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31 May 2012

Senator David Bushby
Chair
Senate Economics References Committee
Suite SG.64
PO Box 6100
Parliament House
Canberra ACT 2600

By email economics.sen@aph.gov.au

Dear Senator

Inquiry into the post-GFC banking sector

CPA Australia represents the diverse interests of more than 139,000 finance, accounting and business professionals living in 114 countries around the world. We are committed to working with governments and their agencies to ensure economic and social policies foster an environment that facilitates improved productivity and economic growth. Against this background we provide this submission to the Inquiry.

The focus of our submission is on the recent experiences of small to medium-sized enterprises (SME) in accessing finance and comparing that experience to the beginning of the global financial crisis. The attached report, *SME access to finance: recent experiences of SMEs in accessing finance May 2012*, summarises recent roundtable discussions with accountants, business owners and corporate finance brokers on SME access to finance and other work on small business financing, including the *CPA Australia Asia-Pacific small business survey 2011*.

In short, this report finds that the SME lending landscape has not changed dramatically since 2009–10, however we found a greater divergence in the experience between industries, with SMEs in some industries finding access to finance relatively easy and *vice versa*. The report includes recommendations for the Committee's consideration.

We would also like to take this opportunity to express to the Committee our serious concerns over the proposal to extend the National Consumer Credit regime to small business lending as part of the COAG Seamless National Economy initiative. We strongly recommend that this proposal not be pursued.

As currently proposed, the regime would lead to small business credit advice and assistance in preparing loan applications being regulated for the first time. As we have stated to Treasury on numerous occasions, this proposed extension to the regulatory regime is not acceptable to CPA Australia as:

- no evidence has been presented that a problem exists with such advice and assistance, and if such evidence exists, the extent of that problem
- it will negatively impact the supply of credit to small business as many accountants, who are critical to assisting small business access credit, would choose not to be licensed. They will therefore be unable to assist in the preparation of loan documentation with the consequence being that prudent lenders will find it increasingly difficult to lend to small business due to the decline in the quality of loan applications
- it would increase the cost to small business of seeking credit

- no evidence has been presented that non-regulatory measures have been considered as an alternative to regulation, and whether such measures have proven insufficient to address any real or purported mischief
- in relation to predatory lending, the proposed regulatory regime is a significant over response and may even encourage more predatory lending as many accountants will not be in a position to advise their business clients against such borrowing and as the supply of credit from prudent lenders decreases for the reason stated above, predatory lenders may be the only viable source of finance for such businesses.

Should you have any queries on this submission, please do not hesitate to contact me.

Yours faithfully

Gavan Ord
Business Policy Adviser

Encl.

SME access to finance: recent experiences of SMEs in accessing finance

May 2012

CPA Australia Ltd ('CPA Australia') is one of the world's largest accounting bodies representing more than 139,000 members of the financial, accounting and business profession in 114 countries.

For information about CPA Australia, visit our website **cpaaustralia.com.au**

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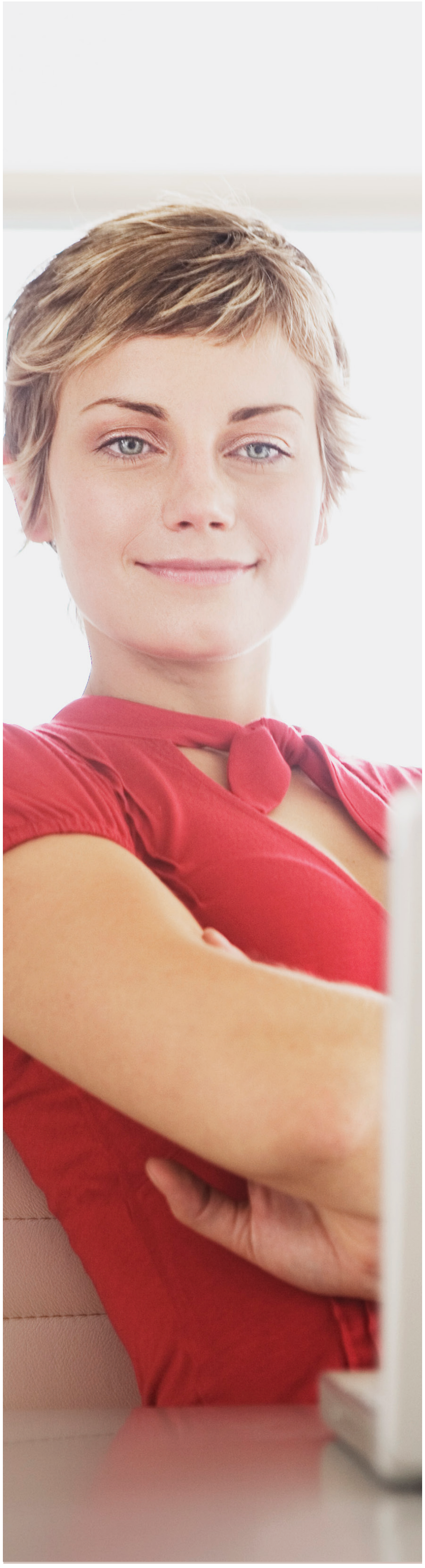


Background

About the publication

This publication is an update of CPA Australia's submission to the Senate Economics References Committee's inquiry into small business access to finance in May 2010, which can be found at cpaaustralia.com.au/smallbusinessfinance.

About the author

This publication was prepared for CPA Australia by Jan Barned CPA, Principal, Financial Management Trainer, www.fmtrainer.com.au. Ms Barned is the author of a number of CPA Australia publications, including *Achieving financial success, Financial management for not-for-profit organisations* and *Improving business performance*.

Acknowledgements

CPA Australia would like to thank all our members who attended the roundtable discussions, held in late 2011 and early 2012, that provided the background for this document.

In particular, CPA Australia would also like to thank the following individuals for their input into this publication: Mike Sewell FCPA, Director, Market Gap Investments; Trevor Beckingham FCPA, Company Secretary, Brisco Butler Automotive Services; Paul Wright, Associate, Matthews Steer Chartered Accountants; and David Clarke, Chief Executive Officer, Belgravia Finance.

Executive summary

Australia's transitioning economy is expected to be unusually challenging for many businesses over the coming year and beyond. Locally, an extremely large capital investment phase is under way in the resources and related sectors. Against that, the wider economy is faced with conditions that reflect a reversal of consumer credit growth and lower confidence generally. Globally a Eurozone recession is likely, United States growth remains subdued and the rate of growth in China's economy appears to be slowing, although still robust. Many of these challenges are reflected in the business responses to *The CPA Australia Asia-Pacific Small Business Survey 2011*, where 43 per cent of respondents indicated that they expect Australia's economy to shrink in the next 12 months[1].

CPA Australia is also of the view that there is a high likelihood that any improvement in measured growth is almost certain to be handicapped by uncertainty and volatility. Uncertainty in capital markets and credit liquidity is likely to be a major factor in the management of many businesses.

Given the reliance that small-to-medium enterprises (SME) have on banks as a source of finance and the significant contribution the sector makes to the broader economy (SMEs contribute 57 per cent towards the industry value added by business[2] and employ 70.5 per cent of private sector employees[3]), reasonable access to finance on appropriate terms and cost for SMEs is a critical economic issue for Australia.

Reasonable access to finance for SMEs is also critical to improving Australia's productivity and competitiveness. SMEs wishing to invest to improve their own productivity or produce higher value products and services will invariably require finance on reasonable terms and costs in order to make such investments.

1 CPA Australia, 2011, *The CPA Australia Asia-Pacific Small Business Survey 2011*, p. 4,cpaaustralia.com.au/documents/Small-business-survey-2011.pdf

2 Department of Innovation, Industry, Science and Research, 2011, *Key Statistics Australian Small Business*, p.3, http://www.innovation.gov.au/SmallBusiness/KeyFacts/Documents/SmallBusinessPublication.pdf

3 Ibid, page 6

This paper brings together details of our recent member roundtables, *The CPA Australia Asia-Pacific Small Business Survey 2011*[4] and external research to describe the current state of SME access to finance and compare those results back to our findings in early 2010.[5]

The key theme from our most recent work on SME access to finance is that access to finance remains a significant issue for many businesses. Many respondents to *The CPA Australia Asia-Pacific Small Business Survey 2011* indicated that they expect lending conditions to remain difficult in 2012[6]. Further, with many SMEs suffering from an extended period of difficult trading conditions and reduced working capital as a source of funds, CPA Australia members are very conscious that there comes a tipping point beyond which it becomes increasing difficult for SMEs to recover.

The SME lending landscape has not changed dramatically since CPA Australia's previous work on the topic in 2009–10. The key theme at that time was that SMEs were subject to tightened lending conditions they were not prepared for, and that the difficulty in accessing finance had impacted business operations and performance. The other important issue was the demise in the relationships between banks and SMEs.

CPA Australia attribute SMEs ongoing difficulty to accessing finance to Australia's two-speed economy and continued stress in global financial markets. Having stated this, *The CPA Australia Asia-Pacific Small Business Survey 2011* shows that in spite of such difficulty, the percentage of Australian small businesses that have external finance has increased year-on-year for the past three years, with 30 per cent of respondents to the 2011 survey confirming that they have a business loan. However, over one third of those small businesses with external finance stated that they had found access to finance difficult[7].

4 CPA Australia, 2011, *The CPA Australia Asia-Pacific Small Business Survey 2011*, cpaaustralia.com.au/documents/Small-business-survey-2011.pdf

5 CPA Australia, 2010, *Access of small business to finance*, cpaaustralia.com.au/cps/rde/xbcr/cpa-site/access-to-finance-submission.pdf

6 CPA Australia, 2011, *The CPA Australia Asia-Pacific Small Business Survey 2011*, p. 26, cpaaustralia.com.au/documents/Small-business-survey-2011.pdf

7 CPA Australia, 2011, *The CPA Australia Asia-Pacific Small Business Survey 2011*, cpaaustralia.com.au/documents/Small-business-survey-2011.pdf

It is worth emphasising that the global banking system remains unsettled, having still to recover from the shocks that flowed from the sharp contractions in global liquidity. In some markets, such as Australia, where global liquidity was a feature of the market's activity and expansion, access to credit and even maintenance of credit has been uncertain. For SMEs, this influence has been in some cases severe.

