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1st December 2010

Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir/Madam

Re: Submission to the inquiry into competition within the Australian banking sector

CPA Australia represents the diverse interests of more than 129,000 members in over 114 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background, we welcome the opportunity to provide this submission to the Senate Economics References Committee inquiry into competition within the Australian banking sector. This submission is not only made on behalf of our members but also the accounting profession and the broader public interest.

This submission builds on the submission CPA Australia made to the Senate Economics References Committee inquiry into access of small business to finance. The submission also draws on round table discussions CPA Australia held with Australian small businesses on access to finance in March 2010 (see Appendix A), a round table discussion CPA Australia held with large corporates on access to finance in August 2010 (see Appendix B) and CPA Australia's Asia-Pacific small business survey 2010.

It is clear that debt markets changed quite dramatically during the global financial crisis (GFC). As a consequence, the GFC was a very challenging period for financing of businesses of all sizes. This is attributed to the scarcity of debt funding, which in part is a consequence of a reduction in funding sources, including a reduction in the number of foreign lenders, changes to the risk profile of Australian and foreign lenders and the increased difficulty of accessing other sources of funding (particularly for large corporates), for example, bond markets and securitisation loans. The consequence of this is that for most businesses of all sizes, the Big 4 Australian banks became the only viable large scale source of funding.

While it is remains difficult to identify any easy solution to increasing competition, particularly in the small business lending market, it however remains important for the Inquiry to not only consider competition in the home mortgage market, but also business lending as well.

Bank and bank client relationships have also been strained. One initiative that may contribute to improving relationships between banks and small business and reduce the possibility of this relationship being damaged again in the future, is for the Australian Bankers' Association (ABA) to consider expanding its existing Code of Banking Practice to include a code of conduct on small business lending. The Senate Economics References Committee made the same recommendation in its report titled *Access of Small Business to Finance*.

Other recommendations from our submissions are:

- the government work with lending institutions to develop information and education products that:
  - improve small business knowledge of the wide range of financing options that may be available to them
  - help small business choose the mode(s) of finance that best suits their needs, and
  - assist small business understand what they may need to do to attract finance from a wider range of sources.
- to help the government, regulators and the business community understand trends in business lending, the government (or its agencies) introduce a Bank Lending Survey measuring changes in demand for debt finance by business (categorised by business size) as perceived by senior bankers
- the government provide further support to small business through subsidised training and information and education products that help to develop their financial management skills.

Should you have any questions regarding this submissions please do not hesitate to contact Gavan Ord on (03)9606 9695 or gavan.ord@cpaaustralia.com.au.

Yours sincerely

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CPA AUSTRALIA SUBMISSION TO THE INQUIRY INTO COMPETITION WITHIN THE AUSTRALIAN BANKING SECTOR

General comments

The state of competition in small business lending

In March 2010, CPA Australia ran four round table events with members involved with small business to gauge their views on small business access to finance. Many participants stated that they have seen a reduction in competition between lenders to small business since the beginning of the global financial crisis (GFC). With small business having few alternatives to bank financing and foreign lenders unlikely to become active in this area, the dominance of the Big 4 banks as lenders to small businesses looks set to continue for the foreseeable future.

Some CPAs believe that the effect of this lack of competition (perceived or actual) and the hassle (perceived or actual) of switching banks is that many small businesses feel captive to their bank. As one participant in a round table stated "*When we were getting competitive quotes for funding for an investment, we found that there would be two banks close together, and another two further apart, but the gap between the two groups was substantial. The goal posts have shifted and what this tells me is that there is less competition out there.*"

Small businesses currently accessing debt finance

CPA Australia's Asia Pacific Small Business Survey 2010 asked 500 Australian businesses with less than 20 employees whether they currently have a business loan; 25.2% of respondents indicated in the affirmative. This is slightly below the average for the other markets surveyed - Hong Kong, Malaysia and Singapore - where 30.8% indicated they currently have a business loan.

Need for additional funds in the past 12 months

The same survey asked small businesses whether they required additional funds to support their business operations outside of their existing cash resources in the past 12 months; 24.8% of Australian respondents indicated the need for additional funds, which was well below the average for the four markets surveyed, which was 35%.

Reasons why additional funding was sought

When asked why such businesses sought additional finance, the three main reasons cited by Australian small businesses were:

- To cover increasing expenses (30.5%)
- Business growth (28.1%)
- Business survival (27.3%)

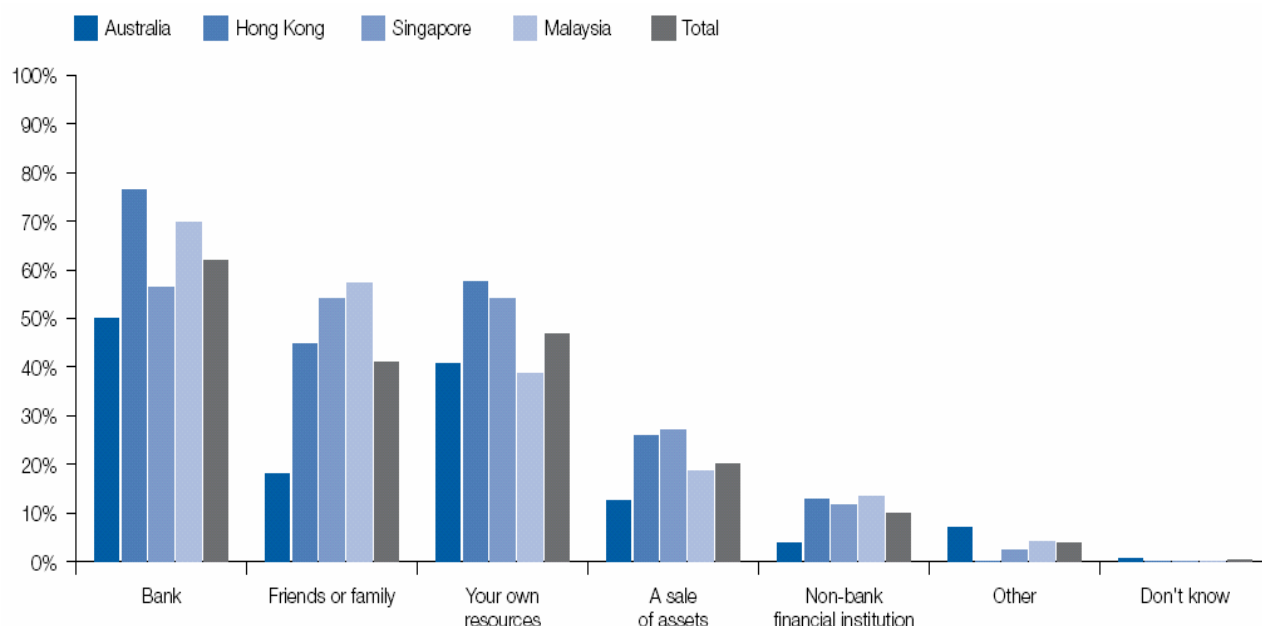
The reasons for seeking additional funds in the other markets surveyed were overwhelmingly for business growth and associated reasons (purchasing assets and stock).

Sources of additional finance

For Australian respondents to our small business survey, the most important source of finance was from a bank. It is interesting that despite the reported difficulties accessing finance from banks, Australian small businesses have only marginally increased the funding of their business from their own sources. The expectation is that if debt funding is difficult to access, businesses would seek to improve their cash position to provide an internal source of funding (which seems to be the case for large corporates). With the survey showing that many Australian small businesses have poor financial management practices, it is therefore not surprising that this is the case. In other words, poor financial management practices may be contributing to the high reliance on bank funding. Governments, lenders, industry associations and accountants all have a role to play in improving the financial management skills of small business.

In comparison to the other markets surveyed, Australian businesses have significantly lower reliance on family and friends as a source of finance and they are less likely to source finance from a non-bank financial institution.

These survey results are reflected in the following table.



[1]

Question 3-4: *And from which of the following sources were those 'required additional funds' obtained? (Multiple response) (Australia n=128, Hong Kong n=85, Malaysia n=96, Singapore n=85)*

Forms of financing used

The survey also asked the types of business financing the business has used. Australian respondents were the most likely to not consider any funding at all and they were the least likely to consider working capital financing (vendor, debtor and inventory financing), instead relying on credit cards and overdrafts. As stated in our submission to the previous *Access of Small Business to Finance* inquiry, CPA Australia suggests that government, lenders, industry associations and accountants all have a role to play in increasing small business awareness of these other forms of financing and when they may be a suitable financing option. Such awareness is key to the uptake of these forms of financing. With the cost of credit card and overdraft financing potentially high, any moves that lead small businesses to use other forms of financing (where appropriate) and/or improving their own cash position through better financial management will lead to more successful and profitable small businesses.

CPA Australia has, in conjunction with Small Business Victoria, developed a detailed guide to financial management, including the forms of financing and when they are most suitable, called *Achieving Financial Success*. Small Business Victoria is using this guide in its financial management training.

Recommendation:
CPA Australia recommends that government, lenders, industry associations and accountants develop and distribute information and education products that:

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

Recommendation:
The government provide further support to develop the financial management skills of small business. Such support should be delivered through subsidised training and information and education products.

[1] Figure 5, page 15 – *The CPA Australia Asia-Pacific small business survey 2010: Australia, Hong Kong, Malaysia and Singapore*

The survey results on the types of financing used is reflected in the below table:

	Australia		Singapore		Hong Kong		Malaysia		Total	
	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010
Credit cards	61.8%	62.6%	46.6%	45.7%	28.9%	36.8%	55.1%	38.3%	51.8%	50.5%
Bank loan (secured)*	–	33.1%	–	41.4%	–	33.8%	–	41.3%	–	36.2%
Overdrafts	33.3%	29.5%	25.7%	28.9%	29.9%	32.8%	40.5%	28.9%	32.6%	29.8%
Leasing	30.0%	22.5%	19.0%	20.7%	30.4%	19.9%	26.3%	6.5%	27.5%	18.8%
Loan or equity injection from family or friend*	–	17.6%	–	30.8%	–	33.8%	–	32.8%	–	25.7%
Hire purchase	21.6%	17.1%	30.6%	31.7%	50.5%	21.4%	51.2%	34.8%	33.9%	23.7%
Bank loan (unsecured)*	–	12.2%	–	19.7%	–	32.3%	–	17.9%	–	18.2%
Chattel mortgage*	–	8.1%	–	2.9%	–	11.9%	–	7.0%	–	7.6%
Vendor financing	8.2%	4.7%	12.6%	11.1%	32.8%	11.4%	22.9%	17.9%	16.2%	9.4%
Debtor financing	3.7%	3.3%	11.2%	11.5%	22.1%	10.0%	23.4%	19.9%	12.0%	9.0%
Inventory financing	1.4%	2.7%	5.8%	12.5%	27.9%	12.9%	11.2%	9.5%	8.8%	7.6%
International trade financing	2.9%	1.6%	7.8%	17.8%	21.1%	13.9%	15.1%	7.0%	9.3%	7.7%
Other	5.9%	2.5%	2.4%	1.0%	2.0%	1.0%	6.3%	2.0%	4.6%	1.9%
None	23.3%	20.5%	29.6%	15.9%	11.3%	16.4%	9.8%	14.4%	19.8%	17.9%

* Option not provided in 2009

Question 3-1: Which of the following types of business financing has your business ever used? (Multiple response) (Australia n=516, Hong Kong n=201, Malaysia n=201, Singapore n=208) [2]

Reasons for not seeking finance

The survey also asked small businesses that did not seek finance in the last 12 months the reason for not seeking such finance. The overwhelming reason in the Australian market was that they did not need such funds. Therefore, except only in a small number of cases, lending conditions, loan procedures and the cost of finance were not cited as reasons for not applying for finance. This does not mean that such issues are not of concern to small business – anecdotal evidence, including the opinions raised in our round table discussions certainly suggests that they are. It may be because of the lack of alternative sources of finance that Australian small businesses have accepted such lending conditions and costs and/or they are accessing sources of finance that are not an appropriate match for the purpose the finance is being used, in particular credit cards.

