

# Competition within the Australian Banking Sector

Submission to the Senate Economics Committee



Invigorating Business Representation

## Executive Summary

The NSW Business Chamber welcomes the opportunity to make a submission to the Federal Senate Inquiry into banking competition. The NSW Business Chamber represents the interests of around 30,000 companies across NSW and the ACT, ranging from owner-operators to corporations and from manufacturers to service providers.

The recent decisions of the major banks to increase their interest rates by significantly more than the cash rate has re-ignited the debate into whether there is adequate competition in the Australian banking sector. At the end of 2008, the policy debate was focussed on ensuring that the banking sector remained viable, and significant broad reaching government guarantees were put in place to restore confidence in the sector with little thought given to their potential impact on competition. With the worst of the crisis behind us, and the economy moving into more stable territory, it is essential that the debate now turns to restoring competition.

In recent years, the major banks have improved their market share and profitability at the expense of smaller banks and financial institutions. These banks have also shifted greater amounts of risk off their balance sheets through stricter lending requirements, such as higher levels of collateral. Net interest margins for the major banks are the highest they have been since 2004, and the last couple of years have seen profitability of the major banks increase relative to their regional counterparts.

All these indicators point to a reduction in competition.

This is not a healthy outcome for the small business sector – the deterioration in competition has reduced the accessibility of small business finance and increased the price at which finance is available. Spreads on small business loans have blown out from around 200 basis points to more than 400 basis points, and business credit has now fallen for 21 months. Tightening credit requirements, and an apparent overreaction towards risk aversion by the major banks continue to constrain the availability of credit. Given the contribution small businesses make to the national economy, this is an issue of significant concern.

Restoring competition is essential to improve conditions for small business lending, but reforms in this area will take time to flow through the sector. Short-term support is needed to improve conditions in small business lending until competition returns to the market.

That is why the NSW Business Chamber supports the introduction of a temporary guarantee of small business loans.

**Recommendation 1: Consideration should be given to the implementation of a guarantee of small business loans in Australia, taking into consideration the principles outlined below.**

The implementation of an appropriately priced government guarantee is an effective way of rejuvenating the flow of finance to productive parts of the economy and can be self-funded. The fact the such a program could be implemented in a timely fashion, and the temporary nature of the support provided are key advantages of this idea.

In order to ensure that such a scheme operated effectively, there are some principles that should be followed:

- **There needs to be a price charged for the guarantee.** Charging a price protects the Government's financial position, and ensures that it is appropriately compensated for the risk transferred to its balance sheet. Providing a price signal also means that use of the guarantee should naturally wind down over time as market conditions return to more normal levels over the medium-term.
- **Banks should remain responsible for the financial assessment of small business applicants.** Bank assessment of the loans will ensure that applications still have to meet minimum standards in order to be eligible for the guarantee. In this way, the risk of defaults, and the Government guarantee being utilised, are minimised.
- **The guarantee should not cover 100 per cent of the loan.** In order to avoid moral hazard issues, it is important that banks still have a financial incentive to carefully consider loan applications. Similar guarantees in other countries tend to cover between 75 and 85 per cent of the loan.
- **The guarantee should not be capped, and should be available to the entire small business sector.** While the scheme would only be eligible to individual loans below a certain threshold, for the scheme to be

effective and to avoid rationing of finance, it is important that the total amount the Government is willing to guarantee is uncapped.

We have also put forward several other recommendations to support the restoration of competition in the banking sector.

**Recommendation 2: The Government should continue to direct the AOFM to invest in Residential Mortgage Backed Securities until conditions in this market have normalised.**

The Government support to date is welcomed, but it may need to be extended given that conditions remain challenging. Giving greater focus to support for small business lending through this initiative is also encouraged.

**Recommendation 3: The Government should put greater pressure on banks to keep small business lending rates down, and publicise good and poor performance in this area by individual banks.**

While Governments are quick to name and shame those banks that increase interest rates outside the RBA cycle, or fail to pass on cuts in full, they have been far less vocal when it comes to the circumstances of small business loans. The Government should draw as much public attention to small business lending conditions as it does to conditions for household mortgage holders.

**Recommendation 4: The Government should continue to remain open to new market entrants, both domestic and foreign, as a means of reinvigorating competition within this sector.**

New market entrants provide an essential source of competition, which would help to place downward pressure on the margins currently being enjoyed by the major banks.