According to the results of *The CPA Australia Asia-Pacific Small Business Survey 2011*, the predominant reason why Australian small businesses considered accessing finance challenging was difficulty in finding a lender willing to provide funding to their industry. This issue was also a common theme from our roundtable discussions. While it is understandable that banks may have found it necessary to rebalance their lending portfolios for prudential and risk reasons, better communication with borrowers and potential borrowers on industry risk and credit worthiness may reduce this as an issue. This also highlights the "one size fits all" approach of lenders, where they take a decision not to lend to particular industries, denying funding even to good businesses in a particular industry.

CPA Australia members and businesses continue to inform CPA Australia that better communication from their lender, and greater certainty and balance in their relationship with their lender are critical to improving access to finance and overcoming the reluctance of some SMEs to borrow. CPA Australia therefore encourage lenders and their industry associations to support Recommendation 6 of the Senate Economics References Committee report, *Access of Small Business to Finance*, being "The committee recommends that the Australian Bankers' Association meet with small business representatives to develop a code of practice for lending to small business" and a similar but more focused Recommendation 3 of the Parliamentary Joint Committee on Corporations and Financial Services report, *Access for Small and Medium Business to Finance*.

Key findings

- CPA Australia members concur that credit conditions remain tight.
- Good credit risks are being funded. However, these approvals are often being given with tight security and on short terms.
- Banks are reluctant to lend to small-to-medium enterprises (SME) in certain industries. However, what those industries are varies between lenders.
- Financial literacy of SMEs continues to impact access to finance and compliance with existing finance facilities.
- Many SMEs entered the global finance crisis (GFC) with reserves. However, due to difficult trading conditions continuing for longer than expected and with credit conditions remaining tight, many SMEs have reduced those reserves and, in some cases, no longer have reserves available.
- Lenders state that SME demand for finance is falling. While not disagreeing with this, some members highlighted that recent experiences with lenders is dissuading some SMEs from borrowing
- The European sovereign debt crisis has led to increasing global instability in financial markets and is likely to send the Eurozone and the United Kingdom into recession in 2012.
- It is likely that the global economy will suffer from weaker international trade, withdrawal of credit by European banks and weaker business and consumer confidence.
- Recent action taken by the European Central Bank to provide around one trillion euros in cheap, long-term funding to European financial institutions has reduced the risk of a new global financial crisis.
- The Australian banking system remains well placed to cope with potential fallout from the European sovereign debt crisis. However, Australian banks with their significant reliance on overseas markets for funding are not immune to any potential global credit crunch.
- The significant reliance on wholesale funding by the Australian banking systems means that any change in global credit conditions will influence the Australian lending market for both households and businesses.
- The demand for smaller loans (under A$2 million) has been relatively stable since the GFC.
- It appears that the experience of business bankers is improving, although CPA Australia members remain concerned at the ability of bankers to assist business.
- CPA Australia members noted an increase in competition on pricing between lenders.
- Many SMEs have been caught off-guard with the withdrawal of working capital facilities, such as debtor and inventory financing, and *The CPA Australia Asia-Pacific Small Business Survey 2011* indicates a high level of reliance on credit cards as a form of financing.
- SMEs are generally less optimistic than larger firms about future activity. Of small businesses, those that are established and experienced are generally the most confident.
- The Australian Taxation Office (ATO) deferral of tax payments by SMEs has the potential to put those SMEs with existing borrowings in technical breach of loan conditions. Many SMEs are unaware of the full impact of having payment arrangements in place with the ATO.
- The Australian Prudential Regulatory Authority has increased the level of oversight of Australian financial institutions and is playing a more visible role in banking operations, which is translating into tighter credit assessments from the banks.
- There has been an increase in the number of insolvencies within the SME sector, with many actioned by directors.

CPA Australia's recommendations

Skills of business bankers

The Australian Bankers' Association (ABA), in conjunction with its members, consider implementing an accreditation course for all small-to-medium enterprises (SME) business bankers. In developing a consistent training course, the ABA should consider consulting with external stakeholders, including CPA Australia.

Business loans fact sheets

The Australian Government, in conjunction with lenders, develop standardised business loan fact sheets to assist SMEs to compare loans between providers, and enable transparency on all terms and conditions attached to each type of loan.

ATO payment arrangements

The ATO provide businesses considering entering into a payment arrangement with a warning to consult their lenders about the potential impacts of such an arrangement, and that such an arrangement may impact their ability to access finance.

Banking code of conduct

To provide greater certainty and balance in the relationship between lenders and SME borrowers, lenders and their industry associations support Recommendation 6 of the Senate Economics References Committee report, *Access of Small Business to Finance*, being that the ABA meets with small business representatives to develop a code of practice for lending to small business. In particular, such a code should include a standardised notice period for notifying business borrowers of changes to loan terms and conditions that may be materially adverse for them.

Improving financial management of small business

The government work with lenders, industry associations and accountants to develop and distribute information and education products, and provide subsidised training to improve the financial management skills of business.

Alternate forms of financing

The government work with lenders, industry associations and accountants to develop and distribute information and education products that:

- increase small business awareness of different forms of financing
- advise when forms of financing may be a suitable financing option
- explain how and where to apply for such financing

Introduction

The global financial crisis (GFC) has had profound effects on all sectors and across all economies. With limited capital and resources, small-to-medium enterprises (SME) have been particularly impacted by the GFC. As noted in a research paper prepared by the University of Ottawa, "With the advent of the GFC, SMEs face additional challenges that interact with each other to exacerbate the situation. In particular, SMEs are especially facing additional obstacles with respect to financing, working capital and demand."[8]

The aftershocks of the GFC continue to be felt worldwide, impacting economic activity across the globe. The International Monetary Fund has revised its growth expectations down for the United States, Europe and China. However, they remain confident of robust growth in other emerging Asian nations. The Australian economy is showing signs of resilience, though this resilience is not shared across the economy with many sectors under stress. In short, financial markets continue to waiver as the European sovereign debt crisis and uncertainty of global economic conditions remain at the forefront.

According to the Department of Innovation, Industry, Science and Research's recent report, *Australian Small Business – Key Statistics*[9], business lending in Australia was expanding at an annual rate of 20 per cent prior to the GFC. However, since July 2009 business lending has been contracting. The report notes that loans to smaller businesses have remained relatively stable since the GFC began. However, CPA Australia members have continued to provide feedback that access to finance remains difficult, hence this stability is most likely due to a number of other factors, including:

- the lack of alternative sources of finance for SMEs
- reduced demand for finance from SMEs
- the difficulty in accessing finance

The main objective of this document is to review current lending conditions for Australian SMEs and contrast that to the conditions experienced by this sector immediately post-GFC.

"SMEs are especially facing additional obstacles with respect to financing, working capital and demand"

8 Wan, L., Riding, A and Chamberlin,T., 2011, *The Global Financial Crisis – Impact on SMEs and public policy responses*, Telfor School of Management, University of Ottawa, http://www.swinburne.edu.au/lib/ir/onlineconferences/agse2011/000053.pdf

9 Department of Innovation, Industry, Science and Research, 2011, *Key Statistics – Australian Small Business*, http://www.innovation.gov.au/SmallBusiness/KeyFacts/Documents/SmallBusinessPublication.pdf

1. Financial markets and business credit

1.1 Global financial markets and European sovereign debt crisis

One of the lessons learned from the global financial crisis (GFC) was that no economy is immune to shocks in the global financial markets. Although some countries fared better than others, three years on, the fallout is still felt in a number of countries, particularly in Europe. As the Reserve Bank of Australia (RBA) recently noted on the European sovereign debt crisis:

> "Public finances have deteriorated substantially in a number of advanced economies since the onset of the financial crisis, particularly in Europe, leading to growing market concerns about the sustainability of sovereign debt."[10]

As a result of the GFC, the sovereign debts of Greece, Ireland and Portugal reached unsustainable levels and hence they received emergency loans and assistance from the European Union, the European Central Bank and the International Monetary Fund (IMF). Markets are also very concerned about the state of public finances in Italy and Spain. The spillover effect of this sovereign debt crisis has been felt worldwide and has particularly affected economic activity in Europe and the funding for European financial institutions.

During the last quarter of 2011, as the European sovereign debt crisis escalated, the global financial markets began to react. In a report by the Bank for International Settlements in December 2011, it was noted that those financial institutions with direct exposure to the European Union saw their costs and access to funding deteriorate. Affected banks took measures to further reduce leverage, selling assets and tightening credit terms.

In the most recent RBA report[11] the European sovereign debt crisis situation was noted as having spread further across the globe:

> "The sovereign debt problems in the euro area escalated over the second half of 2011 as market concerns about debt sustainability intensified in a wider group of countries. Reflecting the links between sovereign and bank balance sheets, bank-funding markets in the euro area came under intense strain, triggering fears of a bank liquidity crisis in the region. The turmoil spread to global financial markets, leading to tighter wholesale funding conditions for banks in many countries, including Australia."

The report, however, noted that global market sentiment has improved noticeably since late December 2011. This is due to the European Central Bank introducing a three-year lending program, which has reduced the funding risks for European banks, and an increased focus amongst most European members on enhancing euro area fiscal governance. The report also notes, "In addition, recent economic data in the United States have been more positive, somewhat allaying fears about a global growth slump."[12] These recent events have eased the pressure in global bank funding markets however the RBA note that spreads are "… fairly high".[13]

With growth expectations being revised downward in the second half of 2011 for the United States, Europe and China, analysts have revised down global growth expectations, which will have a flow-through effect to pricing risk in global financial markets. With many now predicting a recession in Europe, it is likely that the global economy will suffer from weaker trade, withdrawal of credit by European banks and an adverse effect on international business confidence. This is likely to impact availability and cost of finance worldwide. As the RBA recently reported:

> "Even though conditions in financial markets have improved, the ongoing difficulties in Europe as well as the subdued outlook for global growth will continue to pose risks to global financial stability in the period ahead."[14]

In relation to emerging Asia, the IMF expects the region to grow 6.7 per cent in 2012. According to the IMF *World Economic Outlook Report, April, 2012* this "somewhat weaker growth forecast for Asia mainly reflects the deteriorating outlook for exports to advanced economies".