[2] Table 6, page 23 *Op cit*

See the following table for the reasons for not seeking finance:

	Australia	Singapore	Hong Kong	Malaysia	Total
	2010	2010	2010	2010	2010
The business had sufficient funds under its existing arrangements	48.8%	67.0%	63.3%	60.4%	55.7%
The business did not need additional funds	61.2%	50.9%	39.5%	42.9%	53.7%
Procedures to obtain funding from a financial institution are too complicated	2.6%	5.9%	8.3%	15.4%	5.7%
Interest rates were too high	4.2%	15.3%	20.2%	15.4%	10.0%
It was considered unlikely a financial institution would provide the funding required	3.7%	8.5%	6.4%	5.5%	5.2%
A previous loan was rejected	0.3%	0.0%	2.8%	2.2%	0.9%
The likelihood of unreasonable terms and conditions	1.3%	1.7%	5.5%	8.8%	3.0%
The risk of not being able to repay the loan	5.3%	6.8%	4.6%	14.3%	6.6%
The potential to lose control of the business	1.3%	5.9%	3.7%	6.6%	3.2%
The business no longer needed the additional funds (eg cancelled investment plans)	3.9%	9.3%	14.7%	16.5%	8.2%

Question 3-6: Which of the following best describes the reason for not applying for additional funds in the past 12 months? (Multiple response) (Australia n=381, Hong Kong n=109, Malaysia n=91, Singapore n=118)

[3]

Sources of advice

Australian businesses are most likely to seek business advice from their external accountant (47.3%). Banks on the other hand are not seen as a source of business advice, with only 11.6% of respondents indicating that they sought business advice from a bank. For respondents considering seeking finance, the most likely source of advice on such finance is not surprisingly a bank (49.7% of Australian respondents), however a considerable number of Australian businesses will seek advice on their financing needs from independent sources, namely external accountants (46.2%).

Banks in the other markets surveyed are however much more likely to be a source of advice for small business, not just on financing issues but also general business advice. Australian banks could learn much as to why banks in those markets are more likely to be a source of advice.

The state of competition in corporate financing

In August 2010, CPA Australia held a round table with members involved in corporate financing. The key findings from the round table were:

- corporates experienced a significant shrinkage in funding options during the GFC, however they were still able to access funding, but at higher costs and on stricter conditions than prior to the GFC
- some foreign lenders reduced their exposure to the Australian market or withdrew altogether
- some local lenders reassessed their portfolio and reduced lending to certain sectors, and
- other sources of financing, such as offshore bond markets became very difficult to access or were not available.

Corporates were therefore forced to rely on funding from domestic sources, in other words the Big 4 Australian banks, and from internal sources through improved cash management. Large corporates were generally well placed to managed this shift in the power relationship between banker and borrower and devoted extra resources to their relationship with their banker.

While some of the largest Australian companies (ASX 20) were able to access the equity markets for capital during the crisis and to some extent non-intermediated debt (e.g. corporate bonds), such alternative funding sources were generally not available or were too expensive for other large businesses.

[3] Table 4, page 17 – *The CPA Australia Asia-Pacific small business survey 2010 – Australia, Hong Kong, Malaysia and Singapore*

For the corporates at CPA Australia's round table, the key lessons they learned from the crisis were:

- While they may use alternative funding arrangements, it is the Big 4 Australian banks that are for most businesses, the only large source of funds and they must build positive relationships with those banks.
- They can not become overly-reliant on non-Big 4 sources of finance. In other words, corporates have realised that the Big 4 banks are a less risky funding option.
- Good business practice should not be forgotten. Many corporates admitted that the easy credit days prior to the GFC lead them to drop good business practice.
- Good business practice helped to unlock cash tied up within many businesses, and such cash has become an important source of finance.

Given the state of many European and US banks, it is likely that banks from Asia are likely to become a source of finance, particularly for corporates and in particular favoured sectors. As one participant in the round table noted:

"While I think the big four banks are core and key, there are other entrants coming in at the moment and they could be used sparely and profitably. They could create some price tension and better terms and conditions. I just mention some of the Asian banks. The Chinese banks are looking at the market in a very aggressive way. They are looking to build market share and some of the Japanese banks are back. If you can build up a relationship with them and they like your sector then they have a lot of money. With limited credit skills they will look for names and focus on certain sectors, but if you are in those favourite sectors, they will support you." He added: " *At the moment they cannot really be considered central players, but they have demonstrated their interest and, thanks to much of Asia doing fairly well despite the GFC, they have money to lend. At the very least the Asian commercial banking presences in Australia and access to Asian loan markets in particular can be used as leverage when negotiating with the Big 4, and to diversify funding sources.*"

Therefore, market participants expect potential sources of competition to emerge from new areas, such as Chinese banks, rather than from US and European banks. Such banks are likely to concentrate on larger corporates and in specific sectors for the foreseeable future.

Specific comments in response to the terms of reference

(a) the current level of competition between bank and non-bank providers

It is clear from our discussions with businesses of all sizes that the Big 4 banks are seen as the key source of debt financing. Businesses do not see this changing any time soon – in fact the GFC highlighted to Australian corporates the importance of the Big 4 banks as a source of debt finance.

(b) the products available and fees and charges payable on those products

No comment.

(c) how competition impacts on unfair terms that may be included in contracts

While not offering a view as to whether banks imposed unfair terms on borrowers during the GFC, we can state that businesses did feel a shift in the power of the relationship between banks and borrowers and that the banks imposed tougher compliance requirements on business borrowers. The change in the compliance requirements reflected a reassessment of their risk portfolio by banks.

While compliance requirements have increased for all businesses, and banking covenants have typically become stricter, larger corporates have had the resources to manage such increased burden. Participants at our corporate round table took the view that they generally understood why additional requirements were being imposed and it was in their interests to meet those additional requirements so that finance continued to flow. Participants in our small business round tables were definitely not so accepting of the increased reporting requirements and stricter covenants.

We would like to state that CPA Australia is not critical of a tightening of lending conditions, nor of the banks seeking additional security and information. However, such actions do have consequences for small business, and the challenge for lenders is to find the balance between imposing suitable lending conditions and giving suitable businesses reasonable access to finance at a cost that reflects the risk of such lending. We believe this balance has not yet been achieved, and a code of conduct on SME lending (discussed later) may help to achieve such a balance.

Changed credit conditions (including implementing additional reporting requirements) were, at times, imposed with great speed and (often) lack of warning. In our view, the inadequate time many businesses had to adjust their systems to meet the new requirements added to the pressure those businesses felt during the GFC; the banks could have handled this better.

The impact of tighter lending conditions has to be considered in the context that only a minority of small business have an existing loan. As CPA Australia's Asia-Pacific small business survey of 2010 found, only 25 per cent of Australian small businesses had an existing loan. Hence the tighter credit conditions are unlikely to have had a direct impact on many small businesses. However, most businesses would have been affected indirectly in some way; for example, a major customer of a small business reduced their purchases because the business found it difficult to raise the finance to fund such purchases.

The tightening of credit conditions has negatively impacted many SMEs because of their lack of access to well-developed financing alternatives to bank finance that large businesses have available (such as equity financing and corporate bonds). It is unlikely however that such alternative sources of finance will develop for SMEs in the foreseeable future.

(d) the likely drivers of future change and innovation in the banking and non-banking sectors

We believe the likely drivers of future change and innovation in the banking sector will be:

- the emergence of Asian banks as a source of corporate financing (as discussed above).

(e) the ease of moving between providers of banking services

The reduction in competition has resulted in a shift of power to the banks, which according to members is impacting the ability of small business to negotiate competitive deals. With this lack of choice, members expressed concern with the impact this would have on small business switching banks. As one member points out in relation to the ease of switching between banks: "*The government was well intended when it said a few years ago that it would make switching banks easier. However, no one took account of the huge opportunity cost, particularly the government, when a small business has to go and start looking around to get another finance facility. It's not only the business finance, but also the personal, all the ancillary finance and hire purchase etc, that needs to be changed and they just don't have the time. In addition, with small businesses required to use personal assets to secure loans, switching carries large costs*."

Another member agrees, "*There is a large cost associated with transferring banking – stamp duty in particular. So the business owners then say, 'why should I spend $100,000 to transfer my banking across?' Therefore, potentially, the banks have certain leeway to leverage up their requirements on businesses in the form of fees, information, security and any other compliance requirements, which could be difficult to work around in a cost-effective manner due to the lack of competition and costs associated with switching financiers.*"

With small business lending mixed with security over personal assets and personal guarantees and transactional banking, switching small business lending is not easy.

(f) the impact of the large banks being considered 'too big to fail' on profitability and competition

No comment.

(g) regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the global financial crisis

No comment.

(h) opportunities for, and the obstacles to, the creation of new banking services and the entry of new banking service providers

It would be presumptuous to believe that foreign lenders can enter the Australian market and start lending to small business or grow an existing banking network (experience shows us that foreign lenders are mostly interested in corporate lending and lending to particular sectors such as commercial property development). Small business lending not only requires a distribution network but also (and may be more importantly) back office support (particularly a well-managed credit department to assess applications). Such back office support can not be built over night. The easiest way for foreign lenders to enter the market is to purchase an existing branch and support network, however there are limited options for such investment outside the Big 4 banks.

Second tier lenders (smaller banks and credit unions) already established in Australia do offer an alternative to the big 4 lenders, however without larger distribution networks and larger back office support (credit departments), it is unlikely that these lenders will become a major source of competition in small business lending. Also impacting the ability of many second tier lenders to provide competition to Big 4 banks in the small business lending market is that many of them are focused on particular geographical areas and/or they focus on home mortgages. Second tier lenders may require incentives to develop the infrastructure they need to move more into small business lending.

It is difficult to identify any easy solution to increasing competition in the small business lending market. It however remains important for the Inquiry to not only consider competition in the home mortgage market, but also business lending as well. The best place for the Inquiry to start to look at this small business banking is the consider the recommendations of the Senate inquiry into small business access to finance.

(i) assessment of claims by banks of costs of capital

No comment.

(j) any other policies, practices and strategies that may enhance competition in banking, including legislative change

As the Minister for Small Business, Senator The Hon Nick Sherry stated in a recent speech:
"Regrettably, the relationship between banks and small business can often be fraught.

I encourage lenders to get closer than ever to business and urge them to look to fill the gap in funding as much as the regulators will permit and to price risk realistically."[4]

We support the Minister's statement and encourage the Committee to support recommendation 6 of the Senate Economics References Committee *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*". We have raised this recommendation with the Australian Bankers' Association (ABA) and to date have not had a response as to whether they would develop such a Code.

It should be noted that the UK, Canada and Ireland have specific codes of conduct relating to lending to small to medium sized enterprises and that such a Code would therefore bring Australian banking into line with best practice. The UK and Canadian codes are codes of their respective bankers' association and the Irish code has been released by the Irish financial services regulator. The ABA previously had voluntary guidance for its member banks on working with small businesses (called Banks and small business working together). This guidance was withdrawn when the current Code of Banking Practice was released in 2004.

It has been argued that the current ABA Code of Banking Practice effectively covers the areas covered by the small business codes and the guidance previously issued by the ABA, however as shown in the comparison between the ABA Code of Banking Practice and the small business codes at Appendix C, this is not correct – there are significant gaps that could be corrected in an expansion of the Code of Banking Practice or in a separate code of practice.

Such a specific Code would provide the framework for banks to improve their relationship with small business, more clearly set out the rights and responsibilities of banks and borrowers and enable banks "*to get closer than ever to business"*. This would no doubt lead to improved outcomes in small business lending.

Recommendation:
CPA Australia recommends that the Committee support recommendation 6 of the Senate Economics References Committee report titled *Access of Small Business to Finance,* being that the Australian Bankers' Association meet with small business representatives to develop a code of practice for lending to small business.

The governments or their agencies of a number of major economies (including US, UK and Canada) produce a regular Bank Lending Survey, however such a survey is not undertaken in Australia. This survey measures changes in demand for finance by business as perceived by senior bank officials. Such a survey would build knowledge of the government, regulators and the community business lending trends.

Recommendation:
CPA Australia recommends that the government (or its agencies) introduce a Bank Lending Survey measuring changes in demand for debt finance by business (categorised by business size) as perceived by senior bankers. Such a survey would assist government, regulators and the business community understand trends in business lending.

(k) comparisons with relevant international jurisdictions

See Appendix C - Codes of conduct on small business banking – comparison between jurisdictions.

[4] Address to the Council of Small Business of Australia Quarterly dinner – 25 November 2010

(l) the role and impact of past inquiries into the banking sector in promoting reform

As discussed in (j), the Senate Economics References Committee report on *Access of Small Business to Finance* made a number of recommendations. Recommendation 6 relates to the Australian Bankers' Association, and we have not seen a formal response from the ABA or its member banks to the recommendations. More pressure should be brought to bare on the ABA and its member banks to respond and to justify their response.

