mr Evans—People do not necessarily want to say what their financial circumstances are. It is always hard to get that information. I know committees such as this would be served well if they could have actual case studies. I know it is difficult to get that information—not because it is not happening; it is because people are reluctant to provide that level of detail.

Senator BOYCE—Did we talk about the multiple definitions of small and medium—

CHAIRMAN—No, but we probably should.

Senator BOYCE—It is one of my hobby horses. I do not know why we cannot have a single definition instead of the Bureau of Statistics' definition, ATO's definition—and you keep going on and on and on with who has definitions. In terms of the banks themselves setting definitions and those definitions not working with the other multiple definitions, what could we achieve if we were to push for a standard definition?

Mr Evans—Banks normally do it on the basis of the level of the loan advance. Once it gets beyond $10 million it is regarded as a midsize 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.

Senator BOYCE—Is there any positive or negative effect about the fact that banks often do not use the same definitions as each other?

Mr Evans—The only practical outcome for banks is that once it gets above a certain level then it moves from the region to the state head office and the like. As an extension of this particular point, we have had this happen with small and medium sized enterprises in, for example, the Northern Territory and Tasmania. Once their loan goes over a certain size, in the case of Hobart, it is assessed by someone in Melbourne; or, in the case of the Northern Territory, it might even go to Sydney. There has been some negative feedback on that from some of our members, because you are actually having your loan assessed by someone who is not a local and does not necessarily know local market conditions.

Senator BOYCE—Is it not the case that just post GFC a lot of loans that would have been assessed locally were being assessed at head office or wherever, anyway?

Mr Evans—I do not know about assessed. I think what happened—

Senator BOYCE—Approved or not approved.

Mr Evans—Not even that necessarily. I think if you were below the threshold there were set levels. It was quite clear that the credit departments of many of the banks were saying: 'You have to fall within these particular guidelines. It is black and white. If you fall outside that, then you do not qualify for this loan.' So we believe the credit departments in head office became very important in terms of setting policy, and it left loan officers in the regions little discretion to actually negotiate.

Senator BOYCE—That brings me to one of our other terms of reference, which is whether there is any greater difficulty for small and medium businesses to access credit in rural and regional areas than in urban areas?

Mr Evans—We have actually done some limited survey work on that and we found it was about on par; if there was a difference it was because the nature of those industries in rural and regional areas versus what was in the city—

Senator BOYCE—So it was more about the risk profile of the business than the geography, so to speak?

Mr Evans—I think so, yes, and demand conditions may have been worse in regional areas than in city areas for particular businesses.

Senator BOYCE—Again, I am not sure if you have been asked about this. You said in your submission that construction firms had had moderate to major obstacles in getting access to finance. Could you talk a little bit more about that and the result of it?

Mr Evans—This is evidence from one of our members. The Master Builders are constantly making the point that multi-dwelling developments such as apartments and the like have found and continue to find it very difficult to secure finance. Even if they comply with up to 100 per cent presales, they may not qualify for loan finance from the large banks. Our belief, and the banks may well confirm this, is that the banks believed they had enough exposure to that sector and, no matter how good the credit was, they basically were not going to lend for those proposals. I am not sure whether that has eased more recently, but that was certainly the circumstance.

CHAIRMAN—In your submission you talk about access to information and you talk about a standard taxonomy on loan products. I am interested in how you see that happening, whether it is really possible or if something additional is needed, because there are already a number of requirements and standard features.

Mr Evans—It was probably a derivative recommendation of ours about the extent to which that was possible. We do not necessarily have the expertise to see whether that could be developed any further, but it is something

CHAIRMAN—It is something worth while pursuing or having a look at.

Mr Evans—Yes. It is about the operation of those institutions.

CHAIRMAN—We have talked a little bit about the international comparisons, and you have made a recommendation that the government guarantee small-business loans. You provided some information about similar programs in other countries.

Mr Evans—I think we said it would be reasonable for the government to explore that and see whether it had any application in Australia.

CHAIRMAN—There is always that moral hazard, that risk for the government in going out and guaranteeing that anyone else is going to succeed. We all know the realities of life and the success rates of small business. There is a gap between the skill of the lender, as you mentioned earlier, and the skill of the business operator and their capacity not only to manage their affairs but to succeed and repay. I am interested in your thoughts and your perspective.

Mr Evans—We are cognisant of that argument. I guess we wanted just to see an examination of what happens in other jurisdictions. I think we would still envisage that those loans would be provided through existing financial institutions. We were not indicating that the government should have a bank.

CHAIRMAN—It is certainly something I am interested in exploring further, but I think in the back of my mind of all the normal things. Whenever there are extra guarantees provided, there is extra cost attached because somebody else is carrying the risk, be it government or otherwise—reinsurers, other lenders and so forth. But if you think that is something we should look at I am certainly happy to do that.

Mr Evans—It has been looked at in what we regard as fiscally conservative countries such as Singapore. We did not think it was necessarily that radical an idea.

CHAIRMAN—In very broad terms, very generally, do you think for the Australian market that we are too conservative—the general 'we' of the lending institutions? Are they too conservative? Do they just not take enough risk? Is that borne out by any evidence? Is there anything that points to the fact that there could be more risk taken, that the numbers are not that bad? The banks would argue that they weight risk appropriately and they use the Basel II outcomes in terms of weighted risk average and weighted cost to provide finance. I am not sure how that all fits in or whether there is a view that banks are just being too conservative.

Mr Evans—We acknowledge that having well-run banks puts us in a better step after the GFC and we are not advocating non-prudent lending, but we think the banks were able to take their foot off the pedal a bit because there was not the level of competition that there once may have been. Therefore, they tightened their criteria and if you fell outside their criteria they were not even going to negotiate with you because they knew that you could not go next door for a loan. We do not believe they have been putting in sufficient effort in order to assess small business credits. It is not always an easy thing to do; it does require some effort and understanding.

Ms SMYTH—My question follows on from the Chair's questions regarding the international comparisons. I am interested in whether there have been comparative arrangements that dealt with particular sectors within small business generally. I am particularly thinking of circumstances where we may wish to encourage IP and skills development in particular sectors and where a loan guarantee scheme of the kind that you have mentioned might be most useful. I just wondered if any of the countries that you mentioned targeted their loan schemes at particular sectors and whether that proved to be useful.

Mr Evans—I do not think they did. I think it was a broad brush and applied to where that finance was sought. If small business could not access finance it had wider economic implications. At a domestic level we certainly would not be advocating that you have a guarantee system for specific types of loans or sectors.

Senator STEPHENS—In your submission you also recommended phasing out the interest withholding tax on most forms of offshore borrowing by financial institutions. Additionally, you recommended improving market liquidity by allowing the capacity to issue covered bonds. Would you like to extend your evidence on those?

Mr Evans—On the interest withholding tax, we understand the government has gone some way towards that. Our view on that was—we understand that it is a cost to the budget—to the extent that it could be sped up, that it was just another mechanism that may free up some liquidity. On covered bonds, I think there have been some more recent developments there. I think that was referred for further examination to a body—I cannot recall now. We thought at the time that that was another opportunity to provide greater liquidity. No stone should be left unturned if there are those opportunities.

CHAIRMAN—Thank you for appearing before the committee.

Committee adjourned at 6.23 pm