Discussion points
For presentation to the Minister for Small Business’ Banking and small business round table

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Council of Small Business of Australia
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Objectives

COSBOA seeks to productively engage with all financial institutions and their regulators to ensure that small business in Australia can fairly access operational and capital funds at an appropriate market rate, and that the fees for the service provided is also fair and reasonable.

Background

Small businesses are the largest collective private sector employer in Australia, comprising 95% of the total number of businesses in Australia and 30% of the nation's total economic activity. Of the nearly two million small businesses around the country, four million people are employed. Small business can make a critical contribution to the economic recovery in Australia. Small businesses can help to keep people employed, keep the economy stimulated, maintain training levels to avoid a future skills shortage and keep people off the queue for Centrelink benefits.

Proprietors of small businesses are innovators, entrepreneurs and risk takers. They are willing to invest in themselves and thus, in the country. The contribution of small business to the economy is at least as important as national or multi-national companies with hefty balance sheets and high numbers of employees. The impact of small businesses in the community and the economy is harder to visualise, given the geographic spread and diversity within the sector, but these factors should not disqualify the sector from receiving fair treatment from the Government, the banking sector, or any other relevant stakeholder.

Banking issues and concerns

The credit crunch and the Global Financial Crisis

1. As RBA interest rates decline, major lending institutions have in many cases increased loan rates for small business.
2. Small businesses are presently being denied access to credit.
3. Small businesses are being squeezed out of the credit market, as there are many examples where banks have given preferential treatment to consumer loans and corporate loans, ahead of small business finance.
4. Where the private residence of a business borrower is used as mortgage security for the business loan, there are examples where banks have charged an additional 1 – 3% (approx.) above the interest rate for a business loan using the same property as security.
5. Business borrowings for periods beyond three years are attracting a higher interest rate of an additional 2.5 to 3.o% because "the bank is not sure that it will still be able to borrow to support the loan in three years time."
6. Bank profitability is predicted to continue to rise in the foreseeable future, which is in part based on increased rates being charged to small businesses. (The survey released this week by Fujitsu Consulting shows that the fees presently being charged by Australian banks are about 25% above the level of fees being charged by their international counterparts).

7. Small businesses' access to credit is not being assessed on the basis of the ability of that particular business to pay the loan, but on the basis of a generalised assumption about small business' ability to repay debt in this type of economic climate. The range and diversity of small business operations translates to a reduction of overall risk from this sector as the quantum of any one loss will be far smaller than the quantum of a single loss from a large enterprise. This should negate the proffered argument of an aggregate higher risk.
8. (At least) two thirds of SME lending is secured against residential property (the same 'bricks and mortar' security required for retail mortgage lending), which puts into question the banks' argument that 'greater risk' justifies higher lending rates for SMEs.
9. An analysis of the small business residential secured overdraft against big business (corporate) variable loan rate between January 1997 and September 2008 show a major shift in the last decade between the rates charged to these two classes of business customers (http://www.rba.gov.au/Statistics/Bulletin/F05hist.xls).

Banking profitability – at the expense of small business?

1. Banks will profit from higher interest rates from small business in the short term, however this is ultimately inefficient as this strategy could threaten the short, medium and long term viability of many small businesses, and will impact on the overall economy.
2. Some banking bosses have admitted that they have emerged from the financial crisis with enhanced pricing power. This makes small businesses even more vulnerable in a contracted banking market.
3. Concern exists surrounding the introduction of 'line fees' to offset reducing rates. The two main issues with line fees are a) the move from a fixed fee to a percentage based fee, and b) that such fees are adjusted on an arbitrary basis and do not reflect the delivery by the bank of any additional service eg 0.7 % increase on a line fee of 2% is an increased charge of 35% for no additional service.