10 Reserve Bank of Australia, September 2011, *Financial Stability Review* http://www.rba.gov.au/publications/fsr/2011/sep/pdf/0911.pdf

11 Reserve Bank of Australia, March 2012, *Financial Stability Review* http://www.rba.gov.au/publications/fsr/2012/mar/pdf/0312.pdf

12 Ibid

13 Ibid

14 Ibid

However, the IMF also states that Asia's economic expansion will continue to be relatively high due to robust domestic demand and inflation is expected to recede modestly.[15]

The RBA issued a mild warning on Asian credit in their March 2012 report[16]:

> "In Asia, credit and asset prices have been growing strongly in a few countries over recent years, prompting authorities to tighten prudential policies. While non-performing loans are currently at low levels across the region, a decline in asset prices or significant slowing in economic activity could expose credit quality problems."

As *The CPA Australia Asia-Pacific Small Business Survey 2011* noted, with the IMF growth forecasts for Hong Kong, Singapore, Indonesia and Malaysia all declining slightly in 2012, this warning from the RBA appears to be well warranted.

1.2 Current state of the Australian banking system

Having survived the global financial crisis (GFC) relatively unscathed (with the support of Australian Government guarantee of deposits and wholesale borrowing by the Australian banks), Australian banks by all accounts are in a relatively strong position. In response to the GFC and the ensuing global economic climate, Australian households and businesses have supported the banks by deleveraging and increasing bank deposits, which assist the banks funding requirements.

In September 2011 the Reserve Bank of Australia (RBA) noted:

> "The Australian banking system is considerably better placed to cope with periods of market strain than it was before the crisis, having substantially strengthened its liquidity, funding and capital positions in recent years. Growth in bank deposits is continuing to outpace growth in credit, and the major banks are ahead of schedule on their term wholesale funding plans."[17]

However, a watching brief on the Australian banking system remains in place as the European sovereign debt crisis continues to unravel. The RBA predicts "Should conditions deteriorate materially, the effect on the banking system would occur from a somewhat weaker starting position on asset quality than had been the case at the beginning of the crisis."[18] This statement is in reference to what banks term "non-performing assets", which are effectively bad and doubtful debts.

The RBA note that although the Australian economy has benefited from a solid macroeconomic environment, "non-performing assets" on banks' balance sheets remain close to its recent peak, although these are well below the levels seen in the

> "With many now predicting a recession in Europe, it is likely that the global economy will suffer from weaker trade, withdrawal of credit by European banks and an adverse effect on international business confidence. This is likely to impact availability and cost of finance worldwide."

15 The International Monetary Fund defines Asia to include Australia and New Zealand, East Asia, South Asia (except Pakistan) and the Association of Southeast Asian Nations.

16 Reserve Bank of Australia, March 2012, *Financial Stability Review* http://www.rba.gov.au/publications/fsr/2012/mar/pdf/0312.pdf

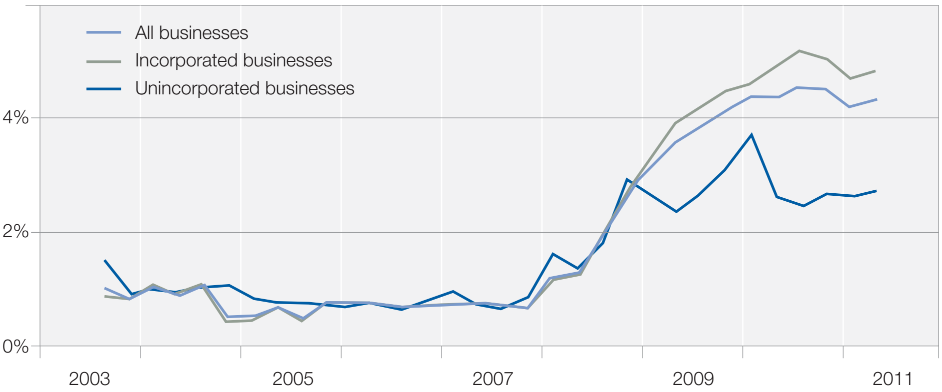
17 Reserve Bank of Australia, September 2011, *Financial Stability Review* http://www.rba.gov.au/publications/fsr/2011/sep/pdf/0911.pdf

18 Ibid

early 1990s and those currently experienced in many other developed countries.[19]

Banks' non-performing business assets*

Domestic books, per cent of outstandings by type



* Includes 'impaired' loans and items 90+ days past due that are well secured; series exclude lending to financial businesses and include bill acceptances and debt securities

Sources: APRA; RBA

> Extended periods of volatility would hurt as Australian banks replace cheap funds raised before the global financial crisis.

Ian Narev, Managing Director and Chief Executive Officer, Commonwealth Bank of Australia (CBA), flagged the potential risk to Australian banks during his presentation at the Commonwealth Bank's annual general meeting in late 2011:

> "We are not immune to vagaries elsewhere in the world. Wholesale funding markets will become more challenging", adding further "Extended periods of volatility would hurt as Australian banks replace cheap funds raised before the global financial crisis. Funding margins have risen ten-fold since then".[20]

Gail Kelly, Managing Director and Chief Executive Officer, Westpac, concurs with CBA. Ms Kelly stated:

> "As a direct result of the turmoil going on around the world, funding has become a more difficult issue, right at the moment term markets are effectively closed. And when they open up, our estimation is that the cost of raising money will actually be more than it was at any point during the global financial crisis."[21]

Robert Gottliebsen, an Australian financial commentator, clarifies this risk:

> "Australia, of course, is not immune because we are one of the biggest wholesale borrowers in the world, funding about 40 per cent of our banking system that way. That 40 per cent figure is set to shrink dramatically over the next three years because the money may not be there. The reduction will be achieved by banks being tougher in granting loans and raising deposits in Australia".[22]

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19 Ibid

20 Commonwealth Bank, November 2011, *Commonwealth Bank: Annual General Meeting*, http://www.commbank.com.au/about-us/shareholders/pdfs/agms/2011_AGM_CEO_address_and_slides.pdf

21 Westpac, December 2011, *Annual General Meeting*, http://www.westpac.com.au/about-westpac/investor-centre/annual-general-meeting/

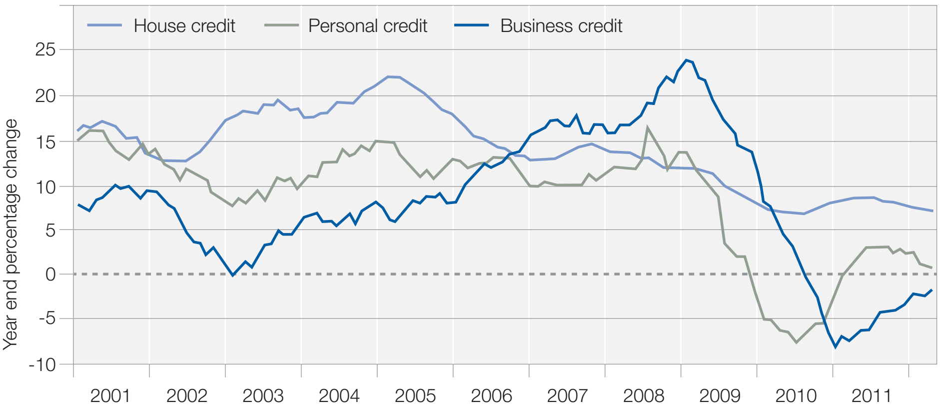
22 Robert Gottliebsen, 15 December 2011, *On the brink of a global credit crunch, Business Spectator*, http://www.businessspectator.com.au/bs.nsf/Article/markets-euro-debt-crisis-credit-defaults-banks-Bas-pd20111215-PJRE3?OpenDocument&src=mp

In summary, while the Australian banking system may currently be better placed to manage any potential global credit crunch as a result of the European sovereign debt crisis, it will not be immune to the impact. It is likely that any change in credit conditions experienced by the Australian banks will influence the Australian lending market for both households and businesses.

1.3 Business lending in Australia

In the publication, *Key Statistics – Australian Small Business*[23], it was noted that "… prior to the global financial crisis, total business credit (for all business sizes) was expanding at an annual rate of around 20 per cent. However, the annual growth rate decreased after peaking at around 23 per cent in January 2008. The slow-down in growth continued until July 2009, when lending to the business sector began to contract. While the rate of contraction has eased since November 2009, the growth rate remains negative."

Growth in selected financial aggregates[24]



*Data does not distinguish between businesses by size

Data Source: RBA Table D1

The continuing decline for all aggregate business lending can be attributed to:

- A decline in demand for credit by business – caused by the slow-down in the economy (or in anticipation of the slow-down in the economy).
- A decline in supply, which is reflected in a tightening of lending conditions by lenders (possibly leading to businesses delaying seeking finance for fear of rejection).
- A decline in demand as a result of increased cost of credit.
- Continual deleveraging by businesses in response to debt finance being more difficult to service both financially and with resources required for increased compliance.

> "Australia, of course, is not immune because we are one of the biggest wholesale borrowers in the world, funding about 40 per cent of our banking system that way."

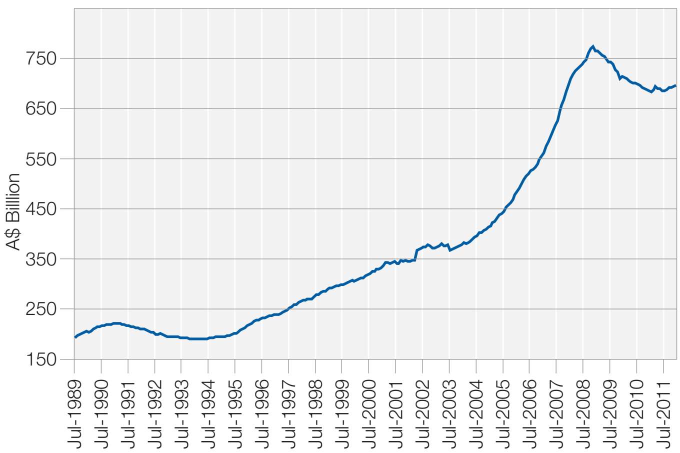
23 Department of Innovation, Industry, Science and Research, 2011, *Key Statistics – Australian Small Business*, http://www.innovation.gov.au/SmallBusiness/KeyFacts/Documents/SmallBusinessPublication.pdf

24 Ibid

The CPA Australia Asia-Pacific Small Business Survey 2011 (the survey) revealed that of the Australian small businesses surveyed, 57 per cent did not require additional funds in the past year, with 33 per cent stating they had sufficient funds under existing arrangements. In the other markets surveyed, 66 per cent of Singaporean businesses and 72 per cent of New Zealand businesses did not require additional funds. However, less than half of those surveyed in Malaysia, Hong Kong and Indonesia stated they did not need additional funding. In line with the reasons attributed for the decline in the growth of business lending, the survey found that lending conditions and the cost of finance had become a more important reason for not borrowing in 2011.