**Recommendation 5: Further mergers between significant players in the banking sector should not be allowed until competition has been restored. Subsequent mergers within the banking sector should be considered very carefully, with a particular focus on their potential impact on competition.**

The NSW Business Chamber supports the current four pillars policy, and is concerned about the potential for further mergers to reduce the number of second tier and regional banks. While acknowledging that some consolidation of the banking sector was necessary to stabilise balance sheets during the global financial crisis, further consolidation of market power within the major banks should not be allowed in the current environment.

**Recommendation 6: The Productivity Commission should complete a review looking at the degree of competition in the provision of business finance.**

An open Productivity Commission review of the costs and constraints faced by small businesses in attracting finance could give this issue greater prominence, and assist in promoting competitive pressures within this part of the banking sector.

## Small Business Access to Finance

The NSW Business Chamber is particularly interested in this Inquiry as small business access to finance is a critical issue for our members, and it is hoped that improved banking competition can help to address this issue over the medium-term.

However, access to finance is a critical issue for small businesses now, and the experience of the past few years has demonstrated that it will take a long time for effective competition to return to the market, even if the government takes proactive steps to encourage this outcome. For this reason, we believe it is necessary for temporary measures to be introduced to support small business lending until such time as other policies are able to return competition to the market.

### Why is small business access to finance important?

The roughly 2 million small businesses in Australia make a very significant contribution to the economy, representing over a third of total industry value added and more than half of all private sector employment.<sup>1</sup> Growth in the small business sector is an essential component of overall economic growth.

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

The Australian economy is currently performing strongly relative to the rest of the developed world, and there is a real opportunity for Australian businesses to capitalise on the current conditions. However, without access to finance, small businesses will be unable to take advantage of the opportunities they identify.

### A guarantee of small business loans

We believe that a guarantee of small business loans would provide effective support to small business lenders until sufficient levels of competition have returned to the market. This is a position we presented in our April submission to this Committee's Inquiry into small business access to finance, and is a policy we continue to support strongly.

Other countries have introduced guarantees on small business loans to assist with alleviating small business credit constraints:

- In the **United Kingdom**, the Enterprise Finance Guarantee, managed by the Department for Business Innovation and Skills, provides a loan guarantee scheme to facilitate business lending to SMEs.<sup>2</sup>
- Under **Canada's** small business financing program, the Canadian government guarantees 85 per cent of eligible small business loans. The guarantee is provided to the small business in exchange for a fee, and in this way, the scheme is self financing.<sup>3</sup>
- In the **United States**, the Small Business Administration (SBA) guarantees loans made to small businesses by financial institutions.<sup>4</sup>

Each of these schemes is different, and has been structured to address the specific difficulties faced by small businesses in each country. However, the programs all recognise that there is a valid role for Government to play in assisting small businesses to access the finance they need to operate and grow. Given the ongoing constraints that small businesses are facing in accessing finance, there is scope for the Government to give consideration to establishing a similar scheme in Australia.

<sup>1</sup> Australian Bureau of Statistics, *8155.0 Australian Industry*, 2007-08

<sup>2</sup> Department for Business Innovation and Skills, <http://www.berr.gov.uk>

<sup>3</sup> Industry Canada, <http://www.ic.gc.ca>

<sup>4</sup> US Small Business Administration, <http://www.sba.gov>

Such a scheme can support small business lending by allowing the banks to extend finance to businesses which they would otherwise be too high risk. It may also allow banks to provide higher levels of finance to individual borrowers than would otherwise be the case. In effect, the guarantee can bridge the gap where a small business is unable to provide sufficient collateral to support a loan.

As the small business is charged for the guarantee, businesses will only use it where they would otherwise be unable to secure finance. In this way, it should be possible to demonstrate the degree to which the guarantee increases aggregate levels of lending to small businesses.

In order to ensure that such a scheme operated effectively, there are some key principles that should be followed:

**There needs to be a price charged for the guarantee.** This approach is consistent with the approach taken by the Government in implementing the wholesale funding guarantee and the guarantee of State and Territory borrowing. Having a price signal on the guarantee is important for a number of reasons.