APPENDIX A

Small Business Access to Finance: A detailed summary of member views-March 2010

1. Background

In March 2010, CPA Australia organised four round tables on small to medium-sized enterprises (SME) access to finance. The round table were held in Canberra, Melbourne, Brisbane and Sydney and involved some 60 members who work for or advise SMEs, and who have had recent experience seeking finance for their employer/client.

The below seeks to represent the views of the CPA Australia members who participated in the round table discussions on the access of small business to finance. CPA Australia does not vouch for the accuracy of these views, nor do these views necessarily represent the views of CPA Australia.

All possible care has been taken to accurately represent the views of members expressed in the round table.

Accessing finance is a critical issue for many small and medium-sized enterprises (SMEs). CPAs, as strategic business leaders and finance experts, play a critical role in advising on and assisting business access finance. Our members therefore have a unique and interesting perspective on the issues surrounding access to finance, therefore this document attempts to capture these views for the benefit of the broader community.

We would like to acknowledge the facilitator of these round tables, Jan Barned CPA, who has worked in the finance industry over the past 20 years and the contribution of members who participated in CPA Australia's access to finance round tables in Brisbane (the CPA Australia Queensland Division SME Committee), Canberra (the CPA Australia ACT Division SME Committee), Melbourne (the CPA Australia Victorian Division SME Committee) and Sydney (the CPA Australia New South Wales SME Discussion Group). We would also like to thank those members who contributed their views and experiences through other mediums.

2. Introduction

In March 2010, CPA Australia conducted a series of facilitated roundtable discussions with members working within the SME sector to gather their own or their clients recent experiences with raising finance for their business. These sessions were held in Melbourne, Canberra, Brisbane and Sydney.
The outcomes of these facilitated discussions are outlined below.

Generally, the findings from the discussion all concluded that the pendulum had swung from pre GFC environment of lenders being often too generous on lending conditions to the banks being so risk adverse that many SMEs are finding it difficult to raise external finance. Members reported that businesses have struggled with the tightening of lending conditions, not only because it affected their ability to raise finance but also because they reported inadequate notice to amend their business practices and systems to meet the new conditions.

The pendulum had swung from pre GFC environment of lenders being often too generous on lending conditions to the banks being so risk adverse that many SMEs are finding it difficult to raise external finance.

As a member stated at the Brisbane roundtable 'I think the biggest problem was that the banks were adamant that there were funds available. Yes the funds were available however they lifted the bar so significantly after the crunch came that it made it almost impossible for some successful small businesses to apply for funds. Prior to December 2008, the availability of funds was fairly easy. You basically went in with standard business plan, couple year's financials and they would approve it there and then. What they then wanted after December 2008 was very detailed financial statements, very detailed cashflow statements, and very detailed breakdown and analysis of financial records; information they had never asked for before.'

The main theme to come out of the round tables was the damage done to the relationship between banks and SMEs over the course of the crisis. While members generally understood the need for banks to take a more prudent approach to lending in the current economic environment, such as requiring greater level of security and more information, members expressed the view that banks needed to improve their

transparency and communication on their tighter conditions to business, including providing more notice on such changes.

The roundtable discussions also highlighted a number of other issues that were found to be impacting both potential and existing financing arrangements for SMEs over the past year. These were:

- Banks were still lending however finance is essentially only available where the loan is fully secured by quality assets and personal guarantees
- Increased compliance/information requirements
- The lack of experience of bankers, the high turnover of business bankers and their lack of authority
- Lack of competition
- The economic impacts on small and medium sized businesses

What is interesting to note is that all of these key themes were issues discussed at the roundtable conducted by Minister Emerson on the same topic in March 2009. Given this, some members expressed the view that the banks have done very little to assist in supporting SMEs to access finance during the past year.

3. Increased security/collateral requirements

It is evident from all four discussion groups that the banks are requesting increased security for both new and existing loans. From the inception of the global financial crisis, the banks were acutely aware that the fallout from this event would change the risk profile of most businesses. The first step that they undertook was to review their loan portfolios with additional rigour. The result was many businesses were required to agree to changed loan conditions that included either security that had not been required in the past or an increase in the level of security that supported the loan. For most new financings, security was now essential. As a member who owns a small business based in Cairns confirms 'If you are looking at start ups, if these businesses do not have solid equity in their own homes, which is what the bank wants as security, then the banks will not even consider them.'

Many businesses were required to agree to changed loan conditions that included either security that had not been required in the past or an increase in the level of security that supported the loan.

With their new risk adverse demeanour, that bank's are also scrutinising the types of security that they were prepared to accept. In days gone past, many established businesses were able to borrow from the assets on the balance sheet. Now the banks are looking at the quality of these assets. In particular, intangibles such as goodwill, cash flow and profitability no longer cut the grade as a quality asset. As a Canberra-based public practitioner stated that one of his customers was 'Wanting to purchase another business that had $100,000 goodwill and the bank said 'No way' but when he went to borrow $100,000 for a car, he walked into the bank and within fifteen minutes walked out with the loan for the car. The banks are looking for tangible security and goodwill does not offer that. The banks cannot quantify goodwill and are concerned that the goodwill will walk with the previous owner.' What makes the current situation even more difficult is that many assets have also suffered from a decrease in value during the GFC. When the banks undertake their annual review, they are now dissecting the balance sheet in more detail than ever before and many businesses are finding that the banks were questioning the implied value of the assets used as security and assigning lesser values.

This approach to asset revaluations has been exacerbated by the suggestions that the banks have decreased the loan to value ratios (LVR) as a response to managing the risk profile of their customers. In many cases the consequences of such action is that the banks are now asking for more security. Such requests may be indirectly affecting cash flow as a member in Brisbane points out: 'small businesses are required to use personal assets to secure loans, such as the family home. With the decreasing value of some of these assets, the banks are now saying that the business has to reduce the level of debt to met decreasing LVR and asset valuations and this is having a major impact on cash flows of small business.' (as they will probably have to use cash to repay debt rather than use it in the business).

Many of the attendees at the roundtables discussions also mentioned that there has been a demise of cash flow and profit lending. The Canberra-based public practitioner stated 'The banks are less willing to lend for future expansion for business where the serviceability of the loan will be tied to future profitability, even where the owner is a very experienced business operator' and a Queensland member goes out on a limb by stating 'Any bank that is telling you that they will do cashflow lending is lying.' They are lending against tangibles that they have a legal right over – the intangibles that they previously used as security has now stopped.' Simply put, the banks want solid security that will provide a 'real' cover for any loan default.

The same member believes 'The current practice of the banks is that they have gone too far. They are only looking for security – if you are a property borrower they are doing 50% LVR, if you are lucky. If you have any other type of business, they will only lend on 80% of your debtors.'

However, as the Canberra-based public practitioner notes, the requests from the banks for additional security can also provide the business with funding that is better suited to the purpose, as was the case for one of his clients: 'The client wanted to extend their current overdraft facility from $250,000 to $ 650,000 to cover the $450,000 for fit out of the two shops [the lease on the shops require a fit out every five years, so the effective life of the fit out is five years]. Last week the bank came back and said that they were withdrawing the overdraft and that the owner now had to take out a lease facility or some other loan facility to cover the $450,000 over a two, three or four year period. The client wanted to keep the full $650,000 facility overdraft, but the bank was only prepared to allow the original $250,000 overdraft. The terms and conditions offered by the bank are very fair and reasonable. I think this is a good thing [as the loan better matched the purpose for which the funds were to be used for], but it is not what the customer wanted.'

The requests from the banks for additional security can also provide the business with funding that is better suited to the purpose.

The roundtable discussions uncovered that in addition to tangible security, the banks are also asking for personal and directors guarantees. Although this is not something totally new, a surprise finding was that a number of the members had also been asked to provide key man insurance. One member shared that 'We did have to try and restructure some of our debt and with that came the personal guarantees from all the directors that had not been in place previously. They were asking for more security and they even asked for key man insurance.' This is insurance covers the key personnel in the business and provides the banks with some certainty that the business will continue to operate under the current management. This type of insurance is quite expensive and of course the cost is borne by the business not the bank.

The upshot of these additional security requirements in many cases is that the businesses are now handing over all of the available security to their bank, which in turn will limits their ability to switch banks. When this point was raised, the Canberra-based public practitioner agreed and even questioned the impact on the SMEs ability to seek competitive finance 'That's exactly right – you cannot go elsewhere because you do not have security to offer and this [inability to switch] removes the negotiating power.' The other area associated with the banks securing all of the assets as security, is that this can increase the SME's risk. The inability to diversify their banking facilities (because all the security is held by the existing bank) may have dire consequences in the shifting appetite of the banks. One CPA confirmed that there is risk in banking with only one bank 'What happened was the bank just fundamentally changed its' mind – it said, I don't want to bank you anymore.'

4. Substantial increase in compliance

The overwhelming response from all of our discussions was that the banks are asking for additional information from business. Obviously with an increase in the perceived risk, the banks are supplementing the level of security with more detailed financial information from the business. Members also reported that the regular reviews that banks undertake of loan facilities are at a more detailed level than ever before, with not only past financial statements being requested, but budgets and forecasts, in particular cash flow forecasts. The banks are in the business of lending and are looking at the ability of the business to service the loans, particularly under this new regime created by the global financial crisis.

The Chair of the Victorian SME Committee confirms this (when speaking about her employer): 'There is no question about the debt coverage because our financials are very strong. The issues are around the fact we have moved to a new risk assessment and all our loan compliance is sent to Head office and they are sending down more detailed requests for more information.' A Queensland member agrees 'They said that the risk profile had changed, and therefore they had to be more discerning in how they evaluated applications for credit. In our own business, they started asking for information that they had never asked for before.

They were always given an abridged version, however now they wanted much more detail.' The Chair of the Victorian SME Committee also mentioned that her banks had asked for access to the business's ATO portal, a request that a number of the participants at the roundtables had also experienced.

What poses as a potential trap for SMEs is the fact that pre GFC banks were not necessarily enforcing compliance requirements and this has created a dangerous environment for businesses that may not be aware of their obligations. The Chair of the Queensland SME Committee makes the observation 'Often it is only when business is faced with risk of insolvency, that they find out what is in their covenants and this is when their banker finds out too, because it is actually only credit department back in the bank that understands this stuff. This department changes the rules and the manager then has to come and tell you that all is changed.' However in response, another Queensland member pointed out 'They don't change the rules, they apply them. Most SMEs don't understand that really their loans are at call at anytime and it does not have to be a practical default, it can be a technical default and the banks are really good at issuing letters of non waiver – in other words, we will let you run on until we are ready to pull the rug. So the real issue that goes back right to the beginning is 'What are you signing up for' which is the old Caveat Emptor – let the buyer beware.' This view may well be confirmed by one members own experience 'We did have quarterly reporting and we had to meet certain covenants. They had, up to that point, given us a lot of flexibility. Then it became black and white. There was the threat of breach notices if it went beyond what we should have been going beyond.'

> This has created a dangerous environment for businesses that may not be aware of their obligations.

In addition to enhanced reporting requirements, there was agreement among the members that the banks are now requiring additional information that is outside of the current loan agreements or covenants. With both the level of information and frequency of the provision of this information on the increase, one member suggested that the banks are in fact testing the real need for funding 'I think they are trying to create a workload for small business that was beyond their means and then was pushing them to the bounds of whether they really wanted the finance or not.' With the GFC creating new challenges to SMEs, those who have obligations to banks have been really starting to feel the extra burden that comes with meeting bank requirements.

As resources start to be stretched to the limit, preparing additional information to support loans members hold the view that these requests are beginning to impact on the overall operations of the business and in many cases increase the costs. The member who owns a small business in Cairns comments: 'Many businesses have had to let go staff which means that the business owners are now back in their business working. This means that they do not have the resources or the time to prepare the extra information if they don't automatically do it anyway.'

Another Queensland member also points to the direct cost factor under these conditions: 'The [extra reporting requirements] has put an extra burden on a lot of small businesses that were not (appropriately) geared up to provide (the banks with) these extra requests. In my experience, they then had to seek requests from practitioners to prepare the extra information to send into the bank, which then cost them.' A public practitioner from Melbourne confirmed these additional costs have the real potential to impact cash flow: 'My experience is that SMEs with turnover in the $10 to $20 million range, if they were established businesses with established relationships and existing facilities in place, survived quite nicely. However at a time when they had cash flow issues and needed more funds, then the banks would put pressure on them for more security, stricter covenants, increase in reporting requirements including audit obligations that the customer had to meet. The banks have often appointed one of the big four accounting firms to undertake an audit at a cost of $10,000 to $30,000 a quarter to the customer.'

