The Pharmacy Guild of Australia

Ref: POLGOV/CCB-SEN WP:kk

31 March 2010

Inquiry into Access of Small Business to Finance
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/Madam,

Inquiry into Access of Small Business to Finance

Thank you for the opportunity to make a submission to the Senate Inquiry into access of small business to finance. Please find attached a submission from The Pharmacy Guild of Australia.

The Guild supports the Senate Economics Committee Inquiry into the issues faced by small business in accessing finance and looks forward to the report on this matter.

The Guild, through the attached submission, is pleased to assist the Committee in its investigations of the current circumstances of issues surrounding access of small business to finance as set out in the Terms of Reference for the Inquiry.

If we can be of further assistance with this issue, please contact Karen Killeen, Small Business Policy Officer, on (02) 6270 1888 or by email karen.killeen@guild.org.au.

Yours sincerely

Wendy Phillips.

Wendy Phillips
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The Pharmacy Guild of Australia

Submission

On The Senate Inquiry into

Access of Small Business to Finance

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The Pharmacy Guild of Australia supports improved access to finance on reasonable terms for small business.

It is recommended that the Senate Committee refer this matter to the Productivity Commission for further investigation.

About the Pharmacy Guild of Australia

The Pharmacy Guild of Australia (the Guild) was established in 1928, bringing together several small retail pharmacy organisations then operating in various States. The Guild is registered under the Fair Work (Registered Organisations) Act 2009 as an employers' organisation. Its members are owners of some 4,500 pharmacies throughout Australia.

Profile of Community Pharmacies

Community pharmacies are typically small business enterprises. They comprise a substantial part of the small business sector in Australia with combined annual turnover of more than $12 billion. Community Pharmacies employ some 50,000 persons. The annual turnover of the average pharmacy is approximately $2.4 million. Of the approximately 5,000 pharmacies in Australia, over 98% are estimated to fall within the $10 million turnover threshold used to define a small-medium enterprise (SME).

Pharmacy as a Small Business

The predominant model of operation of community pharmacy is that of a small business. Whilst the public often identify with banner groups of community pharmacy such as Terry White, Capital Chemist, Amcal, Chemmart and the like, these groups generally comprise separate independent small businesses which band together under a common brand name for marketing, management or promotional purposes. There are only a few genuinely large businesses in community pharmacy.

The Senate Inquiry

The Guild welcomes the Senate Inquiry into the access of small business to finance announced 3rd February 2010. We appreciate the opportunity to respond with information from members on their experiences in dealing with financial institutions since the economic downturn and to highlight real life examples related to the Terms of Reference listed below:

a) the costs, terms and conditions of finance and changes to lending policies and practices affecting small business;

b) the importance of reasonable access to funding to support small business expansion and the sector's contribution to employment growth and economic recovery;

c) the state of competition in small business lending and the impact of the Government's banking guarantees;

d) opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion;

e) policies, practices and strategies to enhance access to small business finance that exist in other countries; and

f) any other related matters.

In preparation for this submission the Guild contacted members seeking current examples of their experiences. The 12 Case Studies collected, outlining their experience and issues, in their own words, have been included as an Annexure to this submission.

Costs and Changed Conditions

Whilst there has been much focus on Home Loan interest rate movements since the commencement of the Global Financial Crisis (GFC), there has been little if any public discussion on the rates applied to Business Lending by financial institutions.

Guild members have reported, that margins applied to business lending were around 1.5% or less, prior to the GFC, they now range from 2% - 3.5% and these margins are being blamed by the banks on the cost of securing funds in the current environment. There is often also a 'sector' margin or liquidity margin which is specific to each bank.

In addition to the increase in Margins, members are also reporting significant increases, in one case in excess of 100%, to their business facility fees. Financial institutions are blaming these increases on regulatory changes to the amount of capital they are required to hold for lines of credit.

These increases in lending costs inhibit the ability of businesses to expand and the majority of small businesses are unable to pass these costs on, being forced instead to absorb them.

New applications are facing high establishment costs, with one example reported of an Application Fee of $6,500 plus the Bank's legal fees of approximately $2,000 per pharmacy being purchased.

