AUSTRALIAN INDUSTRY

GROUP

15 April 2010

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John Hawkins
Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
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Inquiry into access of small business to finance

Dear Mr Hawkins,

I am writing to follow up Ai Group's appearance at the Senate Economics Committee hearings into access of small business to finance on 12 April 2010. We were requested to comment on the applicability of Canada's Small Business Financing (CSBF) Program to Australia and on whether the Australian Prudential Regulation Authority (APRA) lending requirements imposed on financial institutions unduly inhibit lending to small businesses.

The CSBF Program seeks to increase the availability of loans to small businesses by encouraging financial institutions to make their financing available to small businesses. The Canadian Government does this by sharing the risk on loans with the lending financial institution.

The Ai Group has reviewed the various publicly available CSBF Program reports and evaluations. These suggest that the Program appears to have been a success in promoting access to loans by small businesses and, in turn, promoting broader economic benefits. For example, generally positive results have been found with respect to employment growth, sales revenues, firm survival rates and growth of total assets of small businesses that have taken loans through the CSBF. Moreover, a review of the program over 1999-2000 to 2007-08 indicates an economy-wide benefit-cost ratio of 7.7. However, despite this, there are some factors associated with the CSBF that would need to be considered before such a program could be applied in Australia. These factors include:

- The ultimate decision to accept or refuse a loan application rests with financial institutions. Hence, if small businesses are not in a position to put forward viable business cases for loans, financial institutions will still be reluctant to lend, even if the risk of default on the loan is predominantly borne by the Canadian Government. This highlights the importance of Ai Group's call for enhanced financial training for smaller businesses, such as through the Enterprise Connect program, in order to enable small businesses to be in a position to put forward sound business cases to financial institutions.

- The CSBF Program involves administrative costs for financial institutions which has not made the Program as attractive as could be. For example, some financial institutions in Canada have complained about the duplicate set of procedures that are involved in making loans through the CSBF Program with their own loan facilities and procedures.

- Some financial institutions in Canada have found that the loans are unprofitable for them – by design the Canadian Government's CSBF Program involves interest rate and fees caps which make the CSBF loans less profitable to financial institutions than their own loan products.

- Risk sharing arrangements under the CSBF Program ultimately involve the Government of Canada paying lenders 85 per cent of the eligible losses incurred on defaulted loans. Hence most of the risk of default on the loans is borne by the Canadian Government. Some financial institutions in Canada have complained about the burden of the claims administration process by which they are reimbursed for eligible losses. Moreover, it is unclear whether the Australian Government is willing to accept a similar risk sharing arrangement with financial institutions when instead it has chosen in recent times to provide support to small businesses through tax breaks and direct grants.

There is no clear evidence that APRA's lending requirements imposed on banks in relation to small business loans are unduly inhibiting lending to the sector. From a short-term perspective, until recently, finance demand from the sector has been weak, reflecting the slowing of economic growth experienced both here and overseas and it is therefore difficult to be certain of the impact of regulatory constraints on accessibility of finance. From a longer term perspective, it is also difficult to judge what the level of lending may have been in the case where bank capital requirements related to small business lending were at a less stringent level.

Aside from this, the broad reason for APRA's capital requirements (lenders criteria) being relatively stringent for small business loans is that the sector is inherently more risky, and therefore requires tighter criteria to ensure that lending is prudent from an individual lender and a systemic perspective. Assuring access to finance for relatively risky small businesses is better achieved by policy designed to lift the credit worthiness of small business borrowers rather than reducing prudential requirements. To choose the latter path may have the unintended consequence of reducing the stability of the financial system and therefore, potentially, the pool of capital available to finance small business activity. Hence the Ai Group has called for approaches to improve small business credit-worthiness such as enhanced policies aimed to improve financial literacy, business planning and accounting standards among small business owners.

Yours faithfully,

Peter Burn
Director – Public Policy
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