What was very interesting during our discussions was the number of members that actually questioned the usefulness to the banks of this additional information that is being requested. A member working for a Queensland-based mining company comments 'They don't seem to understand what is in the forecast, because they keep asking questions – they just don't seem to get it. I don't think they know what they are looking at, especially for a mining company, unless they have a background in mining. We have been trying a new business model and parts of this are untested, so even the management cannot guarantee the outcomes.' And the chair of the Queensland SME committee agrees: 'I would say it's not just extra requirements, but the very fact that no one knew what was going to happen six months time, yet someone at the bank said you have to forecast it and tell them what you thought on what your earnings were going to be. How can they do this when no one knows – the banks did not know - Ben Bernanke has not got a clue - so how do they think that the business owners will know? But still they ask nonetheless.'

“It’s not just extra requirements, but the very fact that no one knew what was going to happen six months time, yet someone at the bank said you have to forecast it…”

Another member from Brisbane asked the poignant question ‘Do the banks measure the forecasts to actual results?’ and the answer was ‘No’ however another member did clarify the use of such additional information in his view ‘The moment you have an investigating accountant assigned to your business is the day that you will find your forecasts pulled apart. Not last month or the month before, but going back twelve months. They will actually engage external accountants to ask the questions about what is going on. So, there is a very fine line to what I would call the ‘rope’ to which you can continue to lead yourself out and then there’s the time when the rope gets yanked, and then it’s a very painful experience for those involved.’

We did ask the round tables if SMEs should be preparing this type of information to support business practices, and a number of members were quick to reply that due to the size of SMEs, in most cases owners and operators have a good handle on where the business is at, even without this level of detail. One member provides an interesting take on this topic ‘I have not met a small business owner yet that does not know more than the accountant. They have the answer before you even show them the numbers.’ Another member states ‘I believe that this is where the psyche of big business differs from small business. Small business is much more attuned to who their customers are and how they operate than big business. Big business is normally one, two or three times removed from the client.’

The same member also believes it is not just the numbers that the banks are struggling to understand: ‘I think it goes further than what [the members] are saying, not only do they [the business banker] not understand the numbers, they don’t understand the nature of the business. They may see a hairdresser this morning, a cafe at lunchtime, a retailer in the afternoon and they cannot get their mind across the variety of industries that small business is in and I think that this then raises the risk profile across the board for all SMEs.’

Most of the members attending the round tables did have a view on the increase reporting requirements and not all was negative. ‘In some sense I don’t think that the bank asking for extra information is necessarily a bad thing’ is the view of one member which another member supports when he stated ‘I think the banks are now doing what perhaps they should have always been doing. They are now reviewing the information that you have been casually giving them over the past few years, you cannot begrudge them that.’

“I think the banks are now doing what perhaps they should have always been doing”

Perhaps the following observation from one member may provide insight into the rationale for increased reporting: ‘The banks are asking for more detail than before on regular reporting – I believe that this is a way of gauging how confident you are. So they ask a question and if you tend to load them with almost too much information, they back off. It comes to a point where they don’t understand the business, and so they have to have confidence in the people – I think at the end of the day that’s a lot of it – they have to have confidence in you and you have to tick all the boxes.’ Perhaps this is why we are seeing an increase in the requests for key man insurance?

5. Bank staff experience, turnover and authority

During the discussions on increase compliance requirements, members consistently commented on the lack of experience of business bankers. A representative of one of the major banks at the Minister’s round table in March 2009 provided one reason for this when he commented that due to staff turnover at the bank, many of their bank managers have less than three years relevant experience. Members experiences over the last twelve to eighteen months indicates that there may well be the demise in the traditional banking relationship between the bank manager and the customer. With the higher level of reporting and more rigorous reviews, coupled with a perceived shift in risk profile and inexperienced bank managers, bank credit teams are playing a larger role than ever before in loan evaluations, both new and existing.

Members experiences over the last twelve to eighteen months indicates that there may well be the demise in the traditional banking relationship between the bank manager and the customer.

One Canberra-based member notes the importance of the traditional banking relationship and the changing landscape: 'What used to happen, was you would walk into the bank and you would shake the bank managers hand – you knew the bank manager for the last six month, years whatever. Now when I walk into the bank, there is no one there. They don't know you.'

But just how important is the lack of a long standing relationship between a bank manager and a business? As the same member went on to state 'In the past the bank manager would go out on the line [to the bank's credit department] and say 'These are good customers' and you would go and talk to the bank manager and you could get a loan on your creditability, but now, it appears that bank managers do not have the expertise to assess business loans appropriately, no matter how experienced.' One member even went so far as to comment 'They deliberately put managers in branches that have either no authority or no expertise so they simply cannot approve a loan. I think that's a policy.'

The level of experience of the bank managers has, in many cases, led SMEs to dedicate additional resources to educate them on how the business operates: 'The experience of the banker in my previous employment was very good. He would come out and I would present him with a pack and we would discuss it together. He was then redeployed and we started to get new relationship managers through. I had to explain the numbers; they did not understand the business as well. So at the time when you are asking for additional funding and you have to explain the business as well to people that are not familiar with it, there was that double frustration. They were inexperienced in reviewing the financials from a credit risk perspective.' one member confirms.

The other issue that surfaced when discussing bankers experience was the authorisation policy. In particular, during the discussions in Brisbane, where two of our members came from regional areas, it was noted that regional managers are referring business back to capital cities, which in some instances could impact on the how the business manages the relationship. A Rockhampton-based member notes that for their business 'Our banking is all done in Brisbane, not in Rockhampton. Our CFO is based in Brisbane and his job for the last six months has been to talk to the banks constantly.' Although some would argue that this should be one of the roles of the CFO [Chief Financial Officer], it appears that the banking relationship has shifted gear since the beginning of the GFC and can be, in some instances, very demanding on the resources of the business.

Our members in Canberra have had similar experiences. One Canberra-based member states 'Part of the issue with the banks in Canberra is that everything is referred to either Sydney or Melbourne and this is most likely the issue with most regional centres' and another Canberra-based member pointed out that this then can threaten the loan application process 'You are hard pressed to find business managers, or account managers [with a bank] that have the background and skills to argue the toss with head offices.' The real issue for these regional centres is that when a portfolio is referred, then the likelihood that each individual business will be assessed on the merits of the business is reduced. As the Canberra member says 'It then becomes a real issue of 'tick the box'.'

Interestingly, at the Minister's roundtable in March 2009, the banks were adamant that the demand for finance had decreased. At the time, the representatives from the industry bodies argued that this was, in part, due to the 'tick the box' mentality that had surfaced in the face of managing changing risk assessments and that demand had not changed, it was simply the fact that most applications were not meeting the standards set by the credit departments and therefore, the applications were never processed. When we raised these differing views with the members, the response was that both were correct. As one member stated 'I would say that both demand has dropped and also the compliance issues have come into play. Some tasks that were marginal when the boom times were on just are not possible now under the current economic conditions, the price isn't there in the market.' One member from a large business who attended the Brisbane round table stated and other members agreed that business is just disinterested in going to the banks because it is too much hassle and too much expense to have all the information prepared. With manager's time poor, it is easier to finance the business internally. These businesses have not even bothered to go to the banks.

What becomes critical under current circumstances is how the information is prepared and presented to the bank. A Sydney public practitioner believes this is a particular issue for micro businesses 'They don't even know how to approach the bank in the first place. There is no assistance out there to tell them what they will need - for example, three year financials, three years of tax returns, a business plan etc. They don't know how to do it and currently they are too busy trying to survive on a day to day basis to be able to do it.' A Canberra public practitioner does provide some practical advice 'Presentation is everything. You have to have cash flow forecasts, figures, everything that is in a good light – the more paperwork the better. They even want to see photos – really the best presentation they can get. If you are lacking on anything to do with figures or forecasts, you have no chance. Even though they are taking on larger portion of security, they still

want to see forecasts because they would much rather see you pay back the loan than foreclose and then they will keep you as a client.'

Presentation is everything!

It therefore appears that the lack of experience by many banker managers and the elevated level of information that is required is placing additional strain on SMEs to service the needs of the banks and ensure that they can continue to access appropriate finance during this time.

6. Lack of competition

One of the first responses to the global financial crisis was that some foreign banks pulled out or reduced their exposure to offshore lending in a bid to ensure adequate finance was available to their domestic customers. Australia was not immune to this move and the presence of foreign banks has reduced. This coupled with the mergers of a number of second tier banks with major banks has resulted in a reduced range of possible lenders.

One member stated that 'The government has failed by allowing the big four to take over the smaller banks like BankWest and St George. What they should have done is follow the example set by the UK and taken these banks over and kept them until some improvement. This would have kept the competition in the market. There is definitely a lack of competition.' The Chair of the Victorian SME Committee agrees 'When we were getting competitive quotes for funding for an investment, we found that there would be two banks close together, and another two further apart, but the gap between the two groups was substantial. The goal posts have shifted and what tells me is that there is less competition out there.'

Some members stated that the root cause of the issues discussed in this paper is the lack of competition. This has resulted in a shift of power to the banks that is impacting on SMEs ability to negotiate competitive deals. As a Sydney-based member states, 'A lack of competition is still going to be a problem. Now with a number of the second tier banks gone, the major four will just sit back and dictate what they want. I think that there needs to be viable alternative sources because then the big four will actually have to work for their market share.'

Some members stated that the root cause of the issues discussed in this paper is the lack of competition.

It appears that the lack of competition has also impacted the role of the finance broker. With resources dedicated to the increase in compliance and other bank requirements, coupled with the limited ability of some SMEs to appropriately assess finance alternatives, a number of members believe the role of the finance broker has been critical to these businesses. However, the loss of a number of second tier financiers has resulted in limiting the offer that the finance brokers have available, as a member who attended the Canberra roundtable observed 'They do not have the variety on offer to give alternatives and due to lack of competition, the offers are not as good as they used to be. Also, these brokers are at the end of the chain, so when they are applying on behalf of a customer, their application is, in some instances taking up to six to eight weeks to assess when previously it would have taken two weeks. Many small business owners rely on brokers, as they are doing everything for their business and therefore it is beneficial for them to use brokers.' This then raises the question as to whether SMEs have the ability, given these circumstances, to optimise their financing arrangements.

With the role of the finance broker limited and the lack of viable second tier financiers, the ability for business to switch financiers comes into question. Asa prominent Queensland member points out 'The government was well intended when it said a few years ago that it would make switching banks easier. However no one took account of the huge opportunity cost, particularly the government when the small business has to go and start looking around to get another finance facility. It's not only the business finance, but also the personal, all the ancillary finance and hire purchase etc., that needs to be changed and they just don't have the time, particularly now when the business owners have been required to work back in the business and have the extra burden of the additional information required by the banks. In addition, with small businesses required to use personal assets to secure loans, switching carries large costs.' Another member agrees 'This is good point on costs. There is a large cost associated with transferring banking – stamp duty in particular. So, the business owners then say, why should I spend $ 100,000 to transfer my banking across?' Therefore, potentially, the banks have certain leeway to leverage up their requirements on businesses in the form of fees, information, security and any other compliance requirements, which could be difficult to work around in a cost effective manner due to the lack of competition and costs associated with switching financiers.'

7. Economic Impact

The new tighter credit conditions have created many flow-on effects for SMEs. From our discussions with members, it becomes apparent that businesses are being faced with a number of different challenges during this time of transformation.

Businesses are being faced with a number of different challenges during this time of transformation.

Until recently, Australia had been in one of the lowest interest rate environments in history. One of the more surprising outcomes from the roundtable discussions was that during this low interest rate period, most members saw an increase in cost of funds for business. The Chair of the Victorian SME Committee stated ‘It is more expensive to borrow in the low interest rate environment, than it was two years ago when rates were higher. The margins are higher, the fees have increased, even with more reporting and increased security’ Another member went so far as to say that the banks had taken advantage of the situation and repriced risk that had previously been underpriced.

The banks may argue (reasonably) that this was due to the change in risk profile brought about from the GFC, however one member had a differing view to this point, claiming that the tight credit conditions allowed the banks to re-evaluate lending criteria, which in some instances highlighted that fact that they had lent to SMEs that never should have had finance in the first place. A Victorian public practitioner believes that the banks simply used situation to improve their positions ‘I think that this has been a good opportunity for the banks to restructure loans, and if they had any gaps in terms of their security requirements, to make sure they tightened all those up. So I think that in the end it gave them an opportunity to clean their act up at a time when the customer was at their mercy, and would sign just about anything, especially if they needed any increase in facilities or additional funding.’