Charging a price for the loan protects the Government's financial position, and ensures that it is appropriately compensated for the risk transferred to its balance sheet. However, guaranteeing small business loans presents different risk characteristics to a guarantee of State borrowing or wholesale funding. Wholesale funding and State borrowing guarantees cover a relatively small number of very large loans, and while the probability of any individual default is very low, the financial consequences for the Government of any individual default are very high. In contrast, a guarantee of small business loans would cover a large number of loans which individually are relatively small. While the probability of individual loans failing is higher, the financial consequences for the Government of any individual failure are minor.

Setting an appropriate price for the Government guarantee would ensure that the cost to the Government of calls on the guarantee was offset by the fee revenue collected. Such an approach would be similar to the cost recovery model adopted in the case of the Canadian scheme.

Charging a price for the guarantee also means that use of the guarantee should naturally wind down over time as market conditions return to more normal levels over the medium-term. As banks' pricing of small business risk and willingness to lend to small businesses gradually returns to more normal levels over time, the incentive for small businesses to use the guarantee will be reduced. As economic conditions change, the market will naturally wean itself off the guarantee, removing the need to include an explicit sunset clause with the scheme.

**Banks should remain responsible for the financial assessment of small business applicants.** The Government does not have the expertise to assess small business loan applications. Banks and other financial institutions are the organisations best placed to assess the merits of loan applications. Leaving responsibility for loan assessments with the banks also allows the scheme to be implemented in a timely fashion.

Bank assessments of the loans will ensure that applications still have to meet minimum standards in order to be eligible for the guarantee. In this way, the risk of defaults, and the Government guarantee being utilised, are minimised.

**The guarantee should not cover 100 per cent of the loan.** This idea follows on from the principle that banks should be responsible for the financial assessment. In order to avoid moral hazard issues, it is important that banks still have a financial incentive to carefully consider loan applications. Not guaranteeing the loan in its entirety provides the banks with this incentive.

Similar guarantees in other countries tend to cover between 75 and 85 per cent of the loan. The proportion of the loan guaranteed needs to be high enough that banks are encouraged to loosen their lending constraints, while being low enough that the banks still have an incentive to carefully assess each application.

**The guarantee should not be capped, and should be available to the entire small business sector.** While the scheme would only be eligible to individual loans below a certain threshold, for the scheme to be effective and to avoid rationing of finance, it is important that the total amount the Government is willing to guarantee is uncapped. Consistent with the wholesale funding and State funding guarantees, the amount of fee revenue the Government would collect and the value of loans guaranteed cannot be accurately assessed until after the scheme is in place.

**Recommendation 1: Consideration should be given to the implementation of a guarantee of small business loans in Australia, taking into consideration the principles outlined above.**



## Banking Competition

The global financial crisis has had a dramatic impact on financial institutions around the world. While the worst of the crisis appears to have passed, growth remains subdued, particularly in Europe and the United States, and banks in these countries continue to experience difficulties. With foreclosures continuing to depress markets in the US, and the Ireland Government recently accepting a bailout from the EU to support its main banks, it appears likely that the banking sectors in these regions will remain under pressure for some time.

While not immune from the impacts of the global downturn, the Australian economy and banking sector have proved to be more resilient. A combination of accommodative monetary policy, flexible labour markets and fiscal stimulus helped to cushion Australia from the worst of the crisis.

The stability of the domestic economy lessened the impact of the global downturn on Australian banks, however, conditions in the sector were far from rosy over this period. Many smaller lenders were unable to source funding at competitive rates and were squeezed out of the market, and many international banks downsized or withdrew from the Australian market. Mergers between some of the larger banks were allowed to support their ongoing viability, and the Government provided guarantees of wholesale funding and deposits to shore up confidence in the sector.

As conditions stabilised over the past year, the banking sector in Australia has recovered strongly. In its most recent Financial Stability Review, the RBA noted that, "the Australian banking system remains strong having weathered only a very mild downturn compared with international experience over the past few years." The divergence in share prices between the domestic banking sector and international banks clearly illustrates the difference in performance and outlook.