Rising costs for lending facilities are not the only issues faced by pharmacies with existing facilities in place. Many members have reported changes to the expectations of financial institutions with respect to the performance of their businesses.

Cases reported include situations where a change of Business Manager has been accompanied with a complete change in attitude towards the business and advice that the pharmacy trading is inadequate and in technical breach of conditions of their contract.

Pharmacy proprietors have confirmed a change in the consideration of lending covenants which for years have been met without discussion and then for the last two reporting periods have required additional questioning and clarifications when there have been no changes in behaviour or performance in the business.

Since the GFC there have been multiple reports of requests for pharmacy owners to provide additional security or to payout existing loans, following an annual review of their facilities.

Competition

Whilst in years preceding the financial downturn, a business could seek finance from alternate institutions if they experienced difficulties or dissatisfaction with their current provider, the options available to the pharmacy industry has been limited throughout the financial crisis. A significant lack of competition in the market has made obtaining finance almost impossible, with reports of only one Bank offering finance to the industry at the height of the crisis.

To put this into context, in 2007 (before the GFC), we were dealing with 13 banks and financial institutions with a pharmacy lending policy. They were all relatively active. We now have one primary lender throughout Australia and one or two other lenders in each state.

This lack of competition not only prevents borrowers negotiating rates and fees, but removes alternatives in the situation where an institution makes it clear they are not interested in lending to the business for internal reasons.

The loss of non bank lenders from the market has affected the level of competition available and seen the big four banks dominate. This has further reduced funding options for small business borrowers.

Obstacles

For the applicants who find an institution prepared to consider finance for the purchase of a pharmacy or share of a pharmacy business, the issues continue. Applications are taking on average seven months for approval, not including settlement which is taking several more months.

Throughout this process, patient small business owners are continually following up with the institutions regarding their applications and in many instances have to answer to multiple requests for additional information which was not requested previously, or having to resubmit information which has been lost internally by the bank.

These delays are costing both the vendors and the purchaser’s money. They are unable to meet settlement dates and in most cases are not even provided with an explanation of the delays, with one purchaser being told simply that the bank had “other priorities”.

Finally, when approvals are obtained for finance and documents are received for execution, borrowers are finding that the security includes many cross guarantees. These guarantees are putting pharmacists who are selling equity to a new partner, in a position where their decreasing interest in the business is effectively increasing their financial risk, as they become exposed to the debts of not only their business partner, but the associated spousal partners.

This exposure to the debts of parties unrelated to the business, in addition to being asked to personally guarantee the debt of the purchasing partner, is making succession planning within businesses unattractive.

Pharmacy owners and prospective owners have reported a change in attitude by Banks to both their existing facilities and potential borrowings and this view has been supported and confirmed by business advisors who act on behalf of pharmacies throughout Australia.

An accounting and business advisory firm which acts for approximately 70 pharmacies across the country states "Clearly the events of last year created considerable uncertainty in the financial markets. As a result, it was inevitable that financiers would be increasingly cautious in their approach to funding new projects and assisting customers in vulnerable financial positions. However, we have a number of examples where the credit department of financial institutions has, in our opinion, treated our clients with contempt and totally disregarded the long term financial record of the client and not properly assessed the risk, or lack thereof, of the proposed transaction."

Other Issues

No one is advocating for irresponsible lending practices, however it appears that small business lending which can broadly be defined as carrying a higher risk than home lending, has been targeted by lending institutions in an attempt to reduce their exposure during the uncertain economic climate.

In attempting to reduce exposure, financial institutions have increased costs and tightened credit policy for business facilities, making it increasingly difficult for small business growth and investment to occur.

This lack of business growth and investment has far wider implications than for the individual small business owner. This investment is necessary for small business to play its role in driving the economic recovery and jobs growth which is essential in a recovering economy.

In a recent opinion editorial 'Banks must not forget small business' (The Australian Financial Review 3rd March 2010) the Australian Chamber of Commerce and Industry said "as the economy recovers and an increasing number of smaller and medium-sized enterprises wish to expand and invest, a real risk is that the banking sector – through repricing and the adoption of stricter borrowing criteria – will deter even low risk and prudential borrowing proposals".