The Reserve Bank of Australia's (RBA) lending and credit aggregates also show actual volume of aggregate business lending and credit in the Australian economy in December 2011 is still below lending levels in December 2007. It also shows that it took five years for the volume of business lending in the recession of the early 1990s to recover to pre-recession levels.

Aggregate business lending and credit in the Australian economy



Source: CPA Australia and Reserve Bank of Australia Lending and creit aggregates D2

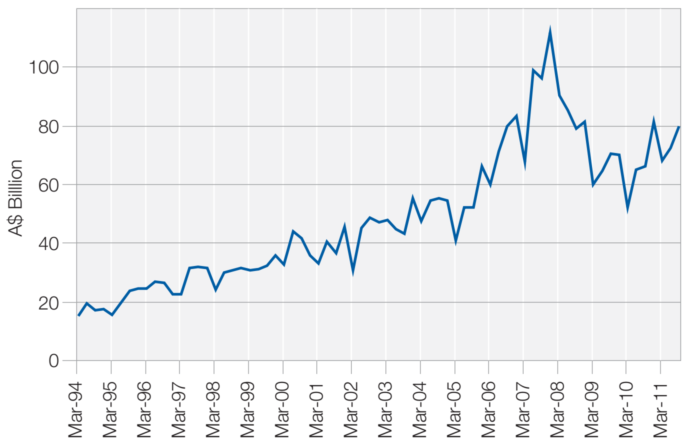
In analysing the graph, "Aggregate business lending and credit in the Australian economy", together with further information taken from the RBA's lending and credit aggregates data, the following can be noted:

- Business lending and credit peaked in the Australian economy at $772.8 billion (seasonally adjusted) in November 2008.
- The total amount of business lending and credit in the economy is $696.1 billion seasonally adjusted as at December 2011.
- The contraction in business lending over the past three years has eased slightly.

The RBA notes that "There has been some variation across institutions, with foreign-owned banks experiencing a more pronounced pick-up in their business lending, while lending by the smaller Australian owned banks has continued to contract."[25]

The graph, "New business credit approvals", shows that the value of new business credit approvals peaked in December 2007, and by March 2010 the value of new business credit approvals had more than halved. Since that time, there has been an improvement in the aggregate value of new business credit approvals, yet it is still well below the peak.

New business credit approvals



Source: CPA Australia and Reserve Bank of Australia Bank Lending to Business - Selected Statistics D8

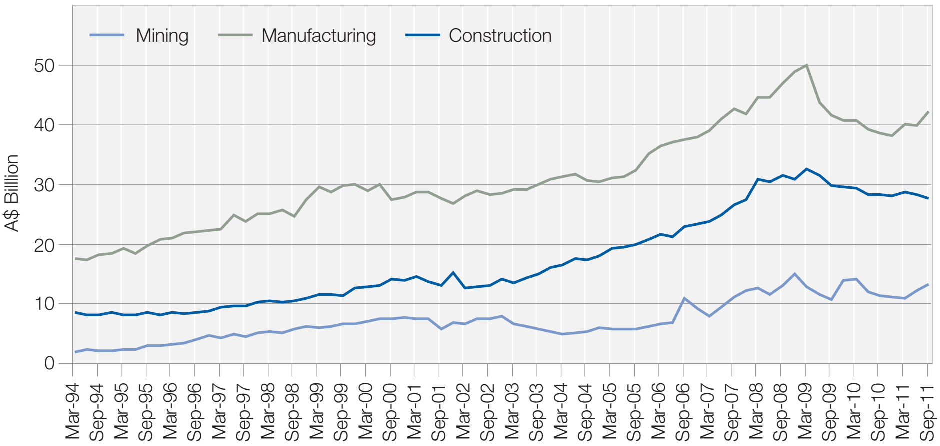
25 Reserve Bank of Australia, September 2011, *Financial Stability Review* http://www.rba.gov.au/publications/fsr/2011/sep/pdf/0911.pdf

The RBA note that this data contains divergence between business sizes:

> "The weakness has been concentrated in lending to larger firms. Loans larger than A$2 million account for almost all of the decline in bank business credit since the end of 2008, and lending to incorporated businesses has fallen by 11.5 per cent over the same period; by contrast, lending to smaller, unincorporated businesses expanded by about 7 per cent."[26]

There has been much discussion that lenders are favouring the mining sector at the expense of other sectors. However, the following graph, "Total credit outstanding by selected sectors", does not bare this out. Given the large capital needs of miners, it is therefore likely that miners are funding their projects through equity financing, non-intermediated debt financing or borrowing off-shore.

Total credit outstanding by selected sectors



Source: CPA Australia and Reserve Bank of Australia Lending to Business – Selected Statistics D8

1.4 Small business lending in Australia

Due to the Reserve Bank of Australia's (RBA) statistical data not identifying business lending by business size, it is difficult to come to definitive conclusions on small business lending in Australia (the RBA collect data on lending by the size of the loan – under and over A$2 million, not by the size of the borrower). However, the Senate Economics Reference Committee suggested that the size of a business loan is a likely proxy for the size of the borrower and that loans under A$2 million could be assumed to be directed to SMEs.

"Lending to smaller, unincorporated businesses expanded by about 7 per cent"

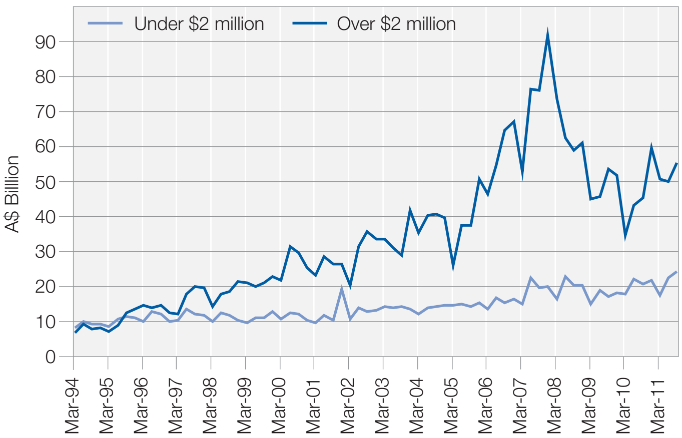
26 Ibid

The Department of Innovation, Industry, Science and Research note:

> "… the value of outstanding loans to smaller sized businesses (loans under A$2 million) has grown steadily, from around A$100 billion in the September quarter 2000 to a peak of just over A$200 billion in the December quarter 2008. Since then, the outstanding value of loans to smaller businesses has been relatively stable, fluctuating moderately around A$200 billion up to the September quarter 2010."[27]

With strong growth in loans to larger businesses, the composition of total loans outstanding has impacted on the percentage of small business loans outstanding "Where the value of loans to smaller businesses constituted around 40 per cent of the total value of outstanding loans in the September quarter 2000, it had fallen to under 28 per cent by the March quarter 2009 and rose slightly to around 30 per cent by the September quarter 2010."[28]

New business credit approvals by size of loan



Source: CPA Australia and Reserve Bank of Australia Lending to Business - Selected Statistics D8

The graph, "New business credit approvals by size of loan", shows that loans under A$2 million peaked at $A23 billion in June 2008, dipping to a low of $A15 billion in March 2009, before a slow increase with some fluctuations in the ensuing period reaching A$24.4 billion in September 2011. The graph also highlights that the smaller loan market since the global financial crisis (GFC) has been relatively stable when compared to the results of credit approvals for loans over A$2 million, which more than halved in size from the peak of $91.8 billion in December 2007 to A$34.4 billion in March 2010. While part of this steep decline can be attributed to falling demand, it is also attributed to larger businesses having access to a broader range of financing alternatives than smaller businesses. For example, larger businesses can and did raise equity financing in 2009 and used that financing to reduce debt. Smaller businesses on the other hand, do not have access to such alternatives.

27 Department of Innovation, Industry, Science and Research, 2011, *Key Statistics – Australian Small Business*, http://www.innovation.gov.au/SmallBusiness/KeyFacts/Documents/SmallBusinessPublication.pdf

28 Ibid

2. Member feedback

2.1 Background

Over the past two years CPA Australia has kept a watching brief on the issues affecting the access to finance for small-to-medium enterprises (SME), as many CPA Australia members have been playing a prominent role in assisting SMEs (whether as an external adviser or an employee).

During 2010, a series of roundtable discussions were held in Canberra, Melbourne, Brisbane and Sydney, and *The CPA Australia Asia-Pacific Small Business Survey 2010* (the survey) also sought opinions from respondents on this topic.

In late 2011, a further series of roundtable discussions were held with members in Brisbane, Sydney and Melbourne, and the survey was repeated. In addition, opinion was sought from a number of specialist corporate finance brokers. The outcomes of this work is compared with the outcomes of similar work done in early 2010 in order to establish if there have been any changes in small business financing conditions within Australia. Where appropriate, references have been made to credit conditions in other countries to add perspective to these results

> "Lenders were no longer prepared to provide finance on "soft" security"

2.2 Access of small business to finance in 2010

The key theme to emerge from member roundtables in 2010 was that the relationships between banks and SMEs had been damaged during the global financial crisis (GFC). CPA Australia members attributed this mainly to poor communication between banks and SMEs, and banks not giving advanced notice of changes to reporting requirements. The other main observations to emerge from members (many of which relate back to the key theme) are:

Banks were still lending, but such lending is predominately secured lending and the lending conditions were stricter than previously

The banks were still lending, however, mostly where the loan is fully secured by a tangible asset and personal guarantees (in some cases, also key man insurance). Where there was an existing loan, banks were requiring additional security. In summary, members stated that lenders were no longer prepared to provide finance on "soft" security such as cash flow or goodwill (unsecured finance) – which had been available pre-GFC.

Banks were requesting increased detailed information from SMEs

According to members, banks had significantly increased their reporting requirements for both existing and new borrowers in the SME sector and the detail required in such information. The frequency of this information had also increased. Where such requests were not inconsistent with existing loan agreements, members stated that this was the first time that much of the additional information requirements had been requested.

Members questioned the usefulness of much of the information generated to meet the extra reporting requirements (both to the bank and the business). Members also stated that most of this additional information was not readily available to SMEs from their existing systems; hence it had been difficult for some small businesses to meet such information requirements without the assistance of a professional (thus adding to the costs of obtaining and maintaining a loan).