**Chart 1 – Banks' Share Prices (1 January 2008 = 100)<sup>5</sup>**



While resilient overall, the Australian banking sector that has emerged from the GFC looks quite different to its pre-GFC incarnation. Consolidation within the sector has seen the four major banks take an increasing share of the overall market, at the expense of smaller players:

- The number of competitors and range of products offered within the industry has been reduced. In October 2007, the Australian mortgage market was serviced by over 150 financial institutions offering over 2,117 home loan products.<sup>6</sup> In November 2010, this had fallen to 100 financial institutions offering 1,600 products.<sup>7</sup>
- The larger banks have increased their market share, largely at the expense of non-bank lenders. In new home loan lending, banks held a steady market share of 80% over most of the decade, but coinciding with

<sup>5</sup> Reserve Bank of Australia, *Financial Stability Review*, September 2010, p. 3.

<sup>6</sup> CANSTAR CANNEX, *Mortgage Star Ratings, Report No 20*, October 2007.

<sup>7</sup> CANSTAR CANNEX, *Mortgage Star Ratings, Report No 24*, November 2010.

the subprime crisis in the second half of 2007, this jumped to 90% in the space of less than a year, and has remained stable around this level ever since.<sup>8</sup> This increased market share has come almost exclusively at the expense of wholesale lenders, who were no longer able to raise funds at competitive prices.

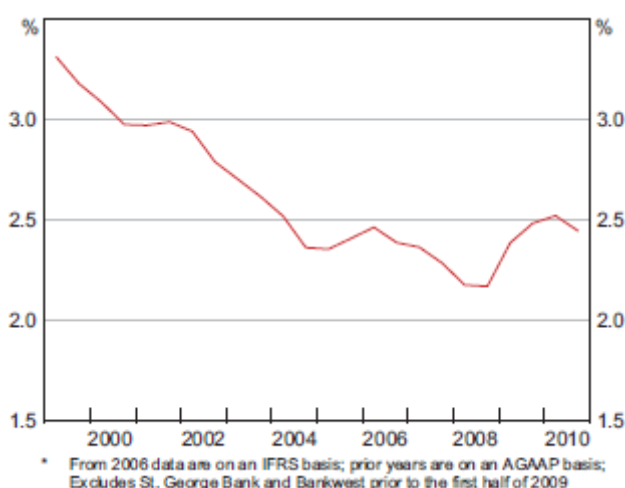
The increased market share experienced by the major banks, coupled with the difficulties smaller player were having sourcing finance, has meant that the major banks have been able to sustain their profitability at levels higher than may have otherwise been the case. Net interest margins and returns on equity at the major banks have both been sustained at healthy levels in recent years.

Prior to the global financial crisis, competition between the banks and non-bank lenders was proving effective in driving down net interest margins. Between 1999 and 2008, net interest margins fell from nearly 3.5 per cent to below 2.25 per cent.

However, net interest margins began increasing late in 2008, and continued to do so throughout 2009, at the same time that the Government was providing substantial guarantees to the banking sector. By early 2010, the net interest margins of the major banks were around 2.5 per cent, a level not seen since early 2004.

In contrast, net interest margins in the regional banks continued to fall, and were running at around 1.5 per cent at the end of 2009.<sup>9</sup> The major banks were able to consolidate their financial position over this period, with a significant widening of the gap in net interest margins between themselves and the regional banks.

**Chart 2 – Major Banks’ Net Interest Margin\* (half-yearly)<sup>10</sup>**



The major banks also continue to operate at a profit margin significantly higher than the other banks. Over the twelve months to 30 June 2010, the four major banks operated at a profit margin of 25.2 per cent, while the remaining domestic banks had a profit margin of 11.9 per cent.<sup>11</sup>

While the global financial crisis had a dramatic impact on the banking sector in other countries, in Australia the major banks were able to maintain a return on equity of above 10 per cent. While the return on equity exhibited by the major banks and regional banks has been fairly similar over most of the decade, the major banks have shown a much greater capacity to sustain their return on equity since the global financial crisis.

