COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Reference: Access of small business to finance

MONDAY, 10 MAY 2010

CANBERRA

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SENATE ECONOMICS

REFERENCES COMMITTEE

Monday, 10 May 2010

Members: Senator Eggleston *(Chair)*, Senator Hurley *(Deputy Chair)*, Senators Bushby, McGauran, Pratt and Xenophon

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Joyce, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Sterle, Troeth, Trood, Williams and Wortley

Senators in attendance: Senators Bushby, Eggleston, Hurley, McGauran, Pratt, Williams and Xenophon

Terms of reference for the inquiry:

To inquire into and report on:

The current circumstances of issues surrounding access of small businesses to finance, including:

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

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

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

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

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

(f) any other related matters.

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Committee met at 7.58 am

CHAIR (Senator Eggleston)—I declare open the seconding hearing of the Senate Economics References Committee inquiry into the access of small business to finance. These are public hearings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may treated by the Senate as contempt.

It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may be also made at any other time.

[8.00 am]

BULTITUDE, Ms Susan, Manager, Funding Markets Unit, Financial System Division, Treasury

LONSDALE, Mr John Peter, General Manager, Financial System Division, Treasury

MURPHY, Mr Jim, Executive Director, Markets Group, Treasury

ROWBOTHAM, Ms Jaclyn, Principal Adviser, Financial System Division, Treasury

CHAIR—I welcome the Department of the Treasury and thank you for agreeing to appear at this very early morning slot, which is 6 am Western Australian time. Would you like to make a brief opening statement?

Mr Murphy—Good morning. Thank you. Treasury sees small businesses as an important part of the Australian economy, accounting for just under 40 per cent of total value added by industry in 2007-08. Small businesses are also a major employer, accounting for just over 50 per cent of jobs in Australia as at June 2008. Access to finance is important in allowing small businesses to maintain their important contribution to the economy and in allowing them to grow. The availability of reasonably placed credit allows small businesses to expand their activities, fund new and innovative investments, smooth cash flows and maintain employment. You will note the Treasury submission to the committee dealt with business conditions, financing, competition and funding, and government support. We drew a number of conclusions and I will outline some of those.

It is important to point out that there are clear signs that small business continue to have access to credit. While credit growth has slowed, the volume of small business credit outstanding has remained broadly flat since the global financial crisis. However, terms and conditions on credit have tightened relative to pre crisis. In particular, interest rates on small business loans have increased relative to the RBA cash rate. We consider that these changes reflect both demand and supply factors. On the demand side, businesses have been deleveraging to strengthen their balance sheets and have cut back their investment plans in line with global economic weakness. On the supply side, banks have faced higher funding costs due to the global repricing of risk and have also raised their assessment of small business risk, reflecting the point in the economic cycle. While competitive pressures have eased since the GFC, a substantial number of competitors remain in the market, especially focusing on small business.

Going forward, it is anticipated that conditions will improve as the economy recovers and global funding markets re-establish themselves. Investment is expected to recover, risk margins are likely to fall and some lenders that have been forced to scale back their activities as a result of the crisis will be in a position to re-enter the market. In the meantime, the government has undertaken a range of initiatives to support small businesses through the recent period of economic weakness. This includes the most recent $8 billion investment in the residential mortgage backed securities, the small business and general business tax break, venture capital investment, small business advisory services dealing with cash flow support and other initiatives. My colleagues and I will be happy to take questions.

CHAIR—You mentioned the fact that credit for small business is still being provided but conditions have been tightened. The economy seems to be doing reasonably well and unemployment is low. Why is small business seen as having a higher risk? Is that a reasonable approach from the banks given that there seems to be a lot of activity out there?

Mr Murphy—I think there are a few factors. One, inherently, lending to small business is seen as riskier than lending for mortgages, and we have a gilt-edged mortgage arrangement whereby it is just on behavioural economics—the last thing default on is their mortgage. So that puts mortgages in a very unique position, I suppose. And, always, small business will be riskier in terms of lending.

The second point I would make is that probably when you go through a time of economic stress, weaker points will be even more focused upon. So I think we would say that the risk factors that the banks have factored into the price of lending to small business are probably too high. As economic conditions improve and as things get back to normal, that should come down. I think it is that, inherently, small business will be seen as riskier but I think the banks may have overplayed their hand in terms of the price of risk they are charging to small business.

Mr Lonsdale—On page 9 of the submission we have provided to you there is a chart of reported companies moving into administrations. That is ASIC data. It shows that, over the last 12 months or so, there has been an increase in companies going into administration. That would have been factored into the banks' impairment charges and fed into higher prices, as Mr Murphy outlined.

CHAIR—Thank you very much.

Senator HURLEY—I think one of the problems with this inquiry is being able to separate out small businesses. There are some which clearly will be at the riskier end—in the building and construction area, housing—and there are other areas not so risky. Do you have any way of separating out those kinds of businesses?

Mr Murphy—We are aware that certain sectors are more targeted with the economy downturns. Commercial property is the first one, as you mentioned. It goes back to the definitional information that is used for deciding what is and what is not a small business, and there are a variety of definitions. I am not sure in terms of our data collections? They break them down into sectors. Can we be more specific?

Mr Lonsdale—I am not sure we can. As Mr Murphy said, it does depend on definitions. There is no clear definition as to what is a small business. They are involved in different activities and different activities will bring different associated risks.