> "Business bankers they had dealt with were inexperienced and therefore unlikely to have the necessary skills to appropriately assess credit applications"

Bank staff experience, turnover and authority

In 2010, members expressed strong views that the business bankers they had dealt with were inexperienced and therefore unlikely to have the necessary skills to appropriately assess credit applications. Members stated that this was adding to the burden on business in securing finance and maintaining finance facilities as they had to spend extra time providing additional explanations and information on their industry and business, which an experienced banker may not normally require. Members also commented that the turnover in business bankers was adding to this burden as it potentially creates a need to re-explain their business to a new person. Regional members expressed concern that bankers in regional areas do not have the authority to assess and authorise loan applications.

Lack of competition

Some members believe that the lack of competition from second-tier banks, overseas banks and alternative finance providers had given the “four majors” (ANZ, Commonwealth Bank, NAB and Westpac) the “whip hand” in their relationship with potential and existing small business borrowers and this had negatively affected the supply of credit.

Economic impact of the tightening of credit conditions

Members raised the impact of the tightening of credit conditions on business and the economy. They were particularly concerned that the higher security requirements would negatively impact the ability of existing businesses and people considering going into business to raise finance (particularly those with a limited asset base). These twin concerns not only affect the ability of existing businesses to grow but also have the potential of reducing the demand for existing businesses (as those considering going into business may have difficulty raising finance),thus decreasing the value of such businesses.

The general conclusion that was drawn from the 2010 CPA Australia roundtables was that the pendulum has swung from the pre-GFC environment where many lenders were too lax with their credit conditions, to banks being very strict in their credit conditions.

Confidence of the SME sector

The CPA Australia Asia-Pacific Small Business Survey 2009 and the CPA Australia sponsored Economist Intelligence Unit global survey *Access to Finance for the Small and Medium Sized Enterprise Sector*[29] (conducted in September 2009) both showed that the mood of SMEs was generally "qualified optimism". While the surveys showed SMEs were optimistic about future growth, such optimism is not fully reflected in forecast employment growth and projected investments.

2.3 SME's access to finance issues in 2011

During the roundtable discussions in late 2011, most participants stated that credit conditions remained tight and not a lot had changed during the past 18 months. The main difference that was with the change in economic conditions, there has been an increase in issues such as serviceability of loans and reduced cash flow by SMEs.

Many of these businesses entered the global financial crisis (GFC) with some cash reserves and strong financials. However, with trading conditions soft in most sectors not exposed to mining, business conditions remain difficult – margins are squeezed, inventory levels are being reduced and costs cut (including expenditure on accounting and bookkeeping services), with many using or seeing part payment of invoices as a cash flow management strategy.

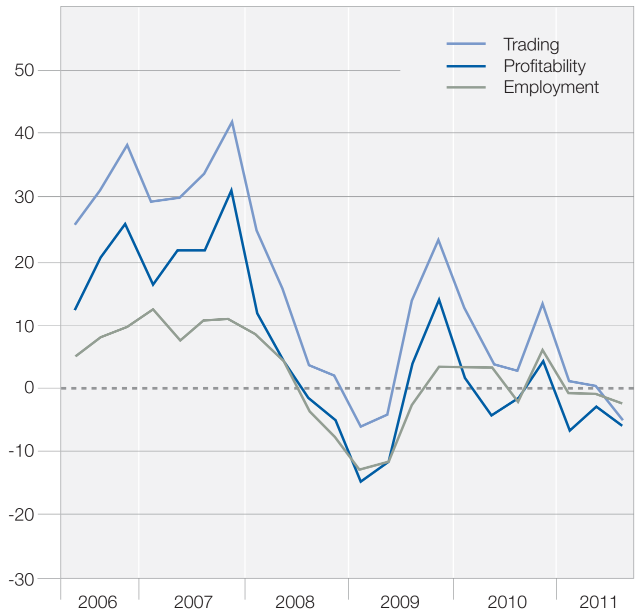
The following graphs taken from the National Australia Bank (NAB) *Quarterly SME Survey – September 2011* show working capital and profitability remain weak for most SMEs.

> "Members all agreed that credit conditions remained tight and that not a lot had changed during the past 18 months"

29 CPA Australia, Certified General Accountant of Canada and the Association of Chartered Certified Accountants, 2009, *Access to Finance for the Small and Medium Sized Enterprise Sector*, cpaaustralia.com.au/cps/rde/xbcr/cpa-site/ACCA-CGA-CPAA_JointReport_201009.pdf

Profitability falters[30]

SME business conditions components (net bal.)

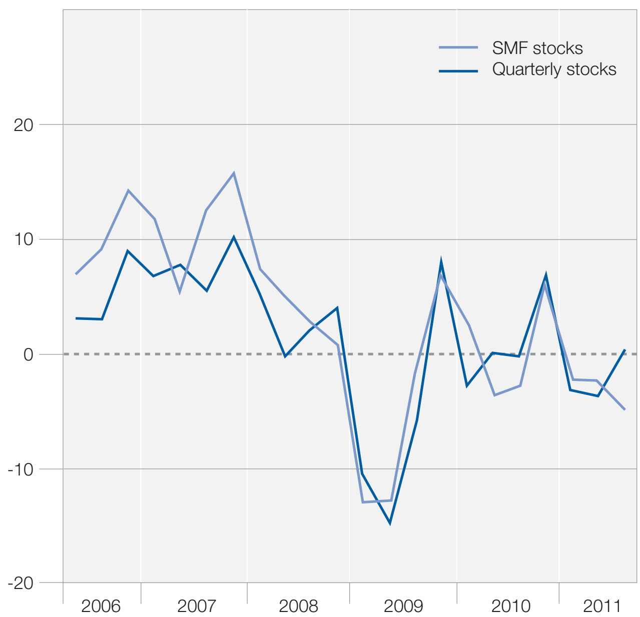


Cash flow unchanged but still weak[30]

SME business conditions components and cash flow (net bal.)

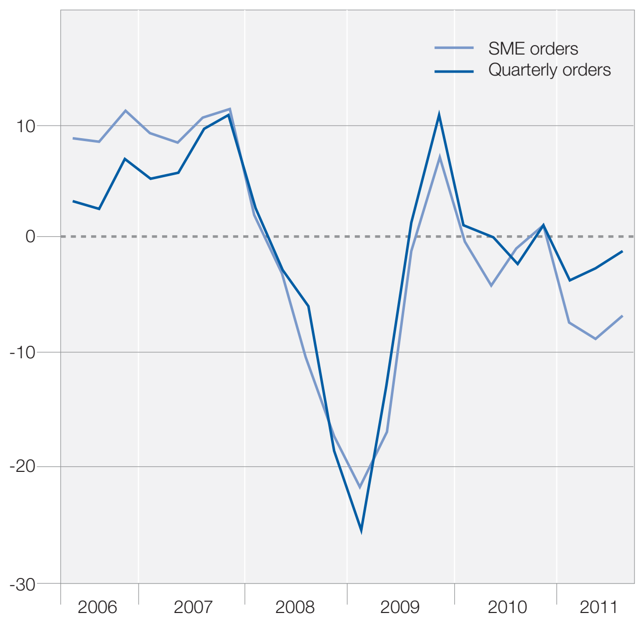
Stock levels contract[30]

SME business conditions components (net bal.)



Orders improve but still weak[30]

Forward orders (net balance), SME and quarterly



30 NAB, September 2011, *Quarterly SME Survey* http://www.nab.com.au/wps/wcm/connect/594c330048ebc62682979b0f27cc1e3e/NABQuarterlySMESurveySeptember2011.pdf

The other major issues that were discussed at the 2011 round tables were:

Business bankers' experience

CPA Australia members generally agreed that banker expertise is slightly improving. It was noted that the "major four" Australian banks had made a large effort since the onset of the GFC to increase the number of business bankers available to small-to-medium enterprises (SME). However, in 2010 members held the strong opinion that their experience in business was severely lacking, and in some cases counter-productive to the relationship between the bank and the SME. By late 2011, it appears the general consensus was the bankers were showing improved levels of expertise. This could be primarily due to the fact that with the passing of time, they are becoming more astute in their roles.

However, it was noted by many that relationship managers do not have the skills to assist SMEs in business improvement or to tell them bad news about poor results. Another observation was the lack of authority that business bankers have to make lending decisions or even influence a decision.

An overriding theme agreed by members was that SMEs needed to understand the decision structure in banks and take a holistic relationship with a number of people in the bank. This may improve the relationship between the banker and business, as the business will understand the bank's needs and who they should go to for various issues as they arise.

In *The CPA Australia Asia-Pacific Small Business Survey 2011*, of the 32 per cent of respondents that found accessing finance either difficult or very difficult, only 8 per cent suggested that the skill level of their banker made accessing finance difficult.

David Clarke, Chief Executive Officer, Belgravia Finance, suggests, "Business bankers' experience is improving, however, many still don't have the discretion to provide approval and this does slow the approval process quite considerably."

Therefore, where an SME requires finance, it is advised that they ensure that they have adequate time for the loan approval process to take place.

Banking relationships

Participants at roundtable discussions were particularly interested in understanding the structure of decision making and reporting within banks. A number of members discussed that having more than one contact within the bank would enhance the banking relationship. By understanding the role of each of the persons with whom the business has contact within their bank, a SME is better positioned to seek out appropriate persons when applying for finance or if they have an issue with an existing relationship.

Paul Wright, Associate, Matthews Steer Chartered Accountants, confirms this by stating "To build on the existing banking relationship, build knowledge and rapport with the area manager and credit manager as well as the relationship manager." Mr Clarke provides advice on how to do this, "Be proactive and encourage the banker to come out to the business on a regular basis, say every three months.

"

To build on the existing banking relationship, build knowledge and rapport with the area manager and credit manager as well as the relationship manager

"

They then will become more comfortable and introduce the client to other support staff within the bank."

Further discussion on banking relationships also raised the question of spreading the banking business to minimise the risk associated with only having one bank providing all the banking business for the SME.

A number of members confirmed that they had implemented this and had been successful. However, it would be fair to say that those who had been successful had good trading results to support such action. Some members also suggested that the non-bank finance sector could provide specialised finance for borrowing certain types of assets such as equipment and motor vehicle finance and this would also reduce the exposure to one bank.