Small business finance is essential to the sustainability and growth of the economy. Whilst it is acknowledged that the responsible lending standards of our banks have assisted in part to help Australia's economy weather the GFC, there needs to be a balance between responsible lending and ensuring that small businesses have access to finance on reasonable terms.

The Guild notes with interest in the article 'Banks used small business to subsidise retail clients' (The Australian 26th March 2010) the Reserve Bank's acknowledgement that "the banks have used small business in particular to subsidise their retail clients, with little evidence of low margins".
The Financial Stability report noted that interest rate spreads were starting to fall for big business loans, "though spreads on new small business loans are yet to see much change". The Reserve Bank added that "banks have also been enforcing more stringent non-price refinancing terms, including tighter loan covenants, collateral requirements and one-off refinancing fees".

The Pharmacy Guild of Australia

Summary

The Pharmacy Guild of Australia hopes that the Senate Inquiry into Access of Small Business to Finance will highlight the issues that pharmacy proprietors have raised and believes these are consistent experiences across all small businesses.

Through raising awareness of the prominence of this issue it is hoped that the Government gain an understanding and appreciation of the full scope of implications for small business and for the broader economy.

Further, it is hoped that the Government will be encouraged to work together with the banks and small businesses, to reach solutions to these issues. It is important that a balance is found between maintaining a strong financial industry and providing small business finance to encourage and enable small business establishment and growth.

The Guild proposes that the Senate Inquiry recommend a Productivity Commission investigation into issues such as the state of competition in the market and changes in the cost and availability of finance for small business.

The Pharmacy Guild of Australia
31 March 2010

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Appendix 1

PHARMACY CASE STUDIES

CASE STUDY ONE – South Australian Pharmacy

A partnership group which owns and operates two pharmacies in a rapidly growing suburb south of Adelaide. One of these pharmacies was established in 1990 while the second pharmacy was established in a new shopping centre in 2006.

Both of these businesses consistently record significant trading profits which show no signs of abating, partly due to local population growth and improvements to service delivery. In addition, we have reduced the debt attached to the business to a very low level, since foundation of the partnership in 1990.

As part of our partnership succession plan, the manager of the business was provided an opportunity to obtain some equity in the business in 2006. As part of this model, she was also promised an option to further increase this equity in 2010.

Agreement was reached between the partner group during November 2009 on the partnership restructure and it was presumed that it would be a simple process because of the low level of business gearing and reliable profit history.

In addition, the business manager had established a "track record" on her ability to effectively manage the business.

The Business Banker at CBA was provided with all necessary financial information prior to Christmas 2009 in order to process the finance application. It was always understood that the partners would allow the bank to mortgage the business, which is worth approx 5 times the loan values, to support the new borrowing. In addition the purchasing partner was expected to provide a personal guarantee and allow personal assets to be mortgaged.

It took until the end of February 2010 for the bank to produce a loan proposal outlining terms and conditions and the related bank documentation. As the vendor, I expected to sign documents confirming the use of the business as security, however, the bank documents effectively required me to personally guarantee the debt of the purchasing partner.

Moreover, if the purchasing partner ever borrowed funds jointly with another party for an unrelated asset acquisition, I could become responsible for the debt of that third party.

When we confronted CBA with the legal opinion on the effect of the documents, they responded, "that is not the way we would enforce the documents", however, they would not contemplate amending the documents to reflect how they say the bank would enforce the documents in the case of default by the purchasing partner.

We are continuing to attempt to reach some reasonable compromise.

CASE STUDY TWO – South Australian Pharmacy

I operate a pharmacy business north of Adelaide with an established and strong trading performance.

As part of my succession planning, I provided an opportunity for one of the senior pharmacists on staff, to acquire a 10% interest in the business.

The business which is valued at over $7million has a very low level of gearing. As a result, it was expected that the CBA, who has been the business banker for thirty years, would see the transaction as low risk.

Agreement was reached between the partners in September 2009 and a detailed finance application was submitted to the bank shortly thereafter.