Senator HURLEY—I think we have all heard anecdotal evidence from what we regard as quite sound companies that have either been refused loans or have been offered them at prohibitive prices. So in certain circumstance and in a threatened recession and the aftermath with the wholesale funding difficulties, you can certainly understand banks to some extent. I suppose what we are trying to do is get to the heart of the problem—whether banks are taking advantage of the situation to make their own position better by lending to more secure businesses or by getting more business. I think somewhere in your submission you talk about the NIM being higher for banks now. No, you were talking about the changes to spread to cash rate in your submission.

Mr Lonsdale—Yes.

Senator HURLEY—It would be handy to have some idea of whether that it is the case that banks are taking advantage of the situation. I realise that it is difficult for you to comment on that, but in terms of competition between banks, is it the smaller banks or the smaller institutions that loan more readily to small business or take the risks?

Mr Murphy—There are two aspects of that. One, the large majority of funding for small business will come from the major banks. The second point is that, yes, the fringe players—or non-banks or finance companies—have traditionally lent to the riskier end of small business or the riskier end of business. So to some extent both factors have worked against small business in a downturn; where as both factors will come back into play to assist small business because all financial institutions are there to make a profit. So, as the economy picks up, they will probably start lending more to small business—this is the majors—and as well as that drop the price of it, one would hope. Also, as the economy picks up, the smaller players will come more into operation and become more available for lending to small business.

Senator HURLEY—I have just one last question, because I know a number of other senators have questions. Because loans to small business are often residentially backed, is it more difficult for those customers to switch banks and lending institutions? Could that be one of the difficulties?

Mr Murphy—The government is very much trying to encourage people to look for the most competitive rates. They have sought to encourage people to be more cognisant of the rates they are paying—to shop around, to try to get better rates and try to stimulate competition in the market. But we know that internationally: (1) switching is probably one of the best things you can do in terms of stimulating competition, and (2) Australia’s switching rates are actually no lower—and probably higher—than other major countries. So I am not sure whether your proposal is right. If you had your small business funding tied to your mortgage on your property it might be more complicated, but I imagine you could switch them both to another lender if you felt you could get a better rate. But it might put an additional constraint on your ability to act in that regard.

Mr Lonsdale—Senator, I do not think we have any systemic data on that. What we can say though is that there is a government information line available that provides information to small businesses on things like difficult loan products that are available and how you get in and out of those. As well as that, there are public information sites available—Cannex, for example, is one that provides comparisons on difficult products. So there is information out there. As to whether your particular issue is an issue or not, we do not have any data on that.

Senator WILLIAMS—Just following on from Senator Hurley’s question about competition. Mr Murphy, you talked about competition between banks and shifting banks if you can get a better deal. What about if you had to pay exit fees to get out of your bank—as many people have to on variable loans? You can understand an exit fee on a fixed loan. If you were fixed in at something and you were going for a cheap rate, you have to pay out that term you are fixed in. But, if you are going to pay out an exit fee on a variable loan and then you have to pay an establishment fee at the next bank. Surely those two things in themselves restrict competition. For example, if I take my car to a garage and I feel as though I have been ripped off for the price of the service of the car and the service is not good enough, I can go down to the other garage next time. That is proper competition. But in banking, while ever you have exit fees on a variable loan and establishment fees on the next loan, isn't that just depleting proper competition in the banking industry?

Mr Murphy—Firstly, the banks have to charge what they feel is commercially reasonable. Secondly, I would say that, if consumers or small business people wanted to be more assertive, a lot of these fees that banks charge are discretionary. Thirdly, there is a debate—

Senator WILLIAMS—But an exit fee would not be discretionary.

Mr Murphy—Well, hang on. With exit fees it is questionable and some people say that they could be challenged as a term of an unfair contract. So the government has introduced—under the new credit legislation—capacity for individuals to challenge unfair conditions in terms of contracts. As I said, it is debatable whether exit fees are such.

Senator WILLIAMS—Challenge to where? To the ombudsman or to a court?

Mr Murphy—To a court. You would only have to have one and then you would find that that would knock them out. But it is hard to say. The analysis we have done on establishment fees and exit fees shows that some banks charge heavy exit fees and very low establishment fees. Others charge very high establishment and very low exit fees. It is the way they put their costs through the mortgages. You cannot be categorical about whether the exit fees are a real impost and an unfair burden on consumers and small business people. But you are right. Treasury questions exit fees, I think.

Senator PRATT—COSBOA have put forward in their submission, on the question of banking fees, a suggestion that there needs to be greater comparability between loan products. They liken it to things like unit pricing. I realise they are far more complex products, but how is it that Treasury assesses the prospects of being able to assist small business in comparing products? Is that something that is viable to do for government, as regulators in this space, to try to encourage more transparency?

Mr Murphy—It is the same with mortgages as with small businesses. The banks offer a wide range of different products that commercially they think are in the interests of people who wish to borrow from them. Mr Lonsdale has mentioned the government advisory services that have been established to try to assist small business in making assessments in that regard. You also wonder whether competition—trying to just explain things simply to people through alternative suppliers of finance—would be the best way to ensure that the complexity of the different products does not overwhelm people. The main thing is that people who are borrowing money understand the terms and conditions on what they are borrowing. On the small business side, it is the advisory side. I agree with you, Senator, that people may find the number of different products quite complex.