However, it should be noted that results of *The CPA Australia Asia-Pacific Small Business Survey 2011* showed only 28 per cent of Australian small businesses have used leasing, 19 per cent had used hire purchase, and less than 10 per cent had used other types of specialised finance, such as vendor, debtor and inventory finance. Therefore, it appears that SMEs either have a reluctance to use specialised finance or more likely they are either unaware that is available or do not understand how it can assist in financing their business.

One of the key benefits in spreading the banking and finance business is that this creates a credit history for the SME and as such may provide alternatives when additional financing is required.

Participants also noted that the negative experiences that many SMEs had with their lender at the beginning of the GFC had made them reluctant to borrow. Therefore, much still needs to be done by lenders to repair the damage done to their relationship with SME sector. While participants noted the increase in small business banking staff, greater certainty and a more balanced relationship between lender and borrower are essential to restoring relationships that are (and perceived to be) mutually beneficial.

Banks are still lending, but requirements remain strict

Predominately, members at the roundtables were of the view that good businesses are being funded, though these approvals are being given with tight security and shorter terms.

Some noted that although tight lending conditions remain, there appears to be slightly more competition on pricing. This is perhaps due to the re-emergence in part of more lenders in the market, with some foreign banks, the smaller Australian banks and other financial institutions participating albeit below pre-GFC levels.

Refinancing remains difficult, as the banks are cautious, particularly where businesses "shop around". Members did note that it was important for growing businesses to spread the risk between banks, as this will provide leverage. However, from a relationship perspective, most banks prefer to have all banking business under the one roof. Of course, where businesses have secured facilities in place, it may be difficult to spread their banking as the banks remain reluctant to release security.

> "Good credit is being funded with increased competition on pricing. However, these approvals are being given with tight security and shorter terms"

Secured finance remains the preference

With declines in profitability and cash flow, many businesses are looking to fund working capital. However, the banks have generally continued their stance in favour of asset-backed secured lending. Some members suggested that banks were not providing finance for cash flow, inventory or debtor finance. Two of the "four major" banks no longer provide debtor financing.

Many SMEs have been caught off guard by the withdrawal of these types of funding, particularly those looking for invoice finance.

As *The CPA Australia Asia-Pacific Small Business Survey 2011* results highlight, many Australian small businesses do not use trade finance, which could substitute finance requirements for inventory. The high response to the use of credit cards as a form of finance from Australian businesses (66 per cent of those surveyed) may indicate that these businesses are substituting working capital finance through the use of credit cards.

Financial literacy of small business

Many participants in our roundtable discussion agreed that financial literacy in small business remains a major problem that is impacting the ability of many small businesses to access finance. With tighter reporting requirements remaining, SMEs are still struggling with the issue that sound reporting practices are not just what the bank wants, it is good for their business.

Members commented that many SMEs don't realise that poor financial management practices and disclosures are affecting their ability to access finance. Members held the firm view that such businesses need to get their house in order, not just to access finance but more importantly, to improve their business. One member who works with SMEs applying for finance noted:

> "Issues within the SMEs remain particularly in regards to control procedures and unrealistic expectations on cash flow – more than 30 per cent of those wanting cash flow lending do not have a cash flow forecast".[31]

It was disappointing to note that in *The CPA Australia Asia-Pacific Small Business Survey 2011* only 39 per cent of the businesses surveyed used accountants as a source of advice if considering seeking finance.

In response to this challenge, CPA Australia's 2010 submission to the Senate Economic References Committee recommended the Australian Government, in consultation with banks, industry associations and accountants, should provide further support to small business through subsidised training and information and education products that help SMEs to develop their financial management skills.

31 CPA Australia, 2011, *The CPA Australia Asia-Pacific Small Business Survey 2011*, http://www.cpaaustralia.com.au/documents/Small-business-survey-2011.pdf

At the Sydney roundtable, a representative of a major four bank noted that they are looking at working with customers on ways they can start their business with less capital expenditure to ensure an outcome that customers have decreased loan requirements and there would be a focus on improved productivity within the business.

As noted in 2010, all businesses need to understand that the lending conditions in Australia, are most likely "the new normal" and it is highly unlikely (and nor is it desirable) that lending conditions will return to the excesses seen before the GFC.

> Businesses that indicated they were confident were mostly established and experienced businesses

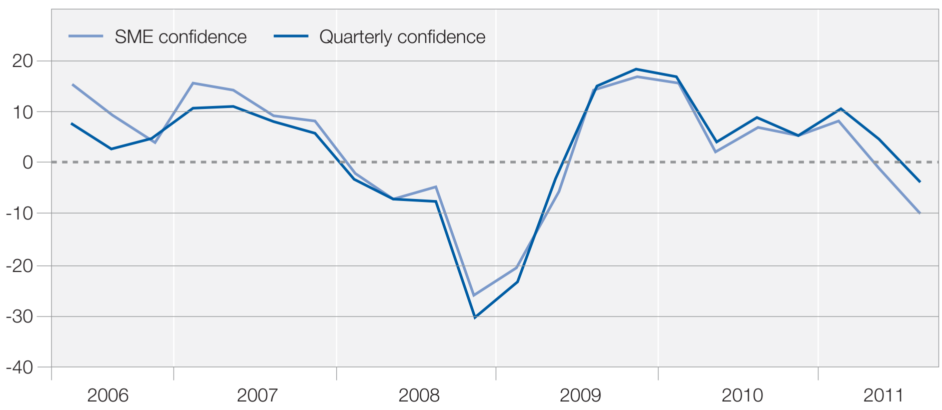
SME business confidence

Although macroeconomic forecasts show the pace of growth in Australia increasing in 2012, *The CPA Australia Asia-Pacific Small Business Survey 2011* noted that Australian small businesses expectations for growth remain considerably lower than that of small businesses from elsewhere in the region. This is most likely a reflection of the two-speed economy, lower business confidence in non-resource based sectors and the low levels of productivity growth in the Australian economy over the past decade.

Two independent surveys by the National Australia Bank (NAB) – *Quarterly SME Survey* and *Quarterly Business Survey* – measured business confidence to the September quarter 2011. The *Quarterly SME Survey* noted that:

> "Business confidence of SMEs fell heavily in the September quarter, consolidating a sharp decline in the June quarter and consistent with the deterioration in confidence reported by larger businesses in the NAB Quarterly Business Survey. SMEs are generally less optimistic than larger firms about future activity, with heightened volatility in global financial and equity markets, concerns about the resolution of European sovereign debt issues and the relatively high AUD appearing to have had more of an impact on the sentiment of smaller sized firms. SME business conditions were weaker but remained above GFC levels."

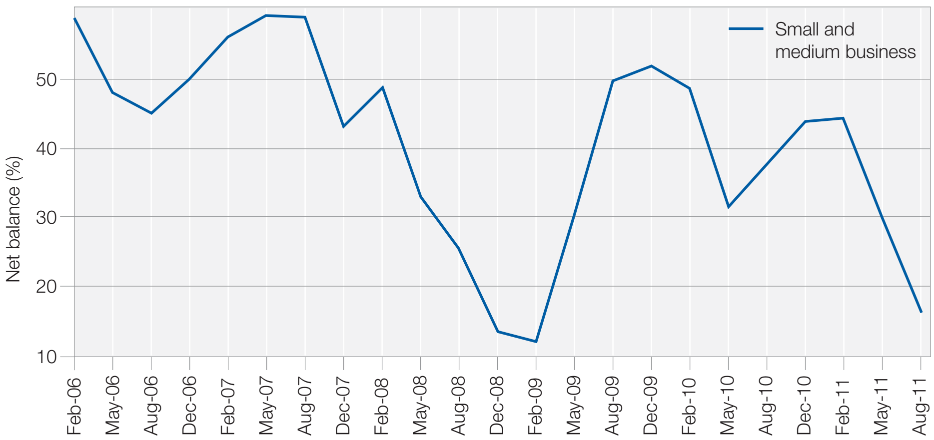
Quarterly SME Survey – September 2011[32]



32 NAB, September 2011, *Quarterly SME Survey,* http://www.nab.com.au/wps/wcm/connect/594c330048ebc62682979b0f27cc1e3e/NABQuarterlySMESurveySeptember2011.pdf

In a similar survey, *Sensis Business Index – Small and Medium Enterprises*[33], it was found that businesses that indicated they were confident were mostly established and experienced businesses.

Sensis SME business confidence[34]



CPA Australia members attending the roundtables tended to concur with the Sensis statistics. They stated that business confidence is low and many SMEs are looking to reduce debt, an opinion that is in line with RBA statistics that show that small business continues to deleverage.[35]

What is interesting is *The CPA Australia Asia-Pacific Small Business Survey 2011* also showed that of all the economies surveyed, Australian small businesses were the most likely to believe that the economy will go into recession in the next 12 months. This result demonstrates the resilience of many Australian small businesses, as while many believe the economy will go into recession, they are of the opinion that such a recession will not lead to the shrinking of their business. It may also be the case that many small businesses believe an economic downturn "will not happen to me, it will happen to another small business".

Banks more focused on industry performance

With profitability declining in many businesses, uncertainty growing in response to the current economic climate and global events, the divergence of business performance between industries is at the forefront of the banks risk assessment. The impact of this is that banks are not lending to certain industries, regardless of the performance of businesses in that industry. What those industries are, however, varies between banks.