Whatever the reasons for increases in cost of funding, one of the more important outcomes from the increase in costs is the impact on cash flow. Feedback from our members suggests that with many SMEs already struggling from a reduce level of demand and tight cashflow, in an environment where finance has been difficult to access and/or service, their focus has shifted to assess alternative ways to finance their needs. This is a direct result of the current credit market conditions. As the Chair of the Queensland SME Committee concedes ‘We are talking about access and access is not just the banks having money. The reality is if you put up the price of the drawdown, make it half a percent, if you put up the registration fee, if you put up the other charges for investigating and evaluating the business, if you have more in holding fees then that puts up the cost of finance. They have ratcheted up the physical margin of the loans, and they have gone security heavy, so now people just look at this picture and say equity is cheaper. It’s cheaper to put my own money in, ask shareholders or frankly, just don’t bother with the growth. So that’s what has happened.’

Another member confirms that their bank have ratcheted up the equity requirement post GFC ‘Subsequent to the GFC [although the facilities had been approved pre GFC], they are now requesting that we fund some of the construction from equity, despite the fact that they would have security threefold of the value of the construction value.’

A Queensland member provides insight into how increases in equity requirements are becoming common place to manufacturers out of necessity: ‘If you are a manufacturer in this country and rely on work in progress (WIP), there is no one in this country that is financing WIP. So these businesses are faced with the task of building up equity to fund WIP and then hopefully finance under factoring for 30 days – most WIP is 90 days plus.’

Various members confirmed the view that tighter credit conditions are impacting the working capital of many SMEs. It was suggested that in some instances, the banks were actually dictating what terms and conditions the business is to impose on their suppliers. The Chair of the Queensland SME Committee states: ‘We saw a $15 million increase in working capital needs in four months because between insurance companies and the banks they tightened all of our supplier’s terms and therefore our creditors days went from 47 to 28. They said if you don’t do it then we won’t supply, it’s as simple as that.’ The member at the same round table adds: ‘and our debtors days went from 47 to 62’ Such dramatic shift in operational trading terms, at a time when many were unable to find finance, can only exacerbate cash flow issues, particularly with SMEs who are often undercapitalised anyway.

However not all the conversations were 'doom and gloom'. A interesting perspective was provided by a representative of a large logistics/transport company. He shared with the Brisbane round table how his employer was supporting customers who have cash flow issues: 'What I have seen is twofold, businesses struggling for working capital [even though they were highly capitalised] and businesses struggling for growth or tangible capital. I worked with our customers more to fund working capital, through the provision of more generous credit terms or extension of credit limits.'

The member went on to say 'We had a lot of customers come back to us and say that they were cutting costs. I think some businesses have been a bit slower in this area and are only just now getting around to it. A couple things happened. A couple of customers came to us seeking help to shorten lead times in transit. Transit time is a big player in inventories. So, by shortening their lead times and shorten their transit times they were able to decrease their inventories and reduce their warehouse costs - that was mostly the east coast customers.

The east to west coast customers actually extended their lead times. They reduced their warehousing capacity by extending lead times through the utilisation of slower modes – the result was for most they gained two weeks free warehousing. So they could put half their warehouse into containers and instead of putting it on a train [which takes about two weeks], they put it on a boat to Perth, which takes about four weeks to Perth. The other thing we did was offer free warehousing at both ends and that was our way of increasing market share, as the smaller transport companies did not have the capacity to do so. This enabled them to either do away completely with the third party warehousing provider, or downsize their own in-house warehouse. In summary, we assisted our customers cutting costs, providing warehousing, inventory management and providing improved working capital (and hence cash flow) through increased credit limits and extended credit terms.'

A member working for a mining business also shared how his employer had used alternative financing arrangements to assist with working capital requirements 'Another thing that we have done has accessed trade finance for our exports – as soon as the stock is on the water, then we receive the funds from the bank. The goods could be on the water for six weeks and then with the customer for another 60 days and then they pay us. This has helped cash flow quite a bit.'

In Sydney, a senior member suggested that SMEs should look towards alternative forms of finance to substitute bank funds that now carry heavy compliance burden and higher cost. The member spoke about funding the business from the debtor book. He believes that this is a viable method of finance, particularly where a SMEs has quality customers on their books. Although the member conceded that most financiers will only finance to a possible maximum of 80% of the value of the debtor book and that this type of finance usually does not come cheap, he made a valid point that for those SMEs who were looking for new facilities, then the barriers to entry on these types of loans are likely to be a lot lower than the financing requirements the banks are demanding.

One Canberra-based member showed real concern for the flow on effects from the tight lending conditions of the banks. In particular, he explained the impact on business as a result of banks now only lending on tangible security: 'I have had three clients in the last twelve months that have attempted to purchase new businesses, all experienced business owners and they have had to pull out of the purchase as they could not access finance through the banks. The banks cannot quantify goodwill and are concerned that the goodwill will walk with the previous owner.' He then reflects on possible further impacts to business 'This then causes older entrepreneurs looking to retire with successful businesses, issues as the banks will not lend against goodwill and therefore they cannot sell their business. How are they going to sell the business?' A Sydney member elaborated on the possible macroeconomic issue this may cause 'The fact that SMEs are big employers and if they cannot sell their business they may just have to close their business down, then that's jobs lost.'

Members agreed that most in this sector were not in a position to move forward with growth. The reasons given varied, however all agreed that the common issue was the uncertainty of the economic environment and the limited ability to access finance to support expansion. One Victorian member confirms 'Our customers were not in growth mode. If they had plans to grow or invest they stopped. There were very few transactions in the market - people did not want to buy at even bargain prices'.

> "Our customers were not in growth mode. If they had plans to grow or invest they stopped".

A Queensland member observes how this lack of growth has other potential economic outcomes 'With SMEs not growing, the flow on effect is that the order books are stagnant, no growth in GDP, they are not expanding their business, if anything they are contracting their business and this impacts importers, manufacturers, and all businesses associated with SME business and then this becomes a slow stagnated process and it will take a lot to get this rebooted.'

8. Conclusion

The round tables on Access of SMEs to Finance has provided an important and interesting insight into the current challenges being faced by SMEs. The participating members have provided valuable contributions that should be considered by all members working within this sector and we thank them for this.

Members participating in the round tables were invited provided concluding comments. The following comments broadly represent the views put across at the round tables:

- 'I think it is returning to normal – the pre GFC conditions were never going to be sustainable set of conditions. We are now in the phase where you need to have very good creditability with the bank. With limited funding from offshore banks available, it's not surprising that there is no money in Australia for easy lending. I am not sure what the answer is, but I suppose what I am saying is that I am not surprised by where we are.'

- 'The banks have been in a state of fear for about two years. The first year they were in a state of fear that they would collapse. Through that fear they started to put a lot of pressure on their clients, in particular the corporates, because that was where a lot of the money was outstanding. The corporates then responded to that by going to the equities market and paying back a significant proportion of the debt. So, when the banks say they have money to lend, that's right as a lot of their book has been repaid. The banks are now concerned that medium size businesses will also repay and this will mean that they will have too much cash. But the flip side to that is that they are too scared to lend because we are now passed the phase of 'everyone chip in' to get past the 'Oh my goodness' moments, to now 'Who's fault was it?''

- 'Most SMEs have looked at it now and said being in a much more conservative debt/equity position makes sense. When tricky stuff comes your way, you don't have as much debt on the books because it is too pricy when the trouble comes.'

- 'Some of my clients are looking to stay in business only until they can sell and retire – there is no longer joy in running a small business – too much regulation, not enough return. They cannot get good staff to run the business. It is too much hassle and therefore they are not expanding. Most just want to cut back.'

From these views, it is apparent that the times have changed for SMEs and that a 'new normal' is probably going to be what they will have to work with.

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APPENDIX B

Corporate access to finance roundtable:
A detailed summary
August 2010
A joint roundtable hosted by CPA Australia and Resources Global Professionals

In August 2010, CPA Australia in conjunction with Resources Global Professionals conducted a round table discussion on the recent experiences of corporate entities accessing finance.

The discussion was conducted in Melbourne and involved 18 senior finance executives from Australian large businesses and Australian subsidiaries of foreign large businesses. The businesses represented were from a range of sectors. Jan Barned of Financial Management Trainer facilitated the discussion.

CPA Australia also conducted a series of round table discussions on small business access to finance in March 2010. A summary of those discussions were attached to CPA Australia's submission to the Senate Economics References Committee inquiry into small business access to finance.

1. Key observations

- debt markets had changed quite dramatically during the global financial crisis (GFC) and as a consequence, the GFC was an extremely challenging period for corporate financing
- as a direct consequence of the GFC, many markets in which corporates had accessed in the past became very difficult to access or closed
- lenders had been too generous with their lending conditions in the period leading up to the GFC
- while participants found accessing finance very challenging (and in some cases unnecessarily challenging), many participants were still able to access finance, but at higher costs and on stricter conditions than prior to the GFC
- corporates worked hard to improve their relationships with their banks
- corporates focussed on improving their working capital
- for many corporates, the Big 4 Australian banks became the only viable large scale source of funding
- compliance requirements increased but large organisations generally had the resources to manage the increased burden
- corporates were concerned about the lack of competition in the debt markets – not only a reduction in the number of lenders but also the closure or limiting of other funding sources such as bond markets
- basic corporate finance fundamentals made a come back

2. Introduction

It was agreed by the participants that attended the round table discussion that the debt markets had changed quite dramatically during the GFC and as a consequence, the GFC was an extremely challenging period for corporate financing. As a direct consequence of the GFC, many markets in which the corporates had accessed in the past became very difficult to access or closed, in particular offshore funding, bond markets, commercial programs and securitisation loans. As one participant noted "*We used to access funding through a number of sources, foreign sourced capital markets – that basically closed ... and when our bonds matured we no longer had access to these because the banks didn't refinance.*"

The participants in both the small business access to finance round tables held in March 2010 and this round table noted that lenders had been too generous with their lending conditions in the period leading up to the GFC. Participants in both round tables also agreed that lending conditions had become very challenging however, unlike their small business counterparts, the corporate participants were less likely to state that lending conditions had become too tight.

Participants in the corporate roundtable were still able to access finance, but at higher costs and on stricter conditions than prior to the GFC. As one participant stated: "*They were very lenient in giving money to basically anyone who wanted money in the past - it was quite easy to get money, and covenants were very light, all documentation was light. Ultimately the banks got burnt by a lot of organisations once the GFC took hold. In response we felt they implemented a blanket approach of saying that everyone who does not have an investment grade rating, we want this as minimum and if you cannot do this, then we won't bank you.*"

In contrast to the round tables held with the SME sector, where there was extremely strong opinions expressed that the banks had not done enough to support small business during the GFC, participants took the view that they understood why additional requirements were being imposed and it was in their interests to meet those additional requirements so that finance continued to flow. This however is not surprising given that larger organisations have (in most cases), the capital base and resources to take this approach.

The key themes that were discussed during the round table discussion were:

- banking relationships
- increase in compliance and funding costs
- balance sheet management
- working capital management
- the outlook for corporate financing

3. Banking Relationships

Much of the discussion during the round table focused on managing banking relationships and in particular, the relationships with the Australian big four banks. As a direct result of the GFC, many international funding sources 'dried up' for Australian based corporates. Many corporates were forced to rely on funding from domestic sources. In other words, the Big Four Australian banks became the only real source of funding. Managing banking relationships and the importance of the Australian banks therefore proved to be a key learning from the GFC for the larger corporates.

As a participant from an Australian Securities Exchange (ASX) 100 company noted, *"The majority of our funding was from the global capital markets. When the crisis hit, the banks that ended up supporting us were the local banks. The international banks retreated to their home markets where they got support from their governments. So the market although stabilised by the implemented regulatory framework as a result of the GFC, was still very much domestically favoured. The only source of liquidity that could be sourced reliably was provided by the big four banks – that's a large lesson to learn for an Australian corporate. Irrespective of what size you are the ultimate source of liquidity, and that's what you need to get through this crisis, is the big four banks."*

The only source of liquidity that could be sourced reliably was provided by the big four banks – that's a large lesson to learn for an Australian corporate.

Many of the participants found that although the primary source of funds was now being provided by the Australian banks, this did not necessarily mean a smooth ride when accessing funds. The GFC had changed the banks approach to risk, even at the corporate level. Their response was perceived to be reactive, to the point that a couple of participants stated that the banks actually over-reacted: "*The banks, well I won't say they took advantage but they seemed to panic a lot.*" A view confirmed by another participant, who stated: "*Our experience is that the banks attitude has changed more so from before the GFC – they are more impatient. The bankers panicked and pulled the plug ... that was more evident from the northern* [US and European] *banks and they felt that the GFC in Europe and US is the same in Africa and Australia to. So the GFC has changed their attitude and they are not prepared to wait anymore, they want to go in while there is some money in there.*"

Of course, the banks themselves also experienced difficulty during the GFC. They too found it challenging to source funding, with the funding they sourced often being more expensive. In most cases this lead to a restructure of their own lending portfolio to reduce risk, as one participant confirmed "*What we found was the banks measured the profitability of their portfolio and if you fell outside the top 100 then they were basically happy to let you go*".