Senator PRATT—Is it possible to see how much one product costs versus another, or how much interest you pay over an average period of time, incorporating the entry and exit fees into those costs? Or does the question of entry and exit fees make it too difficult to do those comparisons?

Mr Murphy—No. I think people are pretty aware, to some extent, of the assessment of different terms and conditions. But it is just human nature, isn’t it, in the quickness and joy of being provided with finance? Whether it is a business loan or a mortgage, people just never think there will be a change of circumstances whereby they will have to exit a mortgage within five years or so. The main thing that drags small business down is just changing circumstances—sickness, or another competitor enters the market. Some small businesses may be not as focused on the terms and conditions of the loan as they should be at the time.

Mr Lonsdale—Just to add to what Mr Murphy was saying, transparency is a very good thing and the more transparency you can get in the system, the better generally. There are websites available that address some of the issues that you have been talking about—comparing different products. In the submission, we refer to the number of products on the market at the moment for small businesses. We say there are around 30, which is a lot. So how do you compare those? You can go to websites and get some comparison of those. As I mentioned, there is a government website that people can go to for assistance on, again, comparability but not just that—other issues as well.

Senator XENOPHON—Because of time constraints I will try to be as quick as I can with these questions. Is it fair to say that as a result of the global financial crisis small businesses did not fare as well in accessing finance as the bigger end of town? Would you agree with that general proposition?

Mr Murphy—If you look at it, all businesses in Australia did reasonably well through the global financial crisis and we did not have any particular area targeted. With the government’s guarantees, the big banks could insure and the second-tier banks could borrow overseas to lend. That would enable them to lend to small business. I made the point earlier that it was the major banks who were the main lenders to small business. I think that the harm was spread evenly across the place—harm is probably not the right word—in terms of the restrictions from the GFC.

Senator XENOPHON—But in relative terms, it would have been a bit tougher for small businesses in their ability to cope with it?

Mr Murphy—Yes, but I think small business were pretty prudent. They stopped investing for a while. Our understanding from the data is that they sought less finance and they sought to hold themselves together over the time period. I do not know whether we can really say that the global financial crisis affected small business more than others.

Senator XENOPHON—As a result of what is happening in Greece and Europe at the moment, do you see that as has having implications for finance generally, given the multibillion euro rescue package in Greece? Is that going to squeeze the supply of local capital—

Mr Murphy—For the Australian banks?

Senator XENOPHON—and, in particular, interest rates?

Mr Murphy—The Australian banking system is very well placed at the present time, given that they made sensible use of the government's guarantee. So there are no concerns about the Australian banking system at the present time and the governors of the Reserve Bank have said that.

Senator XENOPHON—Sorry, that was not my question.

Mr Murphy—No, but whether there are any future concerns, we will just have to wait and see. There is very low exposure to Greece by Australian institutions. As well as that, it looks like this package, if it can be successfully implemented, would nip the problem in the bud.

Senator XENOPHON—My final question is about credit provided to the rural sector declining over recent years, even before the global financial crisis. Why do you think that is the case? And will the decline in banks giving finance to that sector of the economy be exacerbated in years to come, given the forecasts of a hotter, drier Murray-Darling Basin?

CHAIR—That is a very big question.

Mr Murphy—As for rural finance, we all know how important the rural industry is and I think we made some comments on rural finance in the submission.

Senator XENOPHON—I am happy for that to be taken on notice. I am concerned that my other colleagues have questions to ask.

Senator McGAURAN—My question is on Greece and the debt and mess in Europe, too, and you attempted to answer it—though, strugglingly so, I should add. Let me just press you a bit more on that issue to try and flesh out what you really think about that. When you say that our banks are in a good, strong position and that you do not expect much of a knock-on effect because they do not have much an exposure to Greece, you know that there is more to it than that. You know that the knock-on effects are far broader than any narrow relationship Australia may have with Greece. We have already seen the knock-on effect in the share market. Why have our banks taken a big slug? Because there is now fear and deep worry that we are going to go into a second round of credit squeezing. That is my assessment. So I restate the senator's question to you: have you got a deeper analysis than what you have given us in regard to the debt mess in Europe, the knock-on effect on Australia—our banks—and the credit squeeze? The first to take the hit will be small business. What are the prospects of this now affecting small business seriously?

Mr Murphy—It is very easy to run off and be alarmist about these things. You have seen the Prime Minister make some statements. My previous answer dealt with the particular in terms of the direct impact on small business from institutions in the Australian financial system at the present time. Talking internationally: yes, there is concern, but it seems that the European Union is moving to address that. As I noted earlier, if it is implemented successfully that should address the issue and markets will return to normality.

Senator WILLIAMS—In your opening statement you said that interest rates for small business had been increasing in line with the Reserve Bank’s increase in the cash rate. I take you back to 3 September 2008 when interest rates started to fall and we had a four per cent reduction. Many, many small businesses and farmers I spoke to had a maximum two per cent reduction when interest rates went down four per cent. Why is that?

Mr Murphy—It is a matter for the lenders, but one would hope that the lenders would factor in, when interest rates drop, also to drop their rates to small business.

Senator WILLIAMS—They didn’t.

Mr Murphy—I know. You would hope they would. It is whether they have a different assessment of risk on small businesses and, notwithstanding the cost of capital to them, they still regard small businesses as riskier and having a certain residual basic risk that they will factor into their pricing.