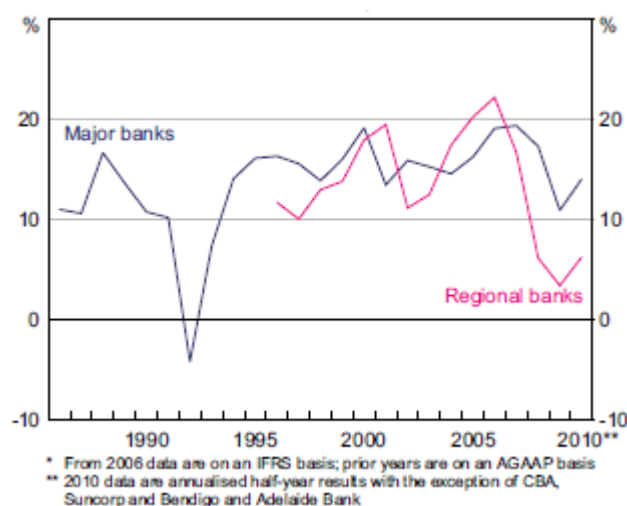
<sup>8</sup> Australian Bureau of Statistics, 5671.0 – *Lending Finance, Australia*, September 2010.

<sup>9</sup> Reserve Bank of Australia, *Bulletin – Recent Developments in Banks’ Funding Costs and Lending Rates*, March 2010, p. 43.

<sup>10</sup> Reserve Bank of Australia, *Statement on Monetary Policy*, November 2010, p. 42.

<sup>11</sup> APRA, *Quarterly Bank Performance Statistics*, June 2010, p. 5.

**Chart 3 – Return on Equity\* (post tax and minority interest)<sup>12</sup>**



All of these indicators would suggest that the major banks have been able to exercise a level of market power beyond what would be expected if the banking sector was currently “competitive,” and support the assertion being made by many that the level of competition in the banking sector has fallen significantly since the global financial crisis.

The experience of the last twelve months has demonstrated that competition has been very slow returning to the market, and that businesses and mortgage holders will continue to struggle as the major banks exercise their marker power.

## The RMBS market

Many smaller lenders and non-bank lenders rely heavily on RMBS issuance as a source of funding. Issuance increased strongly over the first half of the last decade, from less than \$20 billion in 2000 to around \$55 billion in 2006.<sup>13</sup> When the sub-prime crisis hit the US in the middle of 2007, domestic RMBS conditions tightened dramatically. The spreads on RMBS issuance increased to the point where new issuance was no longer economic for the smaller lenders and wholesale lenders. The result was that many of these lenders lost a critical source of funding and had to significantly curtail their lending activities.

We welcomed the decision of the Federal Government to direct the Australian Office of Financial Management (AOFM) to purchase RMBS as a way of supporting the market. Without this support, the appetite for RMBS would have remained at virtually zero. As at 15 September 2010, the AOFM had purchased \$11 billion of RMBS, and had supported issuance of a further \$12.1 billion.<sup>14</sup>

While the support from the Federal Government has been of assistance to RMBS issuers, the RBA notes that “conditions in RMBS markets ... are still challenging.”<sup>15</sup> Even with the support of the AOFM, RMBS issuance is much lower now than it was prior to the financial crisis, with issuance in 2008 and 2009 of around \$10 billion and \$15 billion respectively.<sup>16</sup>

On current prices it appears that excessive risk aversion remains about investment in this market. The spreads on new RMBS issuance remain at around 140 basis points over swap,<sup>17</sup> well above levels it was trading at prior to the

<sup>12</sup> Reserve Bank of Australia, *Financial Stability Review*, September 2010, p. 21.

<sup>13</sup> Reserve Bank of Australia, *Financial Stability Review*, March 2010, p. 28.

<sup>14</sup> Australian Office of Financial Management, *RMBS Investor Program – Investor Update*, September 2010, slide 15.

<sup>15</sup> Reserve Bank of Australia, *Financial Stability Review*, September 2010, p. 26.

<sup>16</sup> Reserve Bank of Australia, *Financial Stability Review*, March 2010, p. 28.

<sup>17</sup> Reserve Bank of Australia, *Financial Stability Review*, September 2010, p. 27.



crisis. This is in spite of the fact that the assets are AAA rated and that “no losses have be borne by investors in a rated tranche of an Australian prime RMBS.”<sup>18</sup>

A well functioning RMBS market is essential to provide smaller lenders with an affordable source of funding which allows them to compete with the big banks. We believe that the AOFM should continue to purchase new issuance of RMBS until the market returns to more normal levels. This may require the Government to commit more than the \$16 billion that has already been set aside for investments of this kind. However, the fact that the assets purchased by the AOFM are AAA rated means that there is very little risk to the Government’s balance sheet.