The importance of the big four Australian banks during this time also lead to the realisation by the participants that they needed to reassess their banking relationships and how they managed such relationships. Opinions varied on this particular issue, some dedicated additional resources to maintaining and developing their banking relationships, whilst others simply found the requirements imposed by their lenders too difficult and actually walked away from some of their banking relationships.

One CFO from a large service provider expressed the following attitude towards banking relationships: "*Our experience is that you do put in the investment in the relationship* [with your bank] *as much as you can through all phases of the cycle, particularly through the good times so that the relationships can give you a return on investment when things get a bit tougher. That's certainly been our experience in the last eighteen months.*"

"*It is important that you have very strong and frequent lines of communication with your bankers, and at various levels in the bank. You need relationships at different levels, so you're not stuck with the one person you know who happens to move on. You need to be proactive and we treat the bankers with the same importance as a shareholder because they are a provider of capital. It is important that you regularly meet with them, give them business updates, so everyone works on a no surprises basis. If that means more compliance and more resources to give them more information and more reports, then that's just the way it is. I think you have to have a mature attitude to that and regard it as any other investment that you will get a return on.*"

It is important that you have very strong and frequent lines of communication with your bankers, at various levels in the bank.

Of course it is fair to say that not all businesses will have the resources available to manage their banking relationship in this manner or in some cases the knowledge or experience. As one attendee noted: "*Unfortunately for the SMEs that don't have the luxury of the treasury function then they are the ones that are really struggling because they don't have the level of sophistication on how they run their financial aspects of their business. They were at the mercy of the bankers. In most cases they did not have the knowledge or know how to work with their relationship banker or talk to a different level within the bank and that's why there is this high level of angst and anxiety.*" This point was confirmed by the participants at the small business access to finance round tables held in March 2010.

It appeared from the experience of the members that the banks were very focused on particular industries when working through this period, a point that the participants in the small business roundtables also noted. One participant from a manufacturing company shared this: *"We found the banks were just absolutely shocking to speak to, they had no interest, the terms – they wanted quarterly reporting and board statements, share pledges, it was a never ending cycle. From a risk perspective they were just not interested in having a manufacturer on their books. They said that if things go wrong, we don't want your hard assets. Its been an absolute nightmare. Well, I left the market nine months ago – I gave up*." Another participant sympathised "*We were trying to complete some transactions through the middle of last year that just were not going to happen, so we went around to other banks and they were all saying there was opportunities there but once you got down to the nitty gritty it was status quo. So we actually withdrew from the relationship that we had with our bank.*"

Its been an absolute nightmare. Well, I left the market nine months ago – I gave up.

It was interesting that one participant who experienced difficulties in their banking relationship took this as an opportunity: "*We saw it as an opportunity to go to another bank. Our banker got really tight. What they wanted was more stringent, they tried to get our partners to put more equity into the business and they would not fund us the way we did and so we saw this as an opportunity to move to another bank that we had wanted to move to anyway because we thought they know our business a lot better and they had much better terms*."

The level of experience of the bankers was also discussed and it was evident that large business's were exposed to the same issue of inexperience bankers that was noted in the small business round tables. Although it could be assumed that banks would have experienced relationship managers managing relationships with large organisations, this was not the case experienced by all participants.

It was this lack of experience that many saw as the significant cause behind their difficulties many experienced with their banks. As one participant noted "*A relationship manager who has had real credit experience is worth so much more than any other banker. We have had a couple of them, however every time they are really good they are put back into credit. So we lose them again and those are the ones that are worth their weight in gold.*" One participant became so frustrated with their relationship banker, that they organised for the banker to be removed from servicing their business "*I had an experience with one banker that just wasn't in touch and was able to use this time to remove that banker and get another one because they just did not understand the business and tried to put you in the category of what they thought you were rather than trying to work out what your business is all about.*"

Many participants expressed the view that the credit departments of banks were driving their business relationship – more so than prior to the GFC. As one participant noted "*Credit was king as they were the ones making the decisions*".

Credit was king as they were the ones making the decisions.

It appears that although the corporate sector in general has more resources to dedicate to the financing function than SMEs, they were still surprised by the lack of support from their banks. It would be fair to say from the discussions that many of the corporates have been forced to reassess the relationships in place prior to the GFC. The positive to emerge from this is that the relationships that they now have in place seem to be more attuned to their business. As one participant points out "*We could see this wall coming up in 2008 and early 2009. Basically it was a global thing so it didn't matter if you were in Europe or the US, the experience was the same everywhere and you begin to really understand which banks are good. The ones that supported us during this time, we knew they were the good banks who really understood our business and would be there for the long haul.*"

The ones that supported us during this time, we knew they were the good banks who really understood our business and would be there for the long haul.

The banks too are now assessing their relationships with corporates in a more targeted manner as noted by one participant, "*The banks are being more proactive in managing their risk; they are checking with our clients more regularly on what is going on and looking at the operations more deeply and working more closely in a practical way*".

One participant provided some advice to the group that drew on the experienced gained during the GFC "*You have to say, if they are still lending then they are still worth talking to. It is really up to you to look after what you have got and to start to build on it. Ask questions - Can I have some more? - What about a rate review? - things like that. – Or if I do these things will this trigger a default. It now becomes a constant relationship thing that you have to manage – you cannot neglect them.*"

This participant's experience with his banking relationships has certainly changed the way he looks at financing, confirming that the GFC has resulted in some large businesses now more focused on relationships than the best deal on offer: "*It's all relationship driven and because of the support we got from moving banks and the relationship we have now formed, it is too important to break. We wouldn't want to look outside of that no matter how good a deal was.*"

It's all relationship driven and because of the support we got from moving banks and the relationship we have now formed, it is too important to break. We wouldn't want to look outside of that no matter how good a deal was.

4. Compliance and cost of funds

As the GFC unfolded, it was apparent that the banks were reassessing their risk portfolio and most of the participants confirmed that compliance requirements and pricing changed: "*What we found was they would say we are happy to lend but it's at 400 basis points – our agreement, our conditions, take it or leave it.*" This can be attributed in part to the poor portfolio management by many bankers prior to the GFC.

Prior to the GFC, bankers were working in a competitive market with low funding costs – this saw many banks relax basic credit assessment policy to chase business. As one participant confirmed "*I have seen clients who had banks throwing money at them at ridiculously low margins and they thought it was never going to end. It was a theme and thought process, particularly with some of the medium businesses with the banks and the relationships managers encouraging them to take more money. Then all of a sudden it just changed overnight. I think everyone was swept up in "It's never going to change, it's Australia you know, it's the lucky country." The businesses in many cases did not understand the terms and conditions they were on.*"

Once the GFC commenced, there was a dramatic turnaround in the attitude of the banks, which, as one participant stated, proved to be quite testing. "*The challenges we saw was lack of experience of bankers, trying to change conditions, changing funding spreads, trying to change anything they could change to actually back themselves.*"

The challenges we saw was lack of experience of bankers, trying to change conditions, changing funding spreads, trying to change anything they could change to actually back themselves.

When questioned on the level of changes in compliance and pricing, some of the participants were puzzled by the reaction of the banks. "*The reporting from our respect has increased, particularly some of the liquidity and turnover numbers – that's what's important. They are not focused on some ratios that we would consider important – non-performing assets and that type of thing*."

Most agreed that the banks were extending the definition of events of default as a way of protecting themselves "*What I think they are more interested in is defining the events of default, making sure any of those things are covered very quickly. They are even broader than they were before – looking at change of ultimate ownership, now they really want to get beyond your parent into the shareholders.*"

However, it is important to note that many participants believe that the banks are beginning to work in a more structured approach to compliance. As one participant noted "*But what I have seen is for one particular counterparty, they have moved from quarterly compliance certificates to half yearly, so things are moving in the right direction.*" This may be due to the increase in communication as pointed out earlier when discussing banking relationships. The participant went on to say "*We found that communication has increased but our covenants actually relaxed by moving banks.*" However, another participant was not so positive about the current compliance requirements, stating "*I just won't have discussions – the banks want to have discussions but I know what it will come down to – they will want documentation that I won't be able to sign.*"

5. Balance sheet management

It was evident from the discussion that the basic fundamentals of good practice corporate financing had slipped during the unprecedented period of economic growth prior to the GFC. Balance sheet management was one such fundamental that many participants commented on.

One participant noted that one of the essential lessons was to maintain sound techniques, particularly when controlling leverage and managing financing risk, however he did also offer the following as an explanation as to why companies may have diverted from these 'sound techniques': "*The long period of moderation and apparent risk free funding had people thinking that the good times would go on forever.*"

One participant from an ASX 100 company agreed: "*I think credit was priced too low for many, many years and that encouraged bad behaviour. Debt was too cheap and companies were using too much of it – the more debt you have the more risk you generate. If the pricing is out of line with the risk it is going to create a problem and debt was far too cheap for far too long and people thought that was going to continue forever.*"

I think credit was priced too low for many, many years and that encouraged bad behaviour.

When questioned on why these experienced senior finance executives would let basic fundamentals slip, a participant provided the following response: "*I think as cycles improve you tend to take up more risk etc and that is actually perpetuated by analysts. I think boards are under pressure from the both the shareholders and the market – it is just inevitable. So I think it is very difficult to maintain the bona fide principles of business going through a strong economic climate when there is healthy competition and business is looking to leverage the markets.*"

Another participant shared the following experience in appropriately managing his balance sheet and the pressure this created prior to the GFC "*Back about two years ago there was enormous pressure from the press about the lazy balance sheet and it was really forcing boards to reconsider their balance sheet structure. A classic example was a writer talking about our business "It's got too much cash" but now cash is king. This pressure a few years ago lead to some believing that the business* [with a strong cash position] *was being poorly run and that was a theme throughout the financial press for years leading up to this disaster.* "

In terms of balance sheet management under current conditions, many participants agreed that they had restructured their balance sheet – some out of necessity, due to the limited funding available. One participant provided this summary on the issue: "*The message from the crisis is that you should manage your leverage very carefully both the size and the maturity structure.*"

The message from the crisis is that you should manage your leverage very carefully; both the size and the maturity structure.

6. Working capital

During the small business round tables held in March 2010, a number of members noted that they were either working with their customers or suppliers to free up working capital as an alternative funding source. When queried on this, some of the participants in the large business roundtable had similar experiences. One participant stated "*Our major contract manufacturers, a large international based company, basically went to their key customers and offered extended trading terms. They did that without us requesting it. They came to us and offered an extra fifty days credit which we took happily. That was them being proactive. Obviously we took it and we still have it even though we did not really need it at that time. Clearly some of their other customers did need it and so they extended it to us as well. In fact we were able to pay back our financing facilities pretty much on the back of that* [the extended trading terms]."

> … *we were able to pay back our financing facilities pretty much on the back of that* [the extended trading terms].

One participant shared how they had been forced to amend the way they were managing their working capital as a direct result of tighter business conditions during the GFC: "*We have gone the other way a bit. In terms of pricing for our customers, we were forced to lower prices and we lost a lot on our pricing. In regards to collections we tried to push these down more partly because we had been too nice in the past. So we did focus on quicker collections. We didn't really extend terms to our customers by choice. We really tried to get our money in harder than we have before, partly because we were being caught on price, reducing price and discounting.*"

> *We really tried to get our money in harder than we have before…*

It was obvious from the discussion, that each business had a different approach to managing working capital. For example, one participant working in the financial services industry stated: "*We actually decided it was better to talk to our customers even more, particularly the ones that maybe had a few difficulties, and make sure that we were still on top of the pile and they were going to pay. So rather than use scare tactics, we made sure that they had direct debit or direct credit or EFT continuing to come through. We made sure we understood their circumstances.*"

It would be fair to say that the consensus of the participants on the topic of working capital was that "cash is king" and that management are continuing to remain focused on cash and liquidity. A participant that works in the operations area of a ASX 100 company told how this impacted on his business: "*In the operations area of our business, there was definitely more focus on cash and cash retention and that had quite severe impact on our capital programs in terms of looking for improvements and efficiency and those types of things. We had to look to exploit as much as we could out there.* "

It appears that the focus on working capital is being driven by executive management more than ever before as a participant confirms: "*We now have a huge focus on cash management and liquidity. That's all the parent company wants to know. Are you making sure you are getting cash in and are you paying out as late as possible? They are saying that we must focus on working capital.*"

> *We now have a huge focus on cash management and liquidity.*

7. What's ahead

In wrapping up the discussions, we asked the participants what they believed the next twelve to eighteen months might have in store for capital markets and corporate financing. Given the mix of industries represented, the opinions varied.