Cultural and attitudinal issues

1. There has been a steady transition in the banking system from providing 'helpful' services through lending officers (who assisted potential borrowers to properly structure applications to give them the best chance of approval), through to today's new roles in areas of risk management and compliance. Arguably, this shift from supporting borrowers towards removing elements of risk, undermines the bank's primary argument that increased risk is in fact the reason for higher interest rates and more fees to be charged today.
2. Banks are not adequately communicating with small business customers about ways to predict and pre-empt their needs for additional funds, and about what services the bank could provide in such circumstances to assist small business to remain solvent.

Reduced competition

There has been a reduction in competitive intensity in the banking sector due to the Westpac St George merger, and the withdrawal of many second tier lenders such as foreign banks who have collapsed or retracted services to their country of origin.

Other issues

1. The question remains unanswered about where small business' money goes, often for days on end, after it has been taken from a customer's bank account through the EFT system. Why does it take between 1 and 5 days for those funds to transfer to the small business that has made the sale? In the modern high technology environment, it seems grossly unfair that banks should take customers' money and not transfer it immediately to the vendor. The vendor is denied cash flow for a period of time and potentially denied interest on the funds which are 'lost in space.'
2. Many small businesses feel threatened and disempowered by their banks. Rather than identifying a problem early, raising it with their bank and working together on a solution, many small businesses conceal their difficulties from their bank, in an attempt to continue accessing various funds and services. This is ultimately to the detriment of the business, and potentially the bank. A communication campaign between banks and their small business customers should be conducted to bridge the communication and restore the confidence of the small businesses community that their bank actually wants them to be a client, and wants them to succeed.
3. Some banks have recently relinquished favourable conditions earned by sound, long term clients. An example includes the ability to access uncleared cheque funds in cases where it was appropriate. Instead, high-cost overdraft facilities have been offered which is more expensive and inconvenient for small business clients.
4. Some banks do not provide a transaction record of declined EFT attempts. This can make it difficult for vendors to accurately reconcile their registers and books in the event that human error is made in wrongly accepting a declined EFT payment.

Working together: a partnership for Australian economic recovery

COSBOA is committed to working with the banking industry, the Government and other representative bodies to ensure the best possible outcomes for small business in this debate. COSBOA believes in practical, mutually beneficial, commercial outcomes.

Commercial opportunities

Individual banks have a chance at this pivotal time to expand their market share by providing fair and accessible products and services to small businesses. Small businesses are loyal, long term customers and would be likely to transfer their personal and family banking to the bank which supports them in their small business venture.

Implementation of simple strategies such as dedicated small business helplines with properly trained and experienced small business banking advisors would be a boon for small business and good for banks.

Attitudinal change

1. Banks must address the real or perceived power imbalance between themselves and their small businesses customers to rebuild trust and re-establish good working relationships. There is a mutual benefit if this situation can be overcome.
2. Serious, high level commitment to small businesses and their importance as a banking customer must be made.
3. Small business must be shown the respect that they deserve, for the important role that they have in our economy, and as a group of banking customers.
4. The extreme diversity that exists within the small business sector must be recognised, and factored in to pricing structures and decision making processes.
5. Qualified, informed small business liaison staff/ trouble shooters could be employed to provide fair and consistent information and treatment to small businesses.
6. Call centre and branch staff should be up-skilled to better service small business' banking needs.

Role of Federal Government

COSBOA appreciates the role that the Federal Government has taken to investigate small business banking issues and help facilitate dialogue and solutions on the issue. The Government should play a continued role, and should be cognisant of small business banking needs and the role of small business in the economy, especially in relation to the economic recovery, when making public statements about interest rates and banking practices.

The Federal Government recently guaranteed bank deposits by using public funds as security to underpin large national commercial enterprises. Given that the banks are a significant beneficiary of a major Federal public/ economic policy decision, it seems reasonable that the Government has some right to request that the recipients of this significant commitment be asked to take a fair and equitable attitude towards their clients, especially those that have such a pivotal role in economic stimulation.