While the initial policy objective was to support residential lending, we note that the Treasurer’s Direction of 30 November 2009 included the additional policy objective to “provide support for lending to small business, through participating lenders using some of the proceeds of the AOFM’s investment for lending to small business.”<sup>19</sup>

While this was an encouraging development, it is unclear what proportion of the AOFM’s purchases has supported residential lending and what proportion has supported small business lending. A more explicit Direction which required a fixed proportion of the AOFM’s investment to support small business loans would be welcomed.

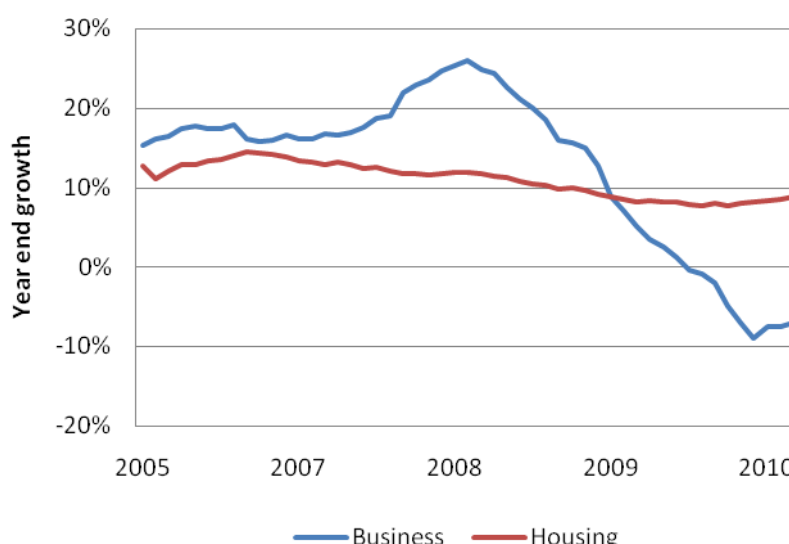
**Recommendation 2: The Government should continue to direct the AOFM to invest in Residential Mortgage Backed Securities until conditions in this market have normalised.**

## Lending conditions for businesses

Actual levels of business lending have declined sharply since the end of 2007, and this decline has continued through 2010. Following an extended period of sustained growth through most of the decade, business credit has now fallen for a period of 21 months. The reduction in business credit has been far more dramatic than the reduction in housing credit, which has remained fairly stable over the same period, and has not fallen below an annual growth rate of 8 per cent.

It is impossible to say with certainty whether the decrease in business credit has been primarily due to businesses deleveraging and seeking alternative sources of finance, or excessive risk aversion on the part of banks curtailing business access to finance. However, it is likely that access to finance, and the cost of funds has been at least partially responsible for the decline.

**Chart 4 – Credit growth<sup>20</sup>**



<sup>18</sup> Reserve Bank of Australia, *Financial Stability Review*, September 2010, p. 27.

<sup>19</sup> The Hon. Wayne Swan, *Direction on Investment in RMBS*, 30 November 2009, p. 1.

<sup>20</sup> Reserve Bank of Australia, *Statistical Table D02 – Lending and Credit Aggregates*

While banks have increased lending through mortgages, lending to businesses, and small businesses in particular, appears to remain stagnant, with limited competition amongst the banks to increase their market share in this area.

The NSW Business Chamber conducts a quarterly Business Conditions Survey, which covers a range of issues, including access to finance and its cost. Business respondents have reported that access to finance has continued to get more difficult every quarter since April 2009. In our November 2010 survey, 19 per cent of businesses reported that access to finance has become more difficult over the past three months, while only 5 per cent reported improvement in this area. Difficulty in accessing finance has been even more pronounced for small business members.

While it was not surprising that access to finance would be difficult during the global financial crisis, it is concerning that conditions remain so challenging so long after the worst of the crisis appears to have passed. As the Government withdraws its fiscal stimulus, it is important that a private sector recovery takes hold if growth is to continue. With businesses continuing to struggle to access finance, growth prospects for the Australian economy will be more limited.

## Small business interest rates

Over recent years, the cost of funds for small businesses has increased significantly. Prior to the global financial crisis, the spread between small business interest rates and the cash rate was around 200 basis points, but the spread has since doubled to more than 400 basis points, with a significant spike following the collapse of Lehman Brothers in the second half of 2008.