When questioned on the current state of financing, one participant confirmed that although it was prudent during this time to fund as long as possible, the market had retracted from terms of five or seven to three years or less. This will provide challenges to many organisations in the next few years. One participant also noted that the banks now have a preference to join club or syndicate arrangements to manage risk and that they are focused on particular industries or sectors that are experiencing strong growth or where cashflow was stable and predictable. They are very much looking for low credit risk.

However, on a brighter note, one participant mentioned that there were new markets opening up to large business: "*I would point out one thing and maybe it only applies to the larger corporates. While I think the big four banks are core and key, there are other entrants coming in at the moment and they could be used sparely and profitably. They could create some price tension and better terms and conditions. I just mention*

some of the Asian banks. The Chinese banks are looking at the market in a very aggressive way. They are looking to build market share and some of the Japanese banks are back. If you can build up a relationship with them and they like your sector then they have a lot of money. With limited credit skills they will look for names and focus on certain sectors, but if you are in those favourite sectors, they will support you." He added: " *At the moment they cannot really be considered central players, but they have demonstrated their interest and, thanks to much of Asia doing fairly well despite the GFC, they have money to lend. At the very least the Asian commercial banking presences in Australia and access to Asian loan markets in particular can be used as leverage when negotiating with the Big Four, and to diversify funding sources.*"

At the very least the Asian commercial banking presences in Australia and access to Asian loan markets in particular can be used as leverage when negotiating with the Big Four, and to diversify funding sources

Another participant, who has also seen an increase in interest from the Asian banks stated: "*We have also seen risk appetite changing a bit within this region. This region is important and Australia is considered part of this region. So they see this as an extra piece of potential market that they can go into. So, I can share that there is a lot of interest. I am not sure that it is genuine hard interest, but there is interest.*"

When questioned on his statement of changing risk appetite, the participant elaborated *"Well, they* [the Asian banks] *have seen Australia to get through this, not unscathed but in a relatively good position and there appears to be an increase in demand for ancillary activities other than mining. So there are things happening so they are keen to have a look. There is demand for funding, so they are saying let's have a look.*" Providing further food for thought, this participant shared his opinion on potential markets for finance "*The Asian foreign markets are growing and I think that Australian corporates should look to tap into this. The big one is of course the liberalisation of China. Bond markets maybe the next thing up there. That's the next big source of capital.*"

The Asian foreign markets are growing and I think that Australian corporates should look to tap into this

On the economic side, participants were not confident that the economy would see a marked improvement in the near term: One participant gave the following view: "*What I will say in terms of the GFC is in the way it originally presented itself as a crisis of confidence – that's over now. The banks are now very strongly backed by governments. It's morphed now into more uncertainty about whether there will be further relapse into recession - particularly in the US – it certainly looks that way."* Another participant went further by saying "*I think it will be very interesting how the banks manage this next phase. There was that belief that it's over now. Now the last few months the financial media has been saying there will be a double dip. It will be interesting how the banks react to that, particularly with such a quick change in the perception of where the cycle is going to go.*"

In terms of growth, one participant shared his thoughts "*Purely in the past it has been referred to as a financial crisis however it really is a crisis of growth. That is something different again and that's the way it might turn now: a lower growth period with limited money for growth. Like a Japanese situation where you have long period of very low growth and that's a very difficult thing to handle. This then brings up one of the original fears of the GFC that following the crisis, the world could lapse into deflation and this is very difficult to manage debt when growth is declining and prices are falling. This is a higher risk than inflation I think. This is extremely difficult to manage when you have debt on your hands – that's tough – you have to deleverage.*" He also added that the company is now putting in place a lot more backstop facilities and prefunding more liabilities as a direct result of uncertain times ahead.

Another participant added "*The only thing that worries me about our business portfolio right now is that when you go into a cycle of growth, that's when the SMEs have liquidity issues. In the early 90's in that recession, the small to medium businesses, particularly in some sectors were having real problems getting the finance to fund growth.*"

8. Key Lessons

During the round table discussion, participants shared with each other a number of key lessons that corporates had learnt during and after the GFC. In summary, these were:

- businesses must have strong banking relationships
- the Australian banks are key to Australian corporate financings
- working capital management must remain a focus at all times
- adequate liquidity buffers should be policy for Australian corporates
- stick to good practice corporate finance principles at all times

Two participants offered this advice in wrapping up our discussion:

"*One of the key take outs from the GFC was that you must have strong banking relationships and even if as an Australian corporate you can diversify funding across the globe, capital markets are not as secure as a strong relationship with banks.*"

"*The key lesson from the GFC: watch out for short term debt, free fund your obligations, have ample liquidity, back up lines and cash and fund long if you can. Going into the crisis we had far too much short term debt and its like that story Warren Buffet says, when the tide goes out, you see who is swimming naked – we had some clothing on but it would have been better not to have the budgie smugglers on but a full wetsuit. So you've got to be careful and that is the key lesson – have access to liquidity, reliable access to liquidity.*"

So you've got to be careful and that is the key lesson – have access to liquidity, reliable access to liquidity."

9. Conclusion

This round table discussion provided a valuable insight into the challenges and difficulties faced both during and post the GFC. Although well experienced in raising finance, many of those who attended were caught off guard by the closure of many international financing markets. This then left them exposed to the Australian banks who, during the GFC, were tightening their risk profile, leaving many corporates in a vulnerable position. The participants in turn accepted that the landscape has changed and have noted the importance of managing their banking relationships in a more proactive manner. The compliance issues are seen to be more stable now, although this view varied according to the industry in which the participant's employer operates.

Participants confirmed that corporate balance sheets had, in many cases been structured in an environment of easily accessible and cheap funding which lead to issues with leverage and working capital once the effects of the GFC kicked in. This has lead to a renewed focus on cash and liquidity and of course improved working capital management.

In summary, it appears that corporates have now moved back to what can be considered good practice corporate finance principles. It will be interesting to see if or when the lessons of the GFC will be forgotten.

APPENDIX C

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Codes of conduct on small business banking – comparison between jurisdictions

The following compares the concepts raised in the final report of the inquiry into *Access of Small Business to Finance* and whether those concepts are covered in the existing ABA Code of Banking Practice and the small business lending codes of comparable jurisdictions. Where the concept is covered in whole or part, the actual reference from the document is included to assist the reader understand how the concept is covered. Where in CPA Australia's opinion, the concept is not covered in whole or part by the ABA Code of Banking Practice (only), then this is stated in ***bold*** and ***italics.***.

Concept (as taken from para 7.11 of the report from the inquiry into *Access of Small Business to Finance*)	**Australia - Code of Banking Practice**	**Australia - Banks and small business working together** (withdrawn upon the release of the Australian Code of Banking Practice in 2004)	**UK – The Lending Code**	**UK – A Statement of Principles – *Banks and micro-enterprises – working together***	**Canada – Model Code of Conduct for Bank Relations with Small and Medium-Sized Businesses**	**Ireland - Code of conduct for business lending to Small and Medium Enterprises**
Banks recognise the need for open communications with their SME customers. This includes banks: ○ outlining joint responsibilities ○ ensuring all information provided about a credit facility is clear and comprehensible ○ key items are brought to the attention of the borrower.	- clause 2.1(b)(i) promote better informed decisions on banking services by providing effective disclosure of information - clause 2.1(c) – provide general information about the rights and obligations that arise out of the banker and	- *Overview* - to promote an environment of open communicatio n between banks, their small business clients and advisers *Overview* – important elements in developing a positive relationship include the	- para 13 (second dot point) – customers will be given clear information about accounts and services, including terms and conditions - para 54 – the information must be provided before the client is bound by contract - para 55 –	- *Introduction* – the relationship between a bank and a customer is a partnership – it needs careful thought and openness on both sides. - 1(a) – the bank will confirm the conditions of any facility in writing - 1(c) – banks will co-operate with	*Openness – second dot point* – banks will provide customers with documents, including contracts that are written in clear and understandable language *Openness – third dot point* – banks recognise the need for open communication with their customers. Banks will outline	*The Code's objectives – second dot point* – promote fairness and transparency in the treatment of SMEs by banks Para 18 – all information provided under the Code is to be clear and comprehensible and that key items are brought to the attention of the borrower

	customer relationship - clause 10.1 – banks will expeditiously provide to you, or any person on request the terms and conditions, full particulars of standard fees and charges and particulars of applicable interest rates - clause 10.2(e)(v) – the advisability of you informing the bank promptly when you are in financial difficulty - clause 10.2(e)(vi) - the advisability of you reading the terms and conditions - Clause 15.1- disclose the existence of any application fee or charge and whether such fee or charge is	exchange of information between small business and their bank. For small business, this includes providing a bank with a business plan, financial information, comparisons of actual versus budgets, and informing banks as soon as possible on adverse trends. Banks will have available information on terms and conditions – such terms and conditions should be easy to understand and should be available before (or as soon as practicable after, the contract for the banking service is made	customers should know that an overdraft is payable on demand - para 129 – customers should be provided with any product terms and conditions and be encouraged to read them - para 130 – all terms should be written in clear and intelligible language	advisers to explain loan facilities	joint responsibilities	Para 25 – a bank must issue statements at regular intervals to the borrower

	refundable if the application is rejected					

For those SMEs applying for credit, the banks should make the following information available:						
○ *directions on how to apply for credit*	- Clauses 10.2(e)(1) and 13.1(a) – account opening procedures ***Uncertain as to whether these clauses cover credit***				*Applications for credit – second dot point* – banks will make available directions on how to apply for credit	
○ *an explanation of the requirements needed to obtain bank credit*	***No mention***	- *We will have available information on terms and conditions* – banks will have available the required security and guarantees, existing or new, including any minimum values - *We will assess an application for financial accomodation in a professional manner* –the document provides a list	- para 49 – Code includes a list factors banks will assess before lending money to microenterprises, including cash flow and business plan - para 51 – if a current account is required before lending, this should be explained - para 126 – if security is required, bank needs to confirm in writing what		*Applications for credit – 3rd dot point* – Banks will make an explanation of their requirements needed to obtain bank credit available to each client	

		of factors that banks will take into account to determine whether a business will be able to meet their financial obligations – eg cash flow forecasts and business plan. Where a decision can not be made, a bank will undertake a range of activities such as notify you of additional information requirements	security is needed and why			
○ *an estimate on how long it will take before a credit decision will be made.*	***No mention***				*Applications for credit process – 5th dot point* – banks will provide an estimate of how long it will take before a credit decision is made	Para 3 – banks must inform borrowers how long the credit application process is considered likely to take
Each application for credit by an SME should be judged on its own merits	Clause 25.1 – before offering a credit facility, banks will exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and in	- *We will assess an application for financial accomodation in a professional manner* – document provides a list of factors that	Para 43 – before lending any money, a bank should assess whether the customer has the ability to repay		*Credit approval – first dot point* – each credit application will be judged on its own merits	*The Code's objectives – first dot point* – The Code is to help facilitate access to credit for sustainable and productive business propositions Para 2 – a bank

	determining the client's ability to repay.	banks will take into account to determine whether a business will be able to meet their financial obligations – eg cash flow forecasts and business plan				must consider each application for credit on its own merits Para 5 – a bank must have appropriate procedures in place to assess a loan application Para 13 – a bank must make each decision to withdraw or amend credit on its merits.
When a credit application is approved, the bank should inform the customer about the terms and conditions of financing This includes information on: ○ Default fees, charges and interest rates ○ further information needed by the bank both before and after the loan is granted.	- Clause 10.4(a) – where relevant, standard fees and charges will be included in the terms and conditions - clause 10.4(b) – where appropriate, the method by which interest is calculated and the frequency of repayment will be included in the terms and conditions - Clause 10.4(c) – where relevant, the terms and	- *We will have available information on terms and conditions* – banks will inform clients through the terms and conditions of a number of things including the nature of the fees and charges, interest rate, when the bank intends reviewing the security and security requirements, when the facility will	- para 52 – before entering a contract clients should receive from a bank clear information on whether there are qualifying criteria for accessing an overdraft - para 53 – as part of pre-sales information, the customer must be provided details of interest rates to be applied and if relevant, the method for calculating actual interest	-1(a) – The document lists the conditions that will normally be included, including the amount and purpose of the facility - 1(d) – the bank will in writing set out what information is required by the bank and when. Examples of information that may be needed include comparisons of forecasts versus actuals, business plans and cash flow	*Credit approval – second dot point* – on approval of a credit application, the bank will inform the customer about the terms and conditions, including documentation needed before the loan is granted	Para 6 – where a new application is approved, a bank must provide the borrower with confirmation of the credit facilities, terms and conditions (including what happens in cases of default), details of fees, charges and interest rates. Para 19 – banks must provide information to borrowers outlining terms, conditions, fees and charges, including a general description of collateral policies

	conditions will include how clients will be notified of changes to the terms and conditions, fees and charges and interest rates - clause 10.4(g) – where relevant, the terms and conditions will include information on repayment details - clause 12 – the bank will make available interest rates and standard fees and charges on credit service products ***There is no information in the code on whether the bank should inform the small business on further information needed before a loan is approved or after a loan is approved***	need to be repaid on demand, the minimum information required at a review and the frequency of such reviews and the need for the client to inform the bank of any problems.	rate. - para 55 – in a facility letter or terms and conditions, customers should be told if an overdraft is repayable on demand - para 132 – customers should be told in the terms and conditions how they will be notified of changes to terms and conditions	forecasts		