Mr Lonsdale—I think there are a couple of factors I would add. One is you are saying that although the headline rate might have dropped it might not have dropped as much as the cash rate. I think funding costs are a key part of that story—greater assessment of the riskiness of obtaining capital—so that pushed up funding costs. Also, the way the banks looked at businesses in general, factoring in higher risk for the class of borrowers and for particular borrowers as well, would have reduced the rate of decline.

Senator WILLIAMS—I make the point that the farmers I spoke to had 70 per cent and more equity in their property. They were not at risk. They had plenty of security, and real security—land. They were getting two per cent, but the ABA told me personally: ‘It’s a more political issue to bring the rate down for home loan borrowers. There are a lot more people in that position.’ The government put a lot of pressure on the banks about that but, as far as I am concerned, small business suffered the cost to keep the margins up for the banks, because they never had the reductions they should have. If they had had the full reduction it would have stimulated the economy more and made it easier for those people, especially in regional areas that had been suffering through drought et cetera. I think it has been very unfair, the way they copped a lot of the burden on interest rate margins compared with home loan borrowers.

CHAIR—We have now run out of time. We only have very short time frames today, I am afraid. I thank Treasury for appearing. If you wish to put in any additional comments in response to the questions then please do so.

[8.29 am]

ANDERSON, Mr Peter, Chief Executive, Australian Chamber of Commerce and Industry

EVANS, Mr Greg, Director of Economics and Industry Policy, Australian Chamber of Commerce and Industry

GOO, Dr Siwei, Adviser, Economics and Industry Policy, Australian Chamber of Commerce and Industry

CHAIR—We welcome ACCI. Would you like to make an opening statement?

Mr Anderson—Thank you. I am aware of the time constraints this morning so I will keep my comments very brief so we have a full opportunity for questions and comments. This is one of the most timely inquiries the Senate has conducted. The issues being dealt with here are very real. Our submission that has been presented to the committee deals with what the general council of the ACCI, on 26 March this year, concluded was the most significant day-to-day issue facing Australia's businesses. That was a conclusion drawn by the presidents and chief executives of the major chambers of commerce from every state and territory, together with 26 industry associations. The significance of the issues are underscored in our submission.

The issues for small and medium businesses relate to access to finance as well as to the cost of finance. I would like to draw attention to a couple of statements which do not come from within the business community but from within the sector. They underscore the significance of the issue. The Managing Director of the Bank of Queensland, on 16 April, when announcing company results said:

> The Australian economy has benefited from the swift actions by the Federal Government in those dark times in 2008 but we now have a position that the four banks have created an oligopoly in our market.

The demise of two of the major regional banks and several significant non-bank lenders, and the funding price disadvantage placed on small industry players has and will continue to place more power in the hands of the four major banks. The environment which we are dealing with here is an environment where there has been diminished competition as well as constrained capital flows from overseas markets, and that combination is a potent combination for Australia's small and medium businesses.

It is also worth noting that just a couple of weeks ago, on 8 April, the Australian Bankers Association, in responding to a report by the Australia Institute, said in a public statement that close to 60 per cent of banking fees are not paid by households but by businesses—in other words, we have seen, and our submission points to, the fattening of margins by retail banks at the expense of small business lending. It is not just margins in terms of repricing credit; it is margins in terms of a range of other fees and costs imposed on customers. Our submission deals with a number of international dimensions to this. Our submission deals with a number of recommendations for further action. I will ask Mr Evans to make a couple of brief comments.

Mr Evans—The key point from our submission is that we have a number of recommendations. The first one goes to the need to promote further competition in the market place. As we are all aware, since the onset of the GFC, and in the aftermath, a number of foreign banks and non-bank lenders have exited the market. We see a return to competition in the market as being absolutely essential. We would also be concerned if there were any further diminution of competition in the market through acquisitions or mergers, be they between banks or other large financial service organisations. We are still pressing the need for further inquiry in this area and we are obviously very encouraged by this particular Senate inquiry, but we also believe further assistance could be provided if there was a more extensive Productivity Commission inquiry.

We are concerned, and we have noted it in our submission, about the impact of international regulatory changes—notably, those changes under Basel II. We make the point in our submission that we are concerned about the level of lending skills within financial institutions and their capacity to assess risk within the small business community. We have observed over the last decade and a half that there has been a stripping out of trained business lending officers within the banking system in favour of lending for households, which is a much easier and less costly thing to do from a banking point of view. It has basically meant the demise of the local bank manager, and that has had an impact on the capacity of banks to assess risk.

We also believe that there is more scope for liaison with business from the regulatory authorities—notably, the RBA and APRA. We do note that other central banks do have extensive officer loan surveys that they conduct. I note the Bank of Canada, the Federal Reserve Board and the Bank of England have extensive surveys from their central banks, asking banks periodically: 'What are the credit conditions? How are you lending to small business? What constraints are you imposing?' We think that level of scrutiny on the banks in a periodic fashion would also be very helpful. They are the key points we made in our submission.

CHAIR—Thank you very much. The committee agrees with you about competition in banking and the fact that there is a need for increased competition to be restored. I notice that you talk about the Basel committee on banking supervision and the fact that that has some impact coming into the second half of 2010—or a fully calibrated set of standards would be developed by then. You say that these changes will certainly lead to 'are certain to lead to smaller banks' balance sheet and lower profits.' Do you think that the banking community in Australia will be happy with the Basel recommendations?