While credit conditions have stabilised somewhat since then, the spread on small business loans has remained at around 400 basis points since November 2008.

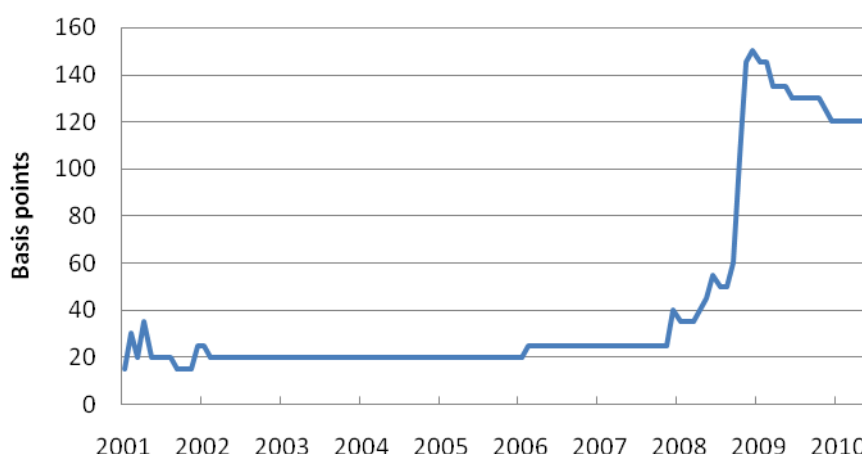
While spreads on home loan interest rates also increased in recent years, the change has been far smaller than has been the case for small business loans. Prior to the global financial crisis, the spread between residentially backed small business loans and home loans was around 20 basis points. This was in recognition of the fact that residentially backed small business loans are a slightly riskier financial product for the banks than home loans.

In giving evidence to the Senate Inquiry into Small Business Access to Finance in April, Mr Ian Narev from the Commonwealth Bank drew attention to the fact that the difference between their home loan and residential secured business loan was 50 basis points. Mr Narev stated that the higher price was set by using “a statistical model that analyses 20-plus years of history and the difference in the probability of default for a business loan versus a home loan...”<sup>21</sup> Given the similarities in the home loan and small business loan portfolios of each of the major banks, it would be expected that the risk premium charged by each of the major banks would be similar.

Despite this, the spread between home loans and business loans have increased from around 20 basis points prior to the global financial crisis, to 120 basis points in October 2010, a six-fold increase.

<sup>21</sup> Senate Economics References Committee, *Hansard – Access of small business to finance*, 12 April 2010, p. E102.

**Chart 5 – Spread between business loans and home loans<sup>22</sup>**



While politicians have been quick to criticise the banks for increasing mortgage rates beyond movements by the Reserve Bank, they have been far more reluctant to do so in relation to movements in small business interest rates. This was most recently demonstrated following the Reserve Bank's decision to lift the cash rate by 25 basis points on Melbourne Cup day, and the subsequent decisions of the four major banks to increase their mortgage rates by significantly more than this amount. Politicians were quick to criticise these mortgage rate increases:

*"I think there's a culture of arrogance among the banks" and "This behaviour, I think, is arrogant, in the extreme..." – Wayne Swan, Interview with Lyndal Curtis, 3 November.*

*"I think the Commonwealth Bank deserves the savage reaction that it's experienced" – Wayne Swan, doorstep interview, 3 November.*

*"...there is no excuse for the sorts of interest rate movements we've now seen from the Commonwealth Bank and the ANZ Bank." – Julia Gillard, Press Conference in Seoul, 10 November 2010.*

Following their decisions to increase mortgage rates by more than the increase in the cash rate, the major banks subsequently passed on similarly large increases in small business interest rates. The Commonwealth Bank increased its small business interest rate by 44 basis points, NAB increased their rate by 43 basis points, while ANZ and Westpac passed on 39 and 35 basis points respectively.<sup>23</sup> Despite this, there appears to have been no public condemnation of this action by any politicians.