The incoming partner also has significant equity in two properties, which would support 50% of the new borrowing.

The acquisition date was scheduled for 15th February 2010, to coincide with the commencement of a new lease. It was thought this would minimise duplication of administration issues and provide the bank with plenty of time to process the finance application.

I was in regular contact with the bank to ensure the finance would be available for the scheduled settlement date. The bank's representatives provided numerous assurances that they would be ready for settlement despite the fact that no finance proposal had yet been received.

During the weeks leading up the proposed settlement date, I initiated contact with the bank virtually every day as I became increasingly concerned about their position to settle.

By 15th February 2010 when no documents had been received, I was again in contact with the CBA to seek an explanation for the bank's lack of performance and in a heated exchange was simply told that they had "other priorities".

Documents have since been received, however they contain many cross guarantees between partners which potentially expose each partner to the debts of the spousal partners unrelated to the business.

At this time, the issue is unresolved.

CASE STUDY THREE – South Australian Pharmacy

In the last 12 months I have had great difficulty in getting increases to my existing facilities – line of credit, overdraft facility and credit card. The response from the bank is due to the economic environment.

This has been going on for the past 12-15 months.

My business is a growing business. I took over in 2006 and at the time was turning over $500,000 annually and in 2009/2010 the turnover is estimated at $2.2million.

In order to continue the growth of my business I have required funding, but over the last 12 months, this has become exceedingly difficult. I have received no cooperation from the banks that I have dealt with for the past 13 years.

Expenses have increased due to the growth, but the banks cannot see this growth and have withheld from increasing my overdraft limit, line of credit and credit card to assist with paying accounts.

This has stretched my cash flow.

CASE STUDY FOUR – Tasmanian Pharmacy

Earlier last year I approached Westpac for finance to payout my Sigma loan through Allco finance. I also wanted to finance the building of a new pharmacy about 100m up the road from my current site.

I began my discussions with Westpac, who I bank with, in August 2009. Initial talks were all positive and I assumed I could complete the refinance by October 2009, however, the process was continually strung out and delayed.

Each time I had supplied all that was requested the bank seemed to move the goal posts. To begin with they were happy using my 07/08 figures but because the process dragged on so long, they then required my 08/09 figures. They made this request at the beginning of January 2010 and my accountant had just commenced 3 months leave.

I supplied my Profit and Loss for the period, plus predictions for 09/10. I had more than enough security to borrow the amount I needed, but the bank kept delaying a final decision and I had to get more up to date valuations and even a new life insurance policy.

I became so frustrated at one point I was going to take all my business to the Commonwealth Bank, but I would have to start the entire process from scratch.

I have missed out on a $2,000 incentive Sigma were offering if any Allco loan was refinanced before the end of February 2010. I have been paying 8.03% on the Allco loan for several years and have never missed a payment, so reducing the loan to less than 6% was going to significantly reduce my repayments.

I am finally signing up for the refinance this week, nearly seven months after commencing the process. If I had been told exactly what was required from the beginning I am sure I could have saved months. I have found the whole process very frustrating and a huge waste of time and money.

The bank has finally agreed to help, but it has been like pulling a tooth!

CASE STUDY FIVE – West Australian Pharmacy

The ANZ Bank has increased my Overdraft Fees by 70% without any discussion. I received notification in the mail advising the changes would commence in June 2010.

The letter sets out that the ANZ "along with other Australian banks, has found it necessary to put aside additional capital on lines of credit, even if the funds are not used by customers. This has significantly increased our costs and as a result of these changes, the Credit Facility Fee on your ANZ Business Overdraft Facility will increase."

The fee which was $1,000 is increasing to $1,700 for my limit of $100,000.

When I contacted the ANZ to discuss the fee, I was told to take it or leave it.

CASE STUDY SIX – New South Wales Pharmacy

There has been a significant change in the bank's attitude to the financial covenants over my loan.

The last few years the covenants have been met with very little discussion or concern.

The last two reporting periods have required additional questions and clarification.

CASE STUDY SEVEN – Victorian Pharmacy

On 30th October 2009 I was sent a letter from my bank to advise that the current annual fee for a Business Overdraft Facility would be increased from $1,250 per annum to $2,550 per annum, an increase of over 100%!