Mr Evans—We have noted the comments from their representative organisation that they are concerned about the implementation. We would I think in large part agree with those comments. We are concerned about the timing of the implementation and also some of the particular details associated with that. It is not an area that we monitor. We do not have particular expertise, but we are concerned about an internationally imposed set of arrangements on our banking system, which is to address issues that are probably not a deficiency within the domestic market. It is something that we are monitoring. We would support perhaps greater scrutiny of that and delay before it is finally implemented.

CHAIR—You say in section 7 of your submission:

Unlike other economies such as the US, Canada, Japan, Korea and Singapore, Australia currently does not have a public or private organisation(s) mandated to provide financial support or assistance to SMEs.

Do you want to tell the committee a little bit about how those sorts of schemes operate in other countries?

Mr Evans—We do note that those countries that you mentioned have specific government organisations which are mandated to provide guarantees for lending for small business. A lot of those schemes came about or were enhanced during the GFC. Even at the time, though we were concerned about that, it is not an area that we would comfortably see government providing guarantees for small business lending. Our resolution to that would be more that we have to promote greater competition within the Australian marketplace rather than seeing taxpayers being exposed to small business lending in that regard.

Senator HURLEY—Thank you for your submission. Your submission and Treasury's were very helpful to me and very comprehensive. I want to ask about the points you made in figure 2 of your submission, paragraphs 9, 10 and onwards. This was about the net interest margin, the NIM. You say:

According to RBA estimates, the average NIM for major banks on their Australian operations was around 2.4 per cent in the second half of 2009, about 20-25 bps above pre-crisis level.

Do you have any more up-to-date information? Has that continued into this year?

Mr Evans—That information was sourced from the RBA and I think it is the most current available at the moment.

Senator HURLEY—It has been said that during the threat of a recession banks were probably quite right to try to limit the defaults and they did not want to allow their bad debts to rise. So it may be that they overreacted a little. But, hopefully, now that the threat seems to be receding, they will respond accordingly. Do you have any anecdotal or other information that that may be the case?

Mr Evans—In the period in which the RBA has been tightening monetary policy, we have been concerned that the banks would pass on more than the official interest rate increases. In fact, we have said that there is capacity, given that there have been increases in those net interest margins, for banks for some classes of borrowers not to pass on even the full official rate increases. We believe it is important to continue that pressure because it is clear that, in the aftermath of the GFC, those net interest margins have actually increased and bank profitability has increased as a result.

Mr Anderson—This is not just an issue for marginal businesses. What we have seen is repricing of credit for long-term customers of banks. It is both the cost and the conditionality. Effectively, unless you are putting your bricks and mortar up, and you can only do that so many times, you are not in a strong position in any discussion with the banks. The banks are unwilling to even come to the table on issues like trade finance largely because there are fewer players who are going to be in that market and, as a result of that, the banks simply see no need to go into anything that has an element of risk associated with it. That type of risk aversion taken to an extreme, as it has been particularly in the area of trade finance, ultimately works against the interests of our economy and will only be healed by additional competition coming into the market.

Senator HURLEY—That competition question is very important. The Treasury officials made the very important point that, as the economy starts to grow again, we will start to get a bit more competition in the market and players will come in. I think it is clear that small businesses need some assistance in assessing loans and being able to switch if they want to. They mentioned a couple of initiatives that the government had taken and the government information line. What is your view of the amount of assistance from local councils, state governments and the federal government for small business and the penetration of that assistance into the small business market?

Mr Evans—Are you speaking from an education point of view?

Senator HURLEY—Yes, and assistance. For small business people it is often a matter of time as much as expertise to devote to ways to assist themselves into getting better loans and conditions, using their money in a better way or looking at alternative means of financing—venture capital and so on.

Mr Evans—Information is important and we do note that at the federal and state levels there are many programs and there is information on websites regarding how to access credit and what sorts of things the bank will be looking for in terms of information you need to provide. But I note, for example, that the ABA have made the point that it is not their problem if borrowers come to them with poorly prepared credit applications. I think we would reject that view. Most businesses have a pretty sound assessment and appraisal of their own financial circumstances and, when they go to seek a loan, they are going to seek a loan because they know they can service it and they know they can repay it. They do not just seek a loan to provide finance on a whim and hope that one day they might be able to repay it. Small businesses themselves have a pretty good handle on their own financial circumstances and their capacity to service borrowings.

Senator HURLEY—Small businesses definitely are riskier and often people will borrow to try and keep their business afloat when it is not that viable and it is getting difficult. But I take your point and I think most small businesses are well run.

Senator WILLIAMS—Mr Anderson, going back to your earlier statement about competition, we had many small finance businesses prior to the global financial crisis that were not registered ADIs. So when the government underwrote the banks, credit unions and building societies, they did not underwrite those small companies; hence people pulled their investments out of those small companies and put them into what they viewed as more secure deposits. We lost a certain amount of those small lenders, especially out in regional Australia, who were lending to farmers and small business as a direct result of not having their investments guaranteed by the government. Would you agree with that?