**Recommendation 3: The Government should put greater pressure on banks to keep small business lending rates down, and publicise good and poor performance in this area by individual banks.**

Banks are well aware that when they increase home loan rates by more than changes in the cash rate, they attract high levels of media attention and condemnation from politicians, but when they do the same thing with small business interest rates, the politicians remain silent. This situation can encourage banks to increase interest rates on their small business loans to in effect cross-subsidise home mortgage holders.

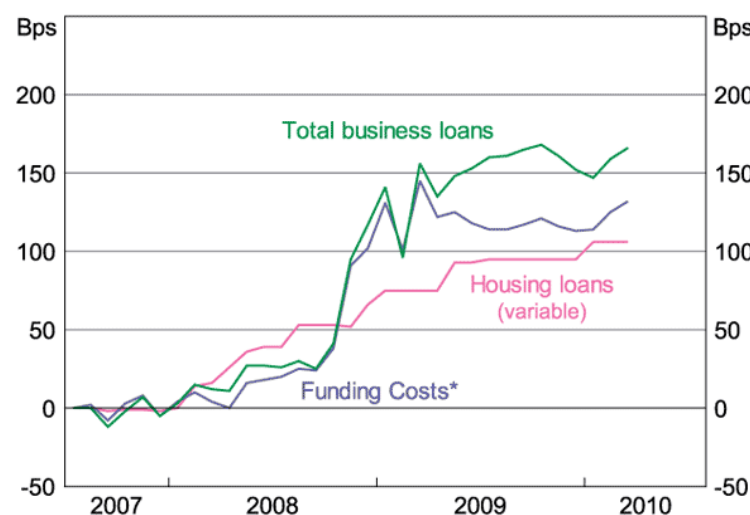
This issue was acknowledged earlier in the year in a speech<sup>24</sup> by Reserve Bank Assistant Governor Guy Debelle, where he stated that: "Looking forward, the competitive state of the current [mortgage] market is reflected in the fact that home lending rates have not risen by as much as funding costs." In relation to business loans, it was noted that "In contrast, banks' business and personal loans have increased by even more relative to the cash rate and by more than the rise in funding costs." This point is illustrated in the chart below:

<sup>22</sup> Reserve Bank of Australia, *Statistical Table F05 – Indicator Lending Rates*

<sup>23</sup> Cannstar Cannex.

<sup>24</sup> Guy Debelle, *The State of the Mortgage Market*, Address to the Mortgage Innovation Conference, Sydney, 30 March 2010.

**Chart 6 – Changes in Margins Between Various Interest Rates and the Cash Rate<sup>25</sup>**



## Improving competition

In our April submission to this Committee's Inquiry into small business access to finance, we made several other recommendations aimed at improving competition in the banking sector, and we believe that these recommendations remain relevant in the current environment.

**Recommendation 4: The Government should continue to remain open to new market entrants, both domestic and foreign, as a means of reinvigorating competition within this sector.**

New market entrants provide an essential source of competition, which would help to place downward pressure on the margins currently being enjoyed by the major banks.

**Recommendation 5: Further mergers between significant players in the banking sector should not be allowed until competition has been restored. Subsequent mergers within the banking sector should be considered very carefully, with a particular focus on their potential impact on competition.**

The NSW Business Chamber supports the current four pillars policy, and is concerned about the potential for further mergers to reduce the number of second tier and regional banks. While acknowledging that some consolidation of the banking sector was necessary to stabilise balance sheets during the global financial crisis, further consolidation of market power within the major banks should not be allowed in the current environment.

**Recommendation 6: The Productivity Commission should complete a review looking at the degree of competition in the provision of business finance.**

An open Productivity Commission review of the costs and constraints faced by small businesses in attracting finance could give this issue greater prominence, and assist in promoting competitive pressures within this part of the banking sector.

Among other things, this review could consider whether the one-size-fits-all approach often applied by the banks to small business lending is appropriate. Under current arrangements, profitable opportunities are often turned down by banks because the small business is operating in a sector which the bank considers to be 'bad business.'

Should you require any further information or clarification of our submission, then please do not hesitate to contact Mr Micah Green, Economist, on (02) 9458 7259 or via e-mail at [micah.green@nswbc.com.au](mailto:micah.green@nswbc.com.au).

<sup>25</sup> Guy Debelles, *The State of the Mortgage Market*, Address to the Mortgage Innovation Conference, Sydney, 30 March 2010.

# invigorating



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