The reason given in the letter was that "Our fees are based on the cost of providing your banking services. Recently there have been some changes to these costs as a result of new regulatory requirements on the capital that banks need to put aside for lines of credit. These changes require us to put aside additional capital on lines of credit, even if they are not drawn down by customers."

So, it would seem that the cost of 'not using credit' far exceeds the cost of actually using credit and that this cost is a government imposition on all banks in Australia. How can the government justify a doubling of bank fees?

The ability to plan well ahead for extra business credit, especially for unpredicted seasonal needs, is absolutely critical for future business confidence and the ability to maneuver in a competitive environment.

I would like to know who is using the capital which is put aside for 'unused lines of credit' because I am the one paying for it.

CASE STUDY EIGHT – Victorian Pharmacy

My current experience in attempting to secure finance for the purchase of an interest in 2 pharmacy businesses in suburban Melbourne is outlined here.

It is my opinion that most of the problems we (my prospective business partner who is the current proprietor of the subject businesses and therefore the vendor, and I) have encountered, stem from a lack of competitors in the pharmacy lending market in 2009.

When we sought funding for the purchase, only one bank, the NAB, was prepared to lend at an LVR of greater than 60% when the funds were secured against the 'cash flow' of the business – a common form of security in the industry. NAB was prepared to lend as much as 80%. The ANZ was not prepared to lend more than 60% of the value. We could find no other willing lender. I am aware that some other lenders have now returned to the market.

We began negotiating with the NAB in early October 2009; they are yet to inform us that they are in a position to enable settlement of the transaction, although I was informed on 20 January that the loan was approved. Here is a list (from memory) of some of the obstacles to my obtaining finance.

Costs/fees – the loan application fee is $6,500. The bank will also charge me their own legal costs, estimated to be $2,000 per pharmacy (ie for each of 2 pharmacies).

Margin on loan – in addition to interest, the bank will charge me an extra 2.23% margin on the loan. That is, the effective interest rate will be the interest rate + 2.23%. They blame the high margin on the cost of securing funds in the present environment.

Incompetent bank employees – since I first applied for the loan, my file has been transferred to a new manager twice, ie I am now onto the 3rd manager. Each change has occasioned a loss of documents, information and momentum for the loan transaction to be completed. For example, I signed account application forms for new trading accounts in the office of the 2nd manager; the 3rd manager can't find them. I faxed transfer of lease forms to 1 of the 1st managers (the 1st manager was actually a team of 2 managers who job-shared); the other manager, her team member, couldn't find them. Documents tracing the leases of the respective pharmacy business premises have been provided to the bank in previous years as part of previous loan applications. These documents were destroyed by the bank as part of a process to store them electronically (the 'paperless office'). The electronic copies have subsequently gone missing too. The bank now requires further copies, on our time and at our expense. They now think that settlement may be able to proceed on 15th March 2010; I'm not holding my breath.

The bank's credit department – in addition to the bank file manager, the credit department is responsible for approving the loan. The credit department required extensive correspondence and meetings with my accountant, the vendor's accountant, as well as the file manager; in all, over a period of 2 months. This despite all of the information sought by them from these meetings having been provided to the file manager by me, at their request, in the month or more prior to credit's involvement. This resulted in time wasting on at least 2 accounts: by me being asked to go to the trouble of providing information to the file manager initially, and by credit being unable to assess the information that they had sought in less than 2 months.

Opportunity cost – as well as the expense of the fees mentioned above, the delay has cost me lost profits from the business that I might have earned if the matter had been dealt with expeditiously and with competence. The vendor continues to pay interest on his borrowings in the meantime, although he does enjoy the profits of the business. I don't know how his borrowings would otherwise be employed if settlement had taken place; perhaps more profitably than the business provides.

No other bank to go to – one response you might take to bureaucratic delays and costs of this nature is to take your business elsewhere. Unfortunately, the financial conditions of 2008/9 caused most banks to eye business borrowings with a great deal of caution, and they withdrew from the market. There has been nowhere else to go until recently. We have overcome many obstacles to date; sometimes the devil you know is better than the devil you don't!