Mr Anderson—Certainly. Whilst the government supported the market and added stability to the market—and that has to be recognised as part of this discussion because it was a point in time when the entire market was extremely vulnerable—the consequence of doing so, in respect of the major lenders, coupled with the global changes in the flow of funds, meant that there was a significant impact on both domestic and foreign sources of competition against the major four. What that did was to strengthen the market position of those institutions and strengthen them in ways that, aside from providing structure and stability to the market, which we recognise, then led to the sorts of consequences that we have alluded to in the submission—that is, a fattening of margins, a re-rating of risk and an unwillingness to come to the table unless, effectively, profitability could be assured from the transaction.

What we are now seeing is, even if you start to recover competition into the markets for SMEs, you are recovering that competition at a higher platform. So effectively, as we point out in the submission, you have an increased cost of finance, which is like a structural change. To use a different analogy with the level of unemployment the structural rate has gone up as a result of some external force. Here, the structural rate of the cost of finance has gone up. A new platform has been set, and that new platform has occurred as a result of less pressure on the institutions to maintain finance at an affordable rate, recognising Senator Hurley's point about marginal businesses. We are dealing here with systemic issues that have been raised by long-term customers of the institutions.

Senator WILLIAMS—We heard from NARGA, the grocery organisation, how hard it is to get finance for young ones to go into businesses such as grocery stores et cetera. Do you think it is time that the government considered something like another Commonwealth Development Bank, specifically for small business and those sorts of areas in the economy?

Mr Anderson—That is a very deep question. Our preference would be for steps to be taken which bring about a market based improvement in the competitive environment. The Commonwealth has the capacity to use a range of levers to assist in that regard. Ultimately, the interests of the economy rest in there being a multiple range of institutions, domestic and foreign, which are capable of providing capital flows to the Australian business community. For the government to enter that market on a broad national base raises a range of additional issues that go to the question of the risks that are attached by government to the business of government. It is very tempting, from an immediate point of view, to answer that question by saying, yes. It is very tempting to say that, because there is a serious issue here that needs to be grappled with. My caution and qualification is to look into the medium- and long-term and conclude that it is probably in the best interests of our economy if that type of transformation in the competitive environment is brought about from within the financial institution market itself, as a result of pressure from government—and, to be frank, from the type of scrutiny that this type of inquiry also brings on the practices of the institutions—rather than from the government getting back into the business of banking.

Senator WILLIAMS—Do you believe that exit fees and establishment fees remove competition in financial institutions? I refer only to variable loans by the way.

Mr Anderson—We have seen a plethora of fees imposed by institutions and then, when there is any variation in fees to the benefit of customers, it is portrayed by the institutions as if it is some gift, when they actually imposed those fees in the first instance. I think competition is only real if it is capable of being experienced by the customer. The capacity of the customer to make good their technical right to move their funds from one institution to another is an important measure of whether there is competition. The nature of the fees, the level of the fees, the disclosure of the fees and the point in time at which those fees are introduced and set in so-called concrete, which is often at the point of the institution agreeing to provide funds, are important issues. If exit fees act in an almost prohibitive way for the transfer of funds from one institution to another, they effectively act in an anticompetitive manner in the market.

Senator PRATT—I was talking to a Western Australian small business a couple of weeks ago and they outlined their current experiences to me about their difficulties in accessing finance. They told me that their finance in February last year was at 6.25 per cent. In February this year it had gone to 8.69 per cent and by April it was up at 9.65 per cent. They noted with concern that, while the RBA rate went up at 0.25 per cent, their interest rate was going up by about one per cent. They said it was easy to get credit below about $25,000, but they were having extreme difficulty getting anything above that. The equity issue had changed. The banks no longer just wanted the new machinery they were purchasing as equity; they were chasing property as well. This small business asked the bank why they were being so non-competitive and the answer they were given was that banks were no longer targeting or focusing on small business lending as government incentives were no longer there. I could not quite see what the connection to government would be, if there was one at all, apart from the fact that things like the guarantee had changed some of those dynamics. Would you say, in a broad sense, that experience is fairly typical of many small businesses?

Mr Evans—That certainly would not be untypical and I think you noted that there has been a major repricing of risk; hence interest rates applying have increased. That is a signal that there is less competition in the marketplace than there once was. Also, banks have imposed stricter lending criteria, such as higher loan devaluation ratios et cetera. You mentioned asset financing. Our advice to a small business that is in that situation would be to go and seek asset financing from anyone else besides the principal bank. Leasing finance is done on the basis that the lender takes security over the asset and they should not need to take any additional security in terms of real estate. We believe all these things can be resolved by greater competition in the marketplace, not only between the banks but hopefully through the return of foreign banks and also the non-bank lenders—those who are involved in asset finance and leasing et cetera.

Senator PRATT—The return of that to the market should mean that banks will in turn have to become more competitive. So small businesses like this should not necessarily have to change banks, although it is clearly important that small businesses shop around.

Mr Evans—Certainly. At the moment, the large banks are able to say: ‘We do not accept your credit application. We do not like the security you are putting up. We do not like your serviceability capacity. Therefore, no is the answer.’ That leaves very little option for an SME because they cannot go to the next large bank as it is likely the answer will be the same. They generally apply fairly uniform lending criteria. In the absence of those smaller players, small business has very few options. What small business is doing at the moment is not borrowing to expand. That can potentially have long-term impacts. Obviously it has longer term economic impacts if businesses are not expanding and employing.