It would be reasonable for the Federal Government to promote competition in the newly constricted banking market by demanding low/no switching costs from the banks for small business customers. At present, switching costs are unduly prohibitive so that small businesses are permanently wedded to their bank. The cost of changing banks usually far outweighs the fees and penalties applied by their existing bank.

Case studies

CASE #1 – Unexpected call-in

A franchised retailer of a national hardware chain located about 50 km from Capital City has been in business about 20 years with a good record with his bank. Due to some excessive stock pushing by the franchisor, he has experienced a slight cash flow problem in the past few months. The proprietors have been working through this with the bank and it was thought that negotiations would result in a satisfactory outcome. However, in the past fortnight the bank has now indicated that it will call in the monies lent.

The impact of this unexpected call-in will have a significant impact on this business owner. The business will probably be bankrupted and the owner may lose his house. Six employees could be out of work which will raise many issues about their entitlements and their re-employment. The flow on effect could stretch to the closure of other local businesses such as the carrier that picks up stock from the city warehouse and delivers orders locally. Furthermore, local people will be inconvenienced as they will have to travel an additional 35kms to purchase hardware and building materials.

CASE #2 – Business credit card denied to profitable audiologist

A professional Australian audiologist has been trading successfully for four years with increases in turnover each year. The business has grown 300% over four years and four staff are employed. He wishes to expand and develop an additional suburban clinic. He provided his bank with a business plan and requested a business credit card with a limit of $25 000. All relevant information was also provided, including tax returns, accounts, access to the accountant etc. There are no borrowings associated with a personal property or the current business. The bank made various inquiries of him over a six week period. Ultimately the card application was rejected without explanation. In addition, the rejection letter stated that 'no further correspondence would be entered into' by the bank.

CASE #3 – Favourable, earned conditions deleted

To whom it may concern:

As a small business I rely on access to funds paid by clients - usually cheques. Up until recently my bank has allowed me automatic access to uncleared funds because I have conducted my account well and the Bank understood the situation. The bank has recently relinquished this facility for all its customers saying that we should encourage clients to direct deposit funds, or alternatively, arrange an overdraft facility to cover this expected gap.- more money raising for the Bank- more cost and inconvenience for the bank's valued client.

In relation to suggestion to get payers to direct deposit funds - they are wonderful if the payer has that facility or access to direct their bank (or go to their bank) to arrange transfer/deposit to my account. But this is not the answer when client wishes to pay you at the job sight as they will not be back at the office for some time (but you have to buy gear to do the job that they wish completed now), the client only pays by cheque or does not do bank transfers, internet banking, or the like.