> "The divergence of business performance between industries is at the forefront of the banks risk assessment"

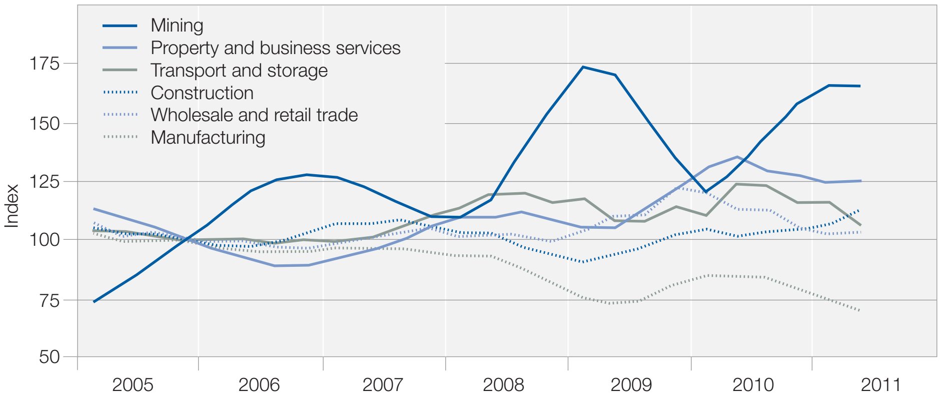
33 Sensis, September 2011, *Sensis Business Index – Small and Medium Enterprises*, http://about.sensis.com.au/IgnitionSuite/uploads/docs/September%202011%20Sensis%20Business%20Index%20FINAL.pdf

34 Department of Innovation, Industry, Science and Research, 2011, *Key Statistics Australian Small Business*, http://www.innovation.gov.au/SmallBusiness/KeyFacts/Documents/SmallBusinessPublication.pdf

35 Reserve Bank of Australia, September 2011, *Financial Stability Review*, p.45, http://www.rba.gov.au/publications/fsr/2011/sep/pdf/0911.pdf

The RBA noted that "Most non-mining industries have seen their profits decline as a share of GDP [gross domestic product] in the past year, particularly manufacturing and construction."[36] This decline can be clearly seen on the graph below.

Industry profitability[37]



*Annual gross operating profits adjusted for inventory valuation effects (except for construction and transport and storage)
Sources: ABS; RBA

The NAB *Quarterly SME Survey – September 2011* confirms that businesses in certain industries are also less confident:

> "Confidence deteriorated very sharply in small transport, business services and health, while it strengthened notably in property and was a little stronger in construction and retail, albeit still poor. Transport sentiment was the weakest of all industries, while confidence was strongest (and positive) in property. Wholesale and manufacturing conditions deteriorated sharply in the September quarter while in contrast, accommodation, cafes and restaurants and business services reported notable improvements in activity. Conditions were strongest in business services, health and finance, and weakest in retail, transport and property services."[38]

One of the standout differences from the roundtables in Brisbane, Melbourne and Sydney and a roundtable held in Perth in early 2012 is that access to finance was not an issue in Perth – that regardless of industry, Perth-based businesses generally seem to have little difficulty accessing finance. This is most likely due to the state of the Western Australian economy, which is strongly connected to the resources sector.

In general, banks will continue to monitor industry sectors as part of their overall risk management strategy and SMEs would be wise to understand that this will impact on their capacity to access financing from the banking sector. As Mike Sewell FCPA, Director, Market Gap Investments, states, "Banks have to manage their portfolio risk and that would entail managing exposure to industries and business types."

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36 Reserve Bank of Australia, September 2011, *Financial Stability Review*, http://www.rba.gov.au/publications/fsr/2011/sep/pdf/0911.pdf

37 Ibid

38 NAB, September 2011, *Quarterly SME Survey*, http://www.nab.com.au/wps/wcm/connect/594c330048ebc62682979b0f27cc1e3e/NABQuarterlySMESurveySeptember2011.pdf

Impact of payment arrangements with the ATO

At the onset of the GFC, the Australian Taxation Office (ATO) assisted the SME sector by providing deferred payment arrangements for outstanding tax debt to those seeking it. This substantially aided cash flow for many small and medium-sized businesses. However, in early 2011, the ATO began tightening these arrangements. The flow-on effect of this action has seen banks focus on those businesses that have outstanding payment arrangements with the ATO.

Where a business has a loan in place, then there will be terms and conditions attached to these loans. It is likely that payment arrangements with government departments will be included in these terms as an event of default for the loan. Unfortunately, CPA Australia members note that most SMEs are not aware of the terms and conditions attached to a loan and with the ATO allowing payment arrangements prior to 2011 many business would be unaware that they are in technical default of their loan requirements.

The impact on small and medium-sized businesses is twofold. Firstly, those who have existing payment arrangements in place with the ATO and need to raise or refinance funding may find that the banks will not entertain these outstanding's and so this becomes a barrier to new funding.

Secondly, members noted that in some cases where businesses were approaching the ATO for a deferred payment agreement, they had to prepare submissions similar to bank loan submissions for these arrangements. Additionally, some members have confirmed that some banks are calling default where businesses have an ATO payment arrangement in place. However, SMEs are generally better placed where there is a formal arrangement with the ATO.

Trevor Beckingham FCPA, member of the Small to Medium Enterprise Committee – Queensland, shares this experience:

> "I know of a larger end SME with what I consider a sizeable tax debt that was forced into a refinance situation and had an ATO repayment facility in place. The bank (Australian major) insisted in a reduction of the bank facility by the amount of the original tax debt. Size of the debt also seems to be a factor and obviously ability to repay along with other existing commitments."

Paul Wright, Associate, Matthews Steer Chartered Accountants, offers this advice:

> "Basically the arrangements need to be formalised which is evidenced by ATO letter with repayment schedule – and then kept to (as evidenced by the ATO portal). Some financiers are now taking a hard, "zero tolerance" view on potential borrowers having any arrears – even with an arrangement – and won't take them on. Others will assess on a case by case basis and prepared to at least understand the position first."

With the ATO tightening their deferred payment arrangements, SMEs should ensure that they understand the full impact of these arrangements and any outstanding to the ATO before approaching a bank for finance.

Australian Prudential Regulation Authority involvement

Following the GFC, the role of prudential regulatory bodies globally was called into question given the demise of a number of large financing institutions. Since these events, it is reported that the Australian Prudential Regulation Authority (APRA) has become more active in the oversight of the Australian financial system. They are conducting audits at the banks and imposing capital requirements and enforcing them. It is these capital requirements that impact access to finance for all businesses.

Capital requirements under prudential regulation necessitate the banks to hold an adequate amount of reserves to ensure the ongoing sustainability of the financial institution. These capital requirements are set in terms of ratios to deposits and loans held by the bank. The RBA recently noted:

> "From a longer-run perspective, the Australian banks' … capital ratio has increased substantially since 2007 as they have responded to market pressures for banks globally to hold more capital as well as in anticipation of tougher regulatory requirements."[39]

With APRA playing a more visible role in banks' operations and the increase in capital requirements, SMEs should be aware that these factors will impact on both the credit assessment of each loan application and the amount of funds available for lending.

39 Reserve Bank of Australia, September 2011, *Financial Stability Review*, p.45, http://www.rba.gov.au/publications/fsr/2011/sep/pdf/0911.pdf

Increase in insolvencies

One of the fallouts from the ongoing uncertainty in Australian and global markets is that the number of small and medium-sized businesses that are struggling to stay abreast of the changing trading conditions is increasing. As noted earlier in this paper, members confirmed that many of these businesses had entered the GFC with some reserves and good profitability. However, with difficult trading conditions continuing, coupled with the inability to access finance for working capital needs, there has been a large increase in the number of businesses forced into insolvency.

The Australian Financial Review recently reported, "Businesses which were trying to hold on, and use up their reserves, can't hold on any longer. It's partly the lag effect from the financial crisis and partly the effect of ongoing poor conditions."[40]

The most recent release of the Australian Securities and Investments Commission's insolvency statistics[41] reveals that 2011 is on track to set record highs in the number of corporate insolvencies.

CPA Australia members also noted that they were aware of increasing insolvencies within the SME sector, particularly initiated by directors of those companies rather than banks. Cliff Sanderson, Partner, Dissolve, provides some insight into this issue:

> "… the Australian Taxation Office is largely behind the increase. At the basis of a lot of them is the ATO. While the petitions they lodge in court are up a bit but not a lot, the ATO's actions cause a lot of directors to move."

"Businesses which were trying to hold on, and use up their reserves, can't hold on any longer. It's partly the lag effect from the financial crisis and partly the effect of ongoing poor conditions"

40 Katie Walsh, 8 September 2011, *Tough Taxman blamed for insolvencies*, Australian Financial Review

41 http://www.asic.gov.au/insolvency

3. Conclusion

Overall, CPA Australia has found that finance is available for small-to-medium enterprises (SME), yet conditions remain tight. Pricing has stabilised although lenders continue to be very focused on business risk. In particular, industry risk has become key in lending decisions for most financiers, with SMEs in certain industries finding it very difficult to access finance. Banking relationships appear to have improved from a low base, with many CPA Australia members agreeing that the experience of business bankers has also improved. However, in both areas there remains significant scope for improvement.

CPA Australia acknowledges that SMEs need to also take responsibility for financing their business by improving business performance and financial management.

We also acknowledge that in addition to credit conditions remaining tight, trading conditions have remained difficult for many businesses for an unexpectedly long period of time and this means that many businesses may be in a precarious financial situation. Such businesses may have decided not to seek finance and hence we may not be getting a full understanding of current credit conditions.

Appendix 1

SME access to finance in other jurisdictions

The following summaries provide an overview of lending conditions in the United Kingdom, United States and Canada, as detailed in senior bank officers' lending surveys from each country.

United Kingdom[42]

According to the Bank of England's *Credit Conditions Survey* for the fourth quarter of 2011, the demand for credit by small businesses fell markedly in the three months to mid-December and was expected to fall further in the next three months. This survey also showed the largest net balance of respondents reporting a negative impact of wholesale funding conditions on credit availability since the fourth quarter of 2007– both for the past three months and the coming quarter, with lenders commenting that economic problems in Europe had led to stressed conditions for funding markets and interbank lending.

United States[43]

In the Federal Reserve Bank's fourth quarter *Senior Loan Officer Opinion Survey*, the domestic banks reported little change in the standards on commercial and industrial loans but continued easing of pricing terms during this quarter. The net of the banks surveyed reported increased demand from smaller firms, the highest level since 2005. The banks cited changes in customers funding needs related to inventories, accounts receivable and mergers and acquisitions as important factors underlying the change in demand.

Canada[44]

The Bank of Canada's *Senior Loan Officer Survey* for the fourth quarter of 2011 reported eased lending conditions across all borrower categories. For corporate borrowers, lending conditions eased for the tenth consecutive quarter. The respondents to the survey continued to consider competition among lenders as the key factor underlying the easing in business-lending conditions and the balance of opinion regarding the demand for credit from financial institutions was that it increased during the fourth quarter. The net increase was mostly related to a rise in demand for financing for "general purposes".

42 Bank of England, 2011, *Credit Conditions Survey*, http://www.bankofengland.co.uk/publications/Documents/other/monetary/creditconditionssurvey120105.pdf

43 Federal Reserve Board, January 2012, *Senior Loan Officer Opinion Survey*, http://www.federalreserve.gov/boarddocs/snloansurvey/201201/fullreport.pdf

44 Bank of Canada, January 2012, *Senior Loan Officer Survey*, http://www.bankofcanada.ca/wp-content/uploads/2012/01/slos_2011q4.pdf

Appendix 2

How has access to finance for SMEs changed over the last 18 months?