Senator PRATT—What is the nexus between that kind of pressure in terms of increased business costs versus the fact that, whilst we weathered the storm of the global financial crisis fairly well compared to other countries, cash still has not freed up for small business? When they are invoicing another business, people are still taking a longer time to pay. That is what this small business reported to me. Is that still the case?

Mr Evans—The underlying dynamics of a business, particularly an SME, have deteriorated since the GFC. All our surveys indicate that, for example, while sales revenue is improving, it is still very difficult. Profitability is still at a low level. So that has put the squeeze on small businesses in terms of their operating cash that is available for reinvestment. We believe a lot of this potentially still has to wash out. Small business was able to batten down during the GFC, cut costs et cetera, but there are potentially some accumulated concerns within the small business sector. Ultimately they are potentially going to need support from their lenders until the economy recovers to trend growth.

Mr Anderson—The problem was even more dramatic for those small businesses that were seeking trade finance—those small businesses that were seeking to maintain some degree of export activity. Competition and other providers in that market dried up dramatically, including one significant provider in your state, Western Australia. In October last year, we actually participated in a forum that was held with the major banks and a number of organisations to look deeply into what could be done about trade finance, because there is a very serious issue there. It was apparent from that forum that the banks were in the very comfortable position of openly saying that they did not see themselves as needing to come to the table in this market, irrespective of the level of business information about the export activities that the SME was going to provide. In fact, it was not just SMEs; there were even some fairly significant Australian businesses that were very frustrated in that market and continue to be.

Senator PRATT—What reason did the banks give for not coming to the table under those circumstances?

Mr Anderson—They did not see the need to exercise any risk whatsoever in respect of Australian businesses who were doing business overseas. They saw market conditions overseas as vulnerable, fluky and fluctuating. Reading between the lines, that said to me that they are in a position of strengthening their domestic base and their domestic base was able to secure the types of returns they sought. In the absence of somebody else providing that business to a customer, they did not see the need to do so.

Senator XENOPHON—In relation to what has occurred in Europe with respect to Greece and the fear of a contagion of other countries such as Portugal, Spain, Ireland and, to a lesser extent, Italy, do you see that having an impact here? If there is a rescue package there of hundreds of billions of Euros, could that squeeze global capital in terms of the finance sector and will small businesses be disproportionately affected by that? My other question relates to the issue of rural finance, where there has been a tightening up. There is a concern that forecasts of a hotter, drier Murray-Darling Basin and the impact that whole issue of water could have on agricultural production will have a cascading effect in terms of small businesses in rural communities. Is there an argument that they are being disproportionately affected in terms of any squeeze because of their vulnerability in the basin? Should there be alternative financing arrangements for that part of the economy?

Mr Anderson—I will comment very briefly, but we will comment further on those three questions on notice because they are very substantive. There is obviously some concern in global markets with the events in Europe that have arisen from sovereign debt issues. Our assessment is that this does not necessarily mean there is a global credit squeeze on. There is some uncertainty in European markets. The issue is how that contagion flows into global financial markets. As things sit right now, we certainly do not see any particular need for the Australian institutions to act opportunistically and say, ‘Because there is nervousness in markets in Europe, somehow we are going to rate risk more highly here.’

Senator XENOPHON—They could though.

Mr Anderson—This is what we have to warn against because it is opportunistic use of global developments like that which should be jumped on from a great height by governments, the parliament and business organisations like ours. Where there are substantive changes in capital flows and where there is an objectively assessed impact on the price of wholesale funds, there are different circumstances that exist. On what we are seeing at the moment, it is largely a European issue. The prospect of the EU effectively underwriting the Euro and underwriting the circumstances in Greece and to a lesser extent, if similar issues arise, in Portugal or Spain, is a positive development and we have to see it in that light. Certainly, at the moment, we would warn against any opportunistic action by Australian institutions.

On the question of the SMEs in regional areas: they are particularly vulnerable. The reason why they are particularly vulnerable is twofold. The types of business circumstances in regional areas are dependent on much narrower markets and a broader capacity for fluctuation in those markets, whether it is drought or the loss of a major industry from a particular regional town or the like. So the circumstances in which an institution can all of a sudden say, ‘There is an external factor outside of your business which is going to lead me to no longer provide finance or rewrite your finance on unaffordable terms,’ are more acute in regional Australia.

It also comes down to the point that Mr Evans made right at the start. With banks having taken away resources from their own businesses in those areas and with the absence of a good stream of people who understand the circumstances of SMEs working in banks and being able to write business for SMEs, there are going to be more random decisions made. Dealing with an SME is not about just doing a credit reference check and ticking a few other boxes, as you would do when you deal with an application from a person seeking home finance. There are a range of factors that the institution needs to have a greater appreciation of in terms of the way in which that business operates, and the lack of capacity inside the institutions to understand the small business market is a concern. That is something that we can do something about, and we have outlined a number of those measures in our submission.

CHAIR—I think we have run out of time now, because it is five past nine and we only have half an hour, unfortunately. If you could return those answers on notice as soon as possible, we would appreciate that. Thank you very much for appearing.

[9.05 am]

SATHYE, Professor Milind, Private capacity

CHAIR—Good morning, Professor. We welcome you to this inquiry. I invite you to make an opening statement.