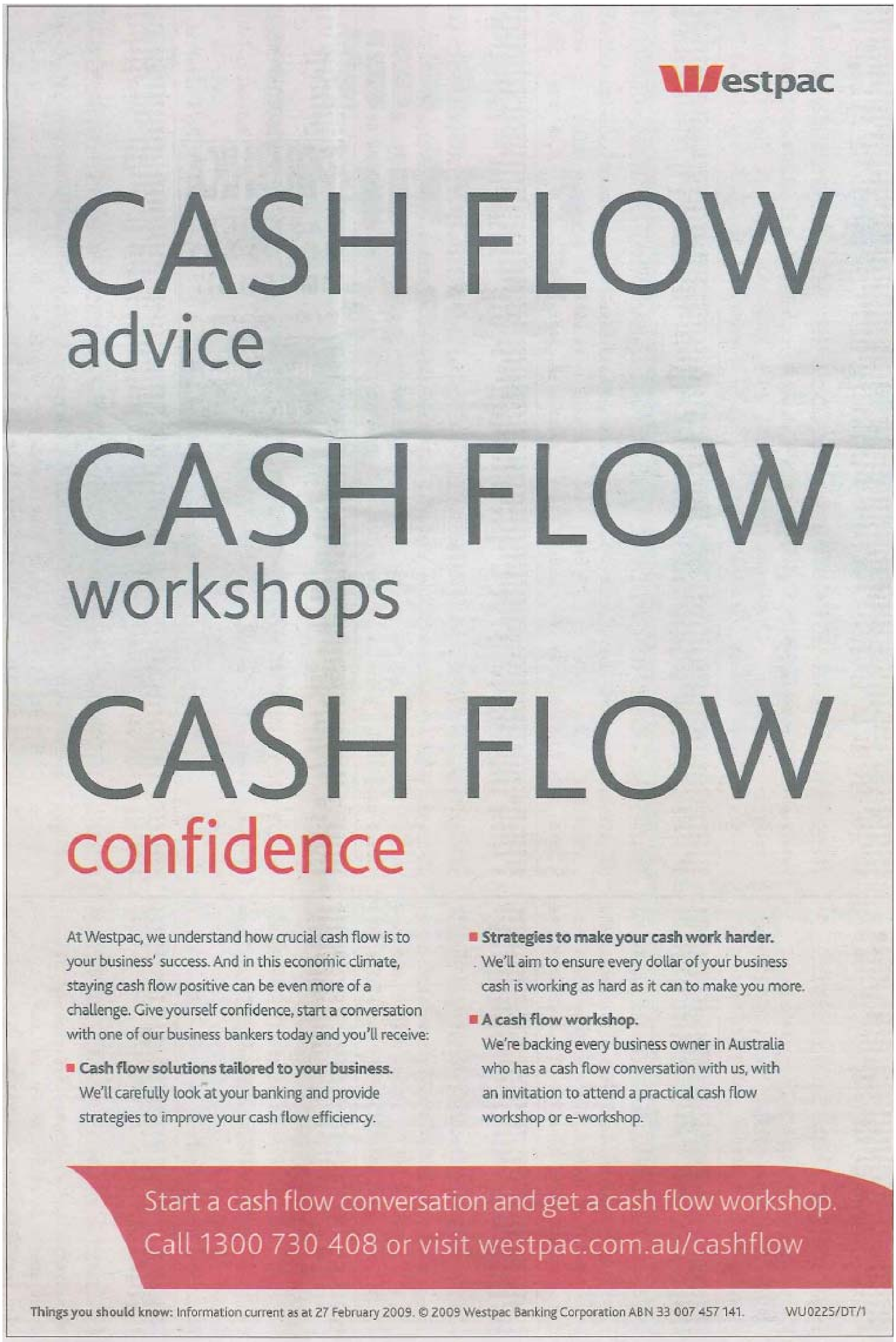
In this day and age - believe it or not, there are still people who only write cheques - it is easier bookkeeping for them to follow.

CASE #4 – Same security, different rates

A small business in rural NSW needed to undertake financial reconstruction. The current enterprise is supported by adequate assets, including a residential mortgage. The reason for the reconstruction is that a third party defaulted on payment to the small business. The business requested the bank to reconstruct the finance using the more than adequate equity in the existing residential property. The bank refused this request, but instead proposed that they would approve the extra borrowings under a separate business loan, and offered interest rates of 10.99% fixed for 5 years or 8.99% fixed for 1 year, with a $1500 set up fee and a $50 per month management fee. The individual has since sold his house to release the cash and reconstruct the business to avoid paying excessive rates.

CASE #5 – No record of 'declined' EFT transactions

A large restaurant in a capital city regularly receives payment via EFTPOS and credit cards. Occasionally his staff act in error and accept 'payment' via card when in fact the transaction is declined by the institution. The owner acknowledges that the error comes from within his business, however he would like to be able to obtain a 'declined transaction' report from his bank to reconcile his payments. His bank claims that no such record is available. He is being told that if the transaction is declined, then in fact there is no transaction to report. He has written to his bank repeatedly to seek a remedy for this situation, but his bank has not replied to his correspondence.



This newspaper advertisement is unlikely to give many small businesses cash flow confidence if they can't access credit at an affordable rate, if at all.