If credit is declined, the bank should inform the customer about:						
○ *the main reason(s) for the decision*	***No mention***	- *We will assess an application for financial accomodation in a professional manner* – bank will provide at the client's request, principal reasons for declining a credit application	- para 56 – if a customer's overdraft request is declined, the bank should explain the main reason why if asked - para 116 – if a customer's loan application is declined, the bank should explain the main reason why if asked	- 1(e) – if asked, a bank will explain the key reasons why a facility has not been offered	*If credit is declined – second dot point* – if an application for credit is declined, the bank will inform the main reason/s for the decision	Para 12 – where an application for credit is declined, the bank must explain clearly to the applicant the reason/s for the decline.
○ *the requirements necessary for the bank to reconsider the application (if applicable)*	***No mention***				*If credit is declined – third dot point* – if an application for credit is declined, the bank will inform the applicant the requirements necessary to reconsider the credit application	
○ *information on alternative sources of financing*	***No mention***				*If credit is declined – fourth dot point* - If an application for credit is declined, the bank will inform the applicant of alternative sources of finance	

Sometimes customers will experience significant change. In these circumstances, banks should carefully review the existing arrangement before deciding what action (if any) should be taken	***No mention***	- *We may seek from you additional information and/or an independent review* – if a business is unable to resolve its problems, the bank may request additional information and/or an independent review. If a bank can not continue to provide support, the bank will give an explanation of that decision	- Para 13 – fifth dot point (in part) – banks will act sympathetically and positively when considering a client's financial difficulties - Para 137 – the first step when a bank becomes aware of a client's financial difficulties (through their own systems) should be to try to contact the customer to discuss the matter. - Para 141 – if a bank becomes aware via their existing systems that a client may be heading towards financial difficulties, the bank should contact the client		*Changing circumstances in the credit relationship – first dot point* – where a customer experiences a significant change in their business, including financial difficulty, banks will carefully review the existing arrangement before deciding if any action should be taken	

If there are changes made to the terms, conditions, reporting requirements, fees or lending margins of an existing SME credit facility, banks should inform the customer/s as soon as possible. Banks should provide clients with a minimum of 15 days' notice of such changes (unless there are exceptional circumstances).	- Clause 18.1 - when making changes to a fee or charge or varying the method by which interest is calculated, the bank will provide written notice at least 30 days before the change takes affect - clause 18.3 – other variations in terms and conditions will be notified no later than the day on which the variation takes effect ***For variations in terms and conditions, Australian banks only need to notify the small business on the day on which the variation takes effect, not 15 days prior to the change taking effect.***	- *We will have available information on terms and conditions* – the terms and conditions will include the manner in which clients will be notified of changes to terms and conditions and interest rates - *We will provide notice of variations to terms and conditions* – when there is a variation to a term or condition, interest rate or fee, clients will be provided notice no later than the day on which the variation takes effect. - *We will confirm any changes to your contract* - where the bank and customer	- Para 13 – third dot point – (in part) – clients will be informed about changes to the interest rates, charges or terms and conditions - Para 62 – within 3 working days of a rate change, banks should inform the public of that change through public notices - Para 65 – banks should tell clients personally at least 30 days before increasing an overdraft charge or introducing a new overdraft charge - Para 134 –if a change to terms and conditions is to the customer's detriment, the bank should personally inform the client at least 30 days prior to the		*Changing circumstances in the credit relationship – last three dot points* – if there are changes in the credit relationship, banks will inform customers as soon as possible about the need for on-going additional information and banks will give customers a reasonable opportunity to provide this information. Under normal circumstances, banks will provide their customers with a minimum of 15 days notice of any bank actions taken because of a change in the credit relationship. Banks must inform clients when changes are made to the terms, conditions, fees or lending margins that are specific to a client's credit relationship.	Para 14 – where a bank decides to withdraw or amend credit facilities, it must notify the borrower promptly of the proposed withdrawal or amendment and the reasons. Para 20 - a bank must inform the borrower in advance of making changes to the terms, conditions, fees and charges (but no time frame) Para 23 – where a bank changes the interest margin on a credit facility, it must notify affected borrowers promptly of such a change

		agree to a change to the terms and conditions, the bank will confirm any changes made or provide a copy of the renegotiated contract as soon as practicable	change - Para 135 – where the change to the terms and conditions is not to customer's disadvantage, the change can be made immediately and the client notified within 30 days of change			
A bank should not impose unreasonable collateral requirements for providing credit facilities.	***No mention***					Para 7 – a bank must not impose unreasonable collateral requirements, having regard to the value of the credit being offered
A bank must not impose unreasonable personal guarantee requirements on borrowers	Clause 28 *Guarantees* (except 28.14, where the principal debtor is a small business) – ***Clause does not fully cover the concept***	*We may ask for guarantees* – (does not address concept)	Para 123 – banks should not take an unlimited guarantee from an individual other than to support a customer's liabilities under a merchant agreement.	- 1(a) – banks will always commit to first considering business assets before determining whether personal assets are appropriate as security		Para 8 – a bank must not impose unreasonable personal guarantee requirements on borrowers.

A bank must promptly, at the request of the borrower, return any security held by the bank, to the borrower when all facilities for which security is pledged, has been repaid.	***No mention***		Para 127 – if asked, a bank should tell a client under what circumstances they will agree to release security			Para 11 – a bank must promptly at the request of the borrower, return any security held when all facilities for which the security is pledged have been repaid
A bank must have in place procedures for handling of arrears cases.	Clause 25.2 – banks will assist small business overcome financial difficulties with any credit facility ***Could have more detail on how banks will manage arrears cases as this is important.***	- *We may seek from you additional information and/or an independent review* – if a business is unable to resolve its problems, the bank we request additional information and/or an independent review. If a bank can not continue to provide support, the bank will give an explanation of that decision	- para 140 – sets out the potential indicators for a bank of a micro-enterprise going into financial difficulty - Para 141 – if a bank becomes aware via their existing systems that a client may be heading towards financial difficulties, the bank should contact the client - para 143 – banks should make available to clients straightforward information on their procedures and systems for dealing with clients in financial difficulty	- 2(a) – banks will consider any financial difficulties a business has sympathetically and positively and if a bank has concerns about a business, the bank will let you know in writing and offer to discuss these with the business personally. The bank will after speaking with a business, also seek to agree on terms of their support for the business. The clause includes examples of what may cause concern about a business to their		*The Code's objectives – third dot point* – the aim of a bank in dealing with arrears cases will be to assist borrowers meet their obligations or otherwise deal with the situation in an orderly and appropriate manner. Para 16 – banks must have in place procedures for the handling of arrears cases.

			- para 166 – where a bank considers the client's financial circumstances to be exceptional and unlikely to improve, the bank may consider writing off or not pursuing part or all of the client's debt – the debt may still a registered as a default with the credit agencies.	banker - 2(b) – the bank may ask for more financial information from a business before actions are considered - 2(c) – the bank may suggest an independent review of a business - 3(b) – banks will support a rescue plan for a business in financial difficulty if the bank believes the plan will succeed - 3(d) – a final decision on not continuing to support to a business is made at a senior level of the bank on the recommendatio n of the relationship manager		

Without prejudicing a bank's regulatory and/or legal obligations and legal rights, a bank must:						*Scope – last paragraph* – nothing in this Code prohibits a bank from acting with all necessary speed in the case of liquidation, fraud etc
○ *give the borrower reasonable time, to resolve the arrears case*	***No mention***	- *We may seek from you additional information and/or an independent review* – if a business is unable to resolve its problems, the bank may request additional information and/or an independent review. If a bank can not continue to provide support, the bank will give an explanation of that decision	- para 146 – bank's should explore a range of options with the client			Para 17(a) – without prejudicing a banks legal rights and obligations, a bank must give a borrower reasonable time to resolve an arrears problem
○ *endeavour to agree an approach that will assist the borrower to*	***No mention***		- para 147 – the initial arrangements for repaying an outstanding debt should be in	- *Introduction* – if a micro-enterprise gets into difficulty and the bank becomes aware		Para 17(b) - without prejudicing a banks legal rights and obligations, a bank will endeavour to agree an approach

resolve the arrears problem			writing - para 148 – repayment plans may be subject to regular review	of it, the bank will discuss with the customer and advise on what action may be necessary to help the business to return to success. When a bank tells a business about its concerns over the viability of the business, the bank will be as relevant and specific as possible - 2(a) – a business that is in trouble should speak to their bank at it earliest opportunity so that terms for support can be agreed		that will assist the borrower resolve an arrears problem
○ *advise the borrower of any possible impact of the default on the other accounts held by the borrower*	***No mention***			- *Introduction* – where the business is not viable as structured, formal insolvency procedures may have to be considered to restructure or wind down the business		Para 17(c) - without prejudicing a banks legal rights and obligations, a bank must advise the borrower of any possible impact of the default on other accounts held by the borrower

A bank should explain to borrowers the basis on which interest is calculated.	- Clause 10.4(b) – terms and conditions will, where appropriate include the method by which interest is calculated and the frequency of debiting or crediting	*We will have available information on terms and conditions* – the terms and conditions will include the method by which interest is calculated	- para 53 – the customer must be provided, where relevant with the method for calculating the actual interest rate - para 59 – for overdrafts, if asked, subscribers should give a full explanation of how interest is worked out			Para 22 – a bank must explain to borrowers the basis on which interest is calculated.
Nothing in a code for SME lending should prohibit a bank from acting with all necessary speed to withdraw credit when there is reasonable suspicion of fraud etc	***No mention***		- para 162 – if a client does not cooperate with a bank, a repayment plan can not be developed, therefore the bank may proceed with normal debt recovery procedures	- *Introduction* – if the business does not ask for or act on advice or take part in meaningful discussions, the bank may have to take action to protect its own position - 3(c) – if the bank does not consider that a rescue plan will succeed, the bank will explain the reasons why and help the customer consider other options		Para 15 – Nothing in this Code prohibits a bank from acting with all necessary speed to withdraw credit where there is reasonable suspicion of fraud, etc

				- 3(e) – if after reviewing all the options, appointing an administrator is considered the most appropriate action, the decision will be confirmed within the bank at a senior level		
Other	Clause 39.3 – This Code replaces the "*Banks and Small Business Working Together – A Set of Principles'* This Code is a mix of principle based clauses and prescriptive clauses. Clause 21.2 – prior to granting a foreign currency loan, banks will give you a general written warning on exchange rate risks and the products to manage such risk	These Principles were withdrawn when the new Code of Banking Practice began. It can not however be said that the Principles were incorporated into the Code	This Code is set and monitored by an independent standards board called the Lending Standards Board. The standards of behaviour for deposit services is set by the UK Government's Financial Services Agency.	This Statement of Principles is followed by all British banks that subscribe to the Lending Code and provides micro-enterprise funding. Should therefore be read in conjunction with the Lending Code.	- *Preamble* - Canada's chartered banks recognise the important role that small and medium-sized enterprises (SMEs) play in Canada's economy. The chartered banks also recognise that they have an important and unique role to play in fostering the growth of SMEs in Canada.	Unlike the other codes mentioned in this comparison, this Code is set and regulated by the Irish Financial Services Regulatory Authority