Issue	SME experience in early 2010	SME experience in late 2011
Key theme	The relationships between banks and small-to-medium enterprises (SME) had been damaged during the global financial crisis (GFC). CPA Australia members attributed this to poor communication between banks and SMEs and a lack of certainty between banks and SMEs due to banks not giving advanced notice of changes to or enforcement of compliance requirements.	Credit conditions remain tight for the majority of SMEs, thus business should view the current lending environment as "the new normal".
Lending conditions	Banks were still lending, but such lending is predominately secured lending against a tangible asset (cash flow or goodwill was not acceptable security), with personal guarantees. In short, lending conditions were stricter than prior to the GFC. Where there was an existing loan, banks were requiring additional security.	Members were of the view that lending conditions remain tight. However, good businesses are being funded. These approvals are being given with tight security and on short terms. Members also noted that banks were unwilling to lend to certain industries, however, what those industries are changes from bank to bank. Some noted that although tight lending conditions remain, there appears to be slightly more competition on pricing. This is perhaps due to the re-emergence of some smaller lenders for the SME market, albeit below pre-GFC levels. Refinancing remains difficult, as the banks are cautious, particularly where businesses "shop around". Banks have generally continued their stance in favour of asset-backed secured lending. Some members stated that some banks were no longer providing finance for cash flow, invoice or debtor finance.
Compliance requirements from lenders	According to members, banks had significantly increased their reporting requirements for both existing and new borrowers in the SME sector and the detail required in such information. The frequency of this information had also increased. Members stated that much of the additional information required was not readily available to SMEs from their existing systems.	Members were generally of the view that compliance requirements had not changed in the last 18 months.

Issue	SME experience in early 2010	SME experience in late 2011
Quality of business bankers	Members expressed strong views in 2010 that the business bankers they had dealt with were inexperienced and therefore unlikely to have the necessary skills to appropriately assess or assist credit applications. Members stated that this was adding to the burden on business in securing finance and maintaining finance facilities, as they had to spend extra time providing additional explanations and information on their industry and business, which an experienced banker may not normally require. Members also commented that the turnover in business bankers was adding to this burden as this potentially creates a need to re-explain their business to a new person. Regional members expressed concern that bankers in regional areas do not have the authority to assess and authorise loan applications.	Members generally agreed that banker expertise has improved slightly in the last 18 months. However, it was noted by many that relationship managers do not have the skills to assist SME in business improvement or to tell them bad news about poor results. A number of members responded to this situation by establishing relationships with a number of different areas of their bank. However, as *The CPA Australia Asia-Pacific Small Business Survey 2011* shows, of the 32 per cent of respondents that found accessing finance either difficult or very difficult, only 8 per cent suggested that the skill level of their banker made accessing finance difficult.
Banking relationships	The relationships between banks and SMEs had been damaged during the crisis. Members attributed this mainly to poor communication between banks and SMEs.	The poor relationship between banks and their SME clients remains an issue. However, it seems some businesses are proactively seeking to overcome that difficulty through, for example having more than one contact within their bank. The damage doing to banking relationships during the height of the GFC had made some SMEs reluctant to borrow.
Banking competition	Some members believe that the lack of competition from second-tier banks, overseas banks and alternative finance providers had given the “four majors” the “whip hand” in their relationship with clients and this negatively affected the supply of credit.	Some members noted that there appears to be slightly more competition particularly in pricing, due to the re-emergence of some smaller lenders to the SME market, albeit below pre-GFC levels.
Economic impact	Members raised the impact of the tightening of credit conditions on business and the economy. They were particularly concerned that the higher security requirements would negatively impact the ability of existing businesses and people considering going into business to raise finance (particularly those with a limited asset base). These twin concerns not only affect the ability of existing businesses to grow but can decrease the value of such businesses due to less potential purchasers.	Although macroeconomic forecasts show the pace of growth in Australia increasing in 2012, *The CPA Australia Asia-Pacific Small Business Survey 2011* noted that Australian small businesses expectations for growth remain low. Members have expressed the view that tight credit conditions are contributing to this lower level of confidence.

Issue	SME experience in early 2010	SME experience in late 2011
Financial management skills of SMEs	Members agreed that the financial management skills and processes of many SMEs were poor and that this was affecting their ability to apply for a loan or refinance.	Many participants in our roundtables agreed that the financial management skills of many small businesses are still a major problem. With credit conditions remaining tight, poor financial management skills are affecting the ability of many SMEs to seek external finance or refinance. It is also impacting on the ability of business to manage their business effectively. This issue featured more prominently in the 2011 roundtables than in 2010.
Bank focus on industry performance	Members noted that businesses from certain industries were finding it very difficult to raise finance.	Participants noted that banks seem to have a greater focus now than in 2010 on which industry the SME is from, and that businesses (even good businesses) in certain industries find it very difficult to borrow from a bank (which industries banks may not lend to vary from bank to bank). With the divergence of performance between industries, it is not surprising that banks monitor industry sectors as part of their overall risk management strategy
ATO payment arrangements	At the outset of the GFC, the Australian Taxation Office (ATO) provided assistance to the SME sector by providing deferred payment arrangements for outstanding tax debt to those seeking it. Members noted in early 2010 that the ATO had continued to be quite accommodating of businesses seeking a payment arrangement.	Members noted that in early 2011, the ATO began tightening eligibility criteria for payment arrangements. Members also noted that many SMEs did not understand that entering into a payment arrangement could be a breach of a loan condition and make applying for a loan or refinancing difficult. Members also noted that they had experienced the ATO becoming more assertive in their debt collection.
APRA involvement	The Australian Prudential Regulation Authority's (APRA) involvement in affecting bank lending policy was not raised in 2010.	Members reported that APRA is more involved in the oversight of the Australian financial system, and that SMEs should be aware that with APRA playing a more visible role in the banks' operations and the increase in capital requirements, that these factors will impact on both the credit assessment of loan applications and the amount of funds available for lending.

Issue	SME experience in early 2010	SME experience in late 2011
Increase in insolvencies	Members stated that they expected the number of insolvencies to rise in the coming years.	Members noted that the number of corporate insolvencies has increased and that an increasing number of insolvencies were initiated by directors of the company. Members believe that with difficult trading conditions set to continue for many industries, coupled with problems in accessing finance and the business reserves being run down, insolvencies are likely to increase further.
Conclusion	The general conclusion drawn from the CPA Australia roundtables in 2010 was that the pendulum has swung from the pre-GFC environment where many lenders were too lax with their credit conditions, to the current situation with banks being very strict in their credit conditions.	The general conclusion from CPA Australia's research in late 2011 and early 2012 is that credit conditions remain tight (or at least tighter than pre-GFC). However, good businesses are able to access funding. Having stated that, some industries are finding it difficult to access finance. Members were also of the general opinion that business themselves have to put more effort into attracting finance.

Appendix 3

Tips to improve access to finance

Key tip

Current lending conditions are the "new normal" – don't try to "sit" it out. Change the way you manage and monitor your business performance, with particular emphasis on increasing cash flow.

Banking relationships

- Understand the decision-making structure within your bank. Take a holistic relationship with a number of people in the bank, including the credit manager, regional manager and front line staff – not just your relationship manager if you have one.
- Approach investors, financiers and bankers well ahead of needing money. Show them your plans, explain what you are doing, show them your finances and projections, demonstrate your track record and then ask for the money you need.
- Be open and up-front in all your dealings with your relationship manager – you never know when you might really need that person in your corner.

Financial management

- Know your cash position. Control debtors promptly, pay creditors within terms and negotiate if you need an extension. Treat these tasks as part of your daily discipline.
- Always have your numbers ready and invite your banker to your business to share your experience.
- Keep financials up-to-date, quarterly financial statements, 12-month budgets and up-to-date forecasts, particularly cash flow forecasts.
- Communicate with clients and suppliers if you want help improving your cash position. They are more likely to help (such as extending trading terms or paying debts quickly) if the value proposition is solid.
- Understand the impact of entering into any payment arrangements, particularly those with the Australian Taxation Office.
- Be realistic in your expectations and projections. Your business banker may not be very experienced, but they know a fairytale story when they see it and they have tools that can deconstruct what you submit in more ways than you can imagine.
- Keep internal reporting tight and current.
- Look at improving business performance. Often there are easy ways to increase profitability and cash flow by reviewing the way your business operates.
- Keep directors well informed at all times. Regular management reporting on key areas of the business should include: cash flow forecasts, compliance requirements and financial ratio analysis.

Financing

- Understand all the terms and conditions that are included in all financing arrangements.
- Make sure you have processes in place to meet compliance requirements of all loans.
- Understand what it takes to service any existing or new loans. Look at all the fees and compliance requirements.
- Internally finance wherever possible.
- If at all possible, keep some assets in reserve that are not pledged to the bank.
- Make your first shot your loan shot, the more times you have to rehash your application the less likely it is to succeed.
- Be aware of lenders risk appetite for particular industries. If you are not sure – ask.
- As competition on pricing has increased, make sure you are getting the best price on offer.
- Do not over extend credit lines as there is a point banks will draw the line
- Use more than one bank to build credit history and to spread funding risk. However, be wary of shopping around.
- Use a broker if need be.
- Try not to default on payments. Defaults make accessing finance very difficult.

Advice

- Use accountants, brokers and mentors to assist in financing and financial management if you feel out of your depth.
- Listen to other people's experiences and learn from them.

Appendix 4

CPA Australia tools to assist SMEs

Fact sheets

Applying for a loan – cpaaustralia.com.au/applyforaloan

Refinance your business debt – cpaaustralia.com.au/refinancebusinessdebt

Checklist for managing in times of financial difficultly – cpaaustralia.com.au/financialdifficulty

Guides

Business evaluation guide – cpaaustralia.com.au/evaluationguide

Improving business performance – cpaaustralia.com.au/improvingperformance

Dashboard reporting – cpaaustralia.com.au/dashboardreporting

Achieving financial success – cpaaustralia.com.au/financialsuccess

Guide to managing liquidity risk – cpaaustralia.com.au/liquidityrisk

Internal controls for small business – cpaaustralia.com.au/Internalcontrols

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