Prof. Sathye—Thank you for the opportunity to appear before the committee. The main points that I would like to put before the committee are about the cost of credit for small businesses. It comprises fees and charges and the interest on advances. There are several different types of fees that are charged by banks. However, the data is not publicly available. Consequently, I cannot comment on the fee aspect of the cost. For the interest cost, though it may seem to be declining, as per table 1 in my submission, the relevant figure to watch is the risk premium, which has gone up significantly. This puts pressure on the financial viability of small businesses.

Coming to credit availability, as can be seen from table 2 of my submission, the proportion of loans outstanding to small businesses has declined over the years, which is indicative of banks reducing their exposure to small businesses. But this can have an impact on credit availability for small businesses. With only X amount of money available, the banks can cherry-pick the businesses they want to finance, even though there are probably other financially viable businesses out there looking for finance. It is possible to do this as there is a heavy concentration in the small business finance market, as can be seen from table 3 of my submission.

Coming to the bank guarantee issue, the bank guarantee helped the banks to reduce their borrowing costs, but the saving was not passed on to customers. For example, if you use the interest paid on online savings accounts as a benchmark and then compare the interest rate charged to small businesses, the pre-crisis spread was 3.80 per cent, which went up to 5.55 per cent during the crisis and currently stands at 5.70 per cent. It is unfortunate that the banks did not pass on the benefits that they received from the taxpayer funded guarantee, which was available to them at probably the lowest cost of the guarantee in the OECD countries. It was 70 basis points. Banks not only secured their position but also made record profits during the financial crisis by raising the bar for small businesses in particular.

Overall, small businesses have got a raw deal at the hands of the banks, which are almost the sole providers of finance, as can be seen from the data that I have given in my submission. So in my opinion there are several action points that can arise. The first action point is about the statistics for loans of different sizes—maybe less than $500,000, $500,000 to $1 million, and $1 million to $2 million. At the moment everything gets grouped under $2 million. These three different groups will have different risks, different stages and different opaqueness involved. As a matter of fact, there is a growth cycle theory in this particular arena by Berger and Udell.

The second is that, while the data on the interest rate that the banks charge is publicly available, the data on the fees that they charge for various services is not publicly available to make possible comparisons.

Third, there was a recent study in Italy which says that the public guarantee has helped small business access to finance and has also ensured there is a reduced cost for borrowing for small businesses.

CHAIR—Excuse me, Professor, where was that study done?

Prof. Sathye—In Italy. It is a very recent study. I can give you a copy if you want.

CHAIR—Yes, please.

Prof. Sathye—In the literature there is still a bit of discussion about public guarantees to be given for the SMEs, but this is the very latest study and it is an empirical study, so something that one can read and give thought to.

One of the points that comes to mind is that because the small business is a risky business—the margins are low—in the pie of the funds that the banks have, the banks will always put small businesses lower in the pecking order. There are different ways in which we can look at this problem. One way is probably improved competition, but that is better said than what actually happens in practice. The second way could be—of course, it’s probably not plausible in Australia in a market economy—to give some sort of mandated target. But that would be interfering in the free market.

As was discussed some time ago, the third way could be to have a mechanism, a separate development bank, for small businesses. There are issues with that kind of mechanism because of the cost that is involved in running it and, ultimately, to the borrower. I am coming now from experience from home. We had the Small Industries Development Bank of India, which was acting as a refinancing agency. It was basically raising capital in the market and, because it was a government bank, it was in a position to raise the capital at much lower rates and then lend it on to banks. So it was really refinancing the banks. Because the banks were getting a line of credit available to them, exclusively for lending to small businesses, it was freeing up their resources which were otherwise locked up—because they were able to get the refinance from the banks. That is a mechanism that can be considered. These are the issues that really require a lot of deep thinking.

If there is anything else you would like me to elaborate upon, I am happy to do it.

CHAIR—Thank you very much for your submission. We just heard from the Australian Chamber of Commerce and Industry that they do not favour governments getting involved in supporting small business in the way you were saying the Small Industries Development Bank of India did. Do you want to make any comparisons with similar support policies around the world for small business, where governments do get involved in supporting small business?

Prof. Sathye—There are several countries where governments do get involved—the US, the UK, Canada, Korea and Singapore, just to name a few—and government guarantees are provided to small businesses. The issue that arises is the running of that guarantee scheme, the costs that are involved and whether that leads to some kind of a moral hazard or problems arising out of it. The answer to that question will again be that we really need to consider it, study it and look at the feasibility and operation of it in an Australian setting. We say that we need to build competition in the banking market. To say that with the Australian banking market is more rhetorical. We say, ‘We need to build competition,’ but that competition is no longer there. The banking market is basically a market of the four banks.

The mechanism which I was suggesting of the SIDBI was a re-financing mechanism rather than a guarantee mechanism. The purpose of that re-financing could be to free up the funds of the banks. So if you have a pie, X amount is allocated to small businesses and the banks will be trying to reduce that pie more and more because it is not profitable. I am an ex-banker. If I have a profitable opportunity available out there in the market, why should I lend to a small business when I can make more money on the other side? One way to handle that is to free up this money. The way to free up the money is to have a refinancing mechanism that can help to push the money to the small business sector. The refinancing that was available from SIDBI, which is the Small Industries Development Bank of India, is exclusively for small businesses. So the banks lend for small businesses and, in turn, go to the SIDBI and take a re-finance from the SIDBI, and SIDBI then