In 2008/9, competition in the pharmacy lending market dried up, ostensibly due to fears brought about by the Global Financial crisis. It transpires that Australia fared better economically during that period than most otherwise comparable nations, and that banks fears were unfounded and their reactions exaggerated. The result has been increased loan margins, very high fees, poor service and a lack of competition.

CASE STUDY NINE – Victorian Pharmacy

I have been a customer of the ANZ for some 30 years now with finance for a previous pharmacy for 20 years, two homes, four renovations and our current pharmacy for the last 5 years.

At no stage have we ever reneged on any payments to the bank. In December 2008, we were appointed a new Business Manager. On her first meeting with us, she completely contradicted our previous manager and informed us that our trading looked inadequate, our future seemed to lack growth (and in fact this applied to all pharmacies, as soon pharmacy ownership restrictions were going to be rescinded with the new Government Agreement), and that we were in technical breach of one of the conditions of our contract (pertaining to the ratio of net profit to interest repayments). She placed us into the "high risk" category and we were referred onto the ANZ's "specialist".

In March 2009, we were told by this "specialist" that we needed to provide an extra $300,000 to $400,000 as security, having down valued our family home and the pharmacy business. We replied that we had no extra funds. The only way out would have been to sell our family home - which they believed appropriate - or to use my 82 year old father's home as extra security - which they weren't too keen on.

Eventually, we were directed to the NAB by a family contact. The NAB refinanced our business immediately and with great disbelief that the ANZ had decided to dump us. Since refinancing in May 2009, the NAB Business Manager has reviewed our performance every 3 months, and keeps reporting her complete satisfaction with our performance - in fact, she keeps repeating that she is "thrilled" with our strong performance.

Our current NAB manager also reports that the gossip doing the rounds in early 2009 was that the ANZ had decided to abandon the pharmacy industry, something that the NAB certainly held the opposite view on.

Subsequently, I have made formal complaints to the Federal government's Minister for Small Business, to the Banking Ombudsman, and to the ANZ's complaints officer. Needless to say, little came of this.

This experience has left my whole family with a great loathing and hatred of the ANZ. After so many years of being a loyal and successful client, and clearly NOT being in any dire circumstances, we were being forced by the ANZ to pay for THEIR disasters that they themselves had created, such as the infamous OPES prime fiasco!

CASE STUDY TEN – Victorian Pharmacy

The main issue facing me as a young pharmacist is accessing finance in the first place.

Without the support of partners already in the business, there is no way I would have access to the amounts of money required to purchase a pharmacy.

Having partners unfortunately means you do a majority if the work and reap only a percentage of the profits/benefits.

Why can't the Government investigate the possibilities of grants for first time small business owners, similar to those for first home owners?

CASE STUDY ELEVEN – Victorian Pharmacy

The pharmacy was purchased with limited financial information some 3 years ago.

We are unsure as to how the bank's credit department or pharmacy team approved the deal.

I purchased the pharmacy for approximately $1.3 million when the estimated annual sales were less than $800,000. The bank approved the deal and a valuer confirmed the value (we remain uncertain as to how). However, the bank took title to additional property and my parent's home as additional security.

Two years later, the best case value was now about $900,000 and the bank wanted additional security or for me to move banks.

Unable to secure additional finance or security, I was forced to pay default bank fees/charges and finally moved banks with additional property security.

The cost and stress were significant.

CASE STUDY TWELVE – Victorian Pharmacy

I had two solid pharmacies that had been performing well for many years. I recently established a new business which took some time to reach capacity because the centre redevelopment was delayed (by the landlord).

One of my existing businesses went through a refit and, as a result, a hiccup in financial performance.

I was not in default or under any financial strain. My wife and I had a strong property portfolio as well as a secure pharmacy business.

The bank, without warning or discussion, sent a demand letter advising that the pharmacies were in default of interest cover covenants and requested I either provide a further $1million in security or move to another bank. The default on the financial covenant was for a couple of months only and at all times my repayment commitments were met.

We have now employed our Business Advisors to frame a response and look for other banks.