Council of Small Business of Australia

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Submission to the Senate Inquiry into Competition within the Australian Banking Sector

from

The Council of Small Business Organisations of Australia

By email to: economics.senate@aph.gov.au

The Council of Small Business Organisations of Australia (COSBOA) appreciates the opportunity to provide a submission to the Senate Economics Committee conducting the enquiry into Competition within the Australian banking sector.

We believe that there are four matters of significant concern for the Australian small business community. These are:

1. The unreasonable practice of the banks applying "Small Business" lending criteria for loans made to individuals seeking funding for small and micro business activity

2. Unacceptable delays by many of the banks in crediting the proceeds of EFTPOS transactions to merchant's accounts

3. The misleading representation and unsatisfactory operation of the Voluntary Code of Banking Practice

4. The complex and expensive nature of switching banks.

Each of these matters is addressed in a separate attachment.

The Council of Small Business Organisations of Australia was established some 29 years ago to lobby on behalf of the Australian small business community. In the matter of banking, which is a vital service to all small businesses, the disparity of power between individual small businesses and banks is overwhelming and it is well known that the possibility of redress through the court system is unaffordable and thus unattainable.

Small Business is often described as "the engine room of the Australian economy" and the largest employer in the private sector and, depending upon which of the various definitions is used, comprises between 1.9 and 2.4 million enterprises. Significantly many small businesses are located outside of urban areas and in many rural and regional towns a small business is the local big business. Nearly every small business is actually a person or two people and need to be given the same rights and consideration as other individuals in our society.

The content of this submission reflects the loudly voiced concerns of small businesses from across Australia.

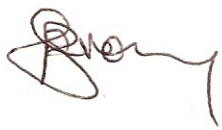
We also note the similarity of business practices adopted by the major banks. We believe that the same practices used by the major banks to "price signal", as recently highlighted by Graham Samuel the Chairman of the ACCC, have also been used to communicate other critical information resulting in small business customers being disadvantaged by a lack of genuine competition.

The practice of the major banks to form committees among themselves to administer such matters as: customer protection standards; and delaying the crediting of EFTPOS payments to merchants bank accounts; is a demonstration of activities that limit the ability of banks to offer more advantageous terms to their customers.

We request the Senate Select Committee give due consideration to the extent to which the matters raised have the potential to impact negatively on some 96% of all businesses in Australia.

Representatives of the Council of Small business Organisations of Australia are available to appear before the Committee to answer any questions that may arise from this submission.

Yours Sincerely



Peter Strong

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Attachment 1

Reduction in the number of available lenders

A substantial reduction in competition in the credit supply market developed rapidly during the period of the global financial crisis and was accelerated by the major banks acquiring many of the smaller banks and second tier lenders.

The resulting lack of competition leaves borrowers dealing with a limited number of organisations that appear to act like a cartel and operate with the behaviour of a monopoly.

The Australian banks choose to apply different and more complex documentation to loans that provide funding for small and micro business activity while demanding higher fees and charges than would be applicable to other residential mortgage backed loans.

There is little evidence of meaningful competition between the major lenders. The loan of funds for use in the operation of small businesses is unjustifiably subjected to higher rates of interest and more arduous conditions than loans made to other customers who provide the same security. This results in small businesses being disadvantaged so that banks can offer lower home interest rates to the domestic market.

Given that this practice is common across all banks it has the appearance of being collusive behaviour. The Council of Small Business Organisations of Australia asserts that in most, if not all circumstances, the small business borrower is in fact a consumer.

It is the consensus view of COSBOA members that the action of a bank in demanding that a third party provide security for a "small business loan" fundamentally changes the nature of the loan transaction and thus it becomes a consumer loan for business purposes and by extension the borrower should enjoy the same levels of consumer protection as would apply to any other consumer.

The basis of this assertion results from the actions of the lender who generally, if not always, requires such a loan to be subject to some form of external guarantee which is usually a director's guarantee or a mortgage over real property. The introduction of this requirement, without which the loan would not be made available, means that in reality the borrower is the person who would be responsible for meeting the guarantee or who authorises the use of the real property mortgage as a security for the loan.

To clarify this interpretation it is necessary to ask: "Will the loan be made available without this security?" If the answer is "yes" then the business is the borrower, if the answer is "no" then clearly the provider of the guarantee is the borrower.

The questions that result from this assertion are: What then is the role of the business? In what way is a natural person, who is the guarantor, different from any other natural person (consumer) who may enter into a borrowing arrangement?

In considering this hypothesis it is clear that the business has the role of being the manager of the loan funds who, by agreement between the lender and the guarantor, is:

1. Authorised to use the funds in a specified manner which is beneficial to the business and
2. Has demonstrated the capacity to make the required interest payments and if either specified or demanded the repayment of the loan.

The status of a natural person who provides the guarantee is in no way different from any other consumer and thus they should not be charged higher interest rates than charged to any other mortgage on residential property.

This submission accepts that there may well be justification for different documentation and different levels of fees, charges and interest where funds are lent for use in business purposes i.e. a loan to a business where residential mortgage security is not requested, but seeks to draw a clear differential between what is genuinely a loan to a business as opposed to a loan to a consumer against the security of a residential mortgage.

Noting that this form of financial abuse is common across all banks there is an indication of apparently collusive behaviour by banks in seeking to gain financial advantage by incorrectly classifying such lending as a "Small Business Loan"

As a corollary to the above we point out the desirability of determining an agreed definition of a Small Business Loan.

We note the use of the Australian Bureau of Statistics/ASIC definition based upon employee numbers which recognises 1.93m small businesses. However the numerical sub groupings used by the ABS do not take account of the differing types of business operations. Note also the ATO definition of "under $2m turnover" which provides a total of 2.4m small businesses – a difference of around 26%. This is no more accurate. What is clear is that the relationships between staff numbers and turnover vary in the extreme between different trade sectors. For example the turnover per employee in a small supermarket would be many times greater than the turnover per employee in a small consultancy business.

Neither of these two approaches provides a relevant definition and thus it is left to the banks to determine the applicable loan documentation and thus the level of interest and charges that they will apply.

It is possible that a more relevant definition could be developed that relates to the quantum of funds borrowed and a clear definition as to whom the borrower actually is as a means of determining a particular class of loan.

When this subject is considered in the context of competition in the Australian banking sector it is noted that the practices referred to above are universal among banks, perhaps by agreement, and thus could be considered to be anticompetitive. Arguably it constitutes a form of agreement between banks to limit competition in what they call the small business market and thus they achieve greater levels of income than would otherwise be justifiable. If this is so, it subverts the notions of competition.

Attachment 2

Banks unreasonably withhold customer's money

The Council of Small Business Organisations of Australia (COSBOA) takes this opportunity to raise a matter that has been of continuing concern. It is the behaviour by the major banks not to provide daily settlement of EFTPOS transactions by way of credits to merchant's accounts. It appears to be a concrete example of anticompetitive behaviour.

The banks choose only to settle EFTPOS transactions on five days each week in a seven day commercial market. This unreasonably denies merchants access to their money.

Many small businesses seek to use the weekends to manage their accounting activity and arrange to pay staff. The in ability to use funds already paid by their customers and cleared from the customer's bank creates undue hardship.

This matter has been on the discussion agenda with the Australian Bankers Association (ABA) for a number of years during which time there has been little or no action by the major banks to resolve the issue.

In March 2009 the matter was raised at a forum hosted by then Small Business Minister, Hon Dr Craig Emerson MP to address small business' concerns with banking practices during the Global Financial Crisis. Since that time no discernable action has eventuated from either the Australian Bankers Association or the major banks.

In June and July this year COSBOA again requested advice concerning this matter and was provided with a copy of a follow up letter from the ABA to Minister Emerson. This letter raises a number of excuses but twenty months later has not resulted in any action from the banks

The concerns of the small business/retail merchants lie in three areas, financial – as in possible loss of interest due to them, operational – as in the availability of funds and emotional – as in why the banks cannot simply get this right.

Availability of funds is the major issue. Put simply, merchants want **their** money and cannot see any valid reason why the banks refuse to credit it to them, given that the bank has already taken the funds from their customers account.

The letter from the Australian Bankers' Association raises a number of issues and excuses. Questions that COSBOA would like answered. These excuses include reference to:

"The Australian Payments Clearing Association rules and practices"
This association is owned by the banks and their rules, as published on the internet show that they can be changed. It is not acceptable for the banks and ABA to hide behind something that they have the ability to change.

"Reserve Bank of Australia settlement arrangements"
There is no suggestion from the banks that they are making any serious approach to RBA to

improve their service or facilitate weekend and public holiday credits to merchant accounts, or that at the time the banks would have liked the Minister to *pursue such changes to help alleviate the banks' or their customers' concerns.*

"The technology of the banks is outdated and cannot manage the process"
The banks may be delaying the replacement of old technology to maintain the current situation. Any business knows that you must keep your technology up to date and the profits of the banks would allow this to happen without too much pain. The reason the old technology has been kept is that it adds to their profits through its inefficiencies.

"RBA infrastructure changes"
Now, twenty months on there is no advice on this or any apparent urgency from the banks to achieve change. Speaking in simple language all that is being asked is for a process that enables x number of transactions that are now being processed over five days/batches to be processed over seven days/batches. This should be simplification and not something that requires a major design change. It could also extend the life of the current system and thus offer an economy.

Emotional
The letter from ABA to Minister Emerson also states in regard to possible changes to speed up credits to merchants accounts "**there are no specific plans to do so at this stage**" Thus clearly it is saying that while this matter has been a concern expressed to the banks for some years, the banks are choosing not to listen.

This matter is not brought to the attention of the Senate Committee for direct action or intervention but simply to provide an example of how the banks have formed committees of themselves to work in a collusive manner to limit competition.

Attachment 3a

Regulatory and Banking Code Protection

COSBOA believe that it is inappropriate that small business are excluded from coverage under the Uniform Consumer Credit Code and fail to understand why government excludes small business loans from this protection. No satisfactory or indeed reasoned argument has been provided by the regulators for this exclusion.

The impact of this exclusion is compounded by the problematic application of the "Voluntary Code of Banking Practice"

The accompanying paper (Attachment 3b) headed "The Australian Bankers' Problematic Code" demonstrates that this code fails to operate fairly or satisfactorily. This evidence based information notes the level of disadvantage applicable to both small businesses and to consumers in general.

Arguably the "Voluntary Code of Banking Practice" is a collusive agreement between the twelve Code Subscribing banks to limit the extent of redress available to small businesses and consumers.

The attachment compiles an extensive range of referenced activities that are clearly deceptive and apparently misleading. Such behaviour by those banks that have chosen to subscribe to the "Voluntary Code of Banking Practice" is implemented in a collusive manner.

COSBOA notes that while the Code itself promises fairness and protection when dealing with the banks the monitoring of the voluntary code is undertaken by a group of persons appointed by, and indemnified by, the banks under terms of appointment that precludes them from effectively carrying out their duties.

We note also that while the Code Monitors have a defined duty to "represent small business" there is no publically available evidence that any of the present Monitors have ever owned and operated a small business. It is thus difficult to comprehend how an individual can represent the interests of a specific group of bank customers when he/she has no experience in the particular subject area.

As noted in Appendix 3b there is a need for independent and effective monitoring of the Code of Banking Practice. This could be achieved by a combination of legislation and regulation or more simply by determining that the Code of Banking Practice be a mandated code and thus subject to monitor by government officials.

The importance of an effective code of Banking Practice cannot be overemphasised as such a code is the only process by which small businesses –and other bank customers – can engage on reasonably even terms in negotiating dispute resolution. The inordinate, indeed overwhelming power of the banks and their huge financial resources simply precludes the use of the courts for all but the wealthiest of the bank's customers.

The deviant behaviour by the banks, as evidenced in the Attachment 3b, provides a clear indication of the extent to which they will go to gain financial advantage over any small business or retail customer.

It appears that through the establishment of the Code of Banking Practice Code Compliance Monitors Committee Association all of the CEO's of the code subscribing banks have reached a collective agreement which has the effect of reducing competition in the Australian banking sector.

COSBOA places before the Senate Committee the suggestion that these matters be independently investigated as a formal enquiry by an appropriate authority, that a short moratorium period be allowed to enable the necessary changes to be made and then legislation be enacted to ensure that the rights of all bank customers are suitably protected.

Attachment 3B is in a separate document

Attachment 4

Procedural practices and costs that inhibit small business borrowers from a reasonable opportunity to switch between banks

Changing banks is too hard and unduly complicated.

Among the most difficult and time consuming activities involved in making a change to a business's banking arrangements is the process of informing customers and suppliers and changing the details of the bank account number used by third parties for established and continuing financial transactions.

Currently, if a business wishes to change banks it has to notify all its customers and all its suppliers of this change. In some cases that may be hundreds of different businesses and people that need to be contacted. It creates confusion and additional work for everybody involved and often creates delays in payments and impacts on cash flow. To miss even one could be both damaging to the business's reputation and possible even its ongoing financial viability.

In the recent past the mobile telephone service providers had a similar practice which inhibited a consumer from changing providers by demanding that there will have to be a mobile phone number change as well. This was then seen to be anticompetitive and an artificial inhibitor to switching between service providers.

Suppliers were required to find an effective alternative and one that enabled customers to retain their previous telephone number. The process developed by the service providers works effectively and provides a useful precedent.

COSBOA believes that a portable bank account number (PAN) would be a major contributor to achieving greater competition.

The portable bank account number (PAN) would simplify the process of changing banks and give small businesses a realistic opportunity to access any competitive offers that may be available to them, and do so at a minimum level of cost and disruption of the business.

This recommendation would greatly increase competitive pressures on banks and help fulfil the objectives' of the Senate Economics Committee to increase competition in the Australian banking sector. It could be introduced quickly and would have an immediate effect in promoting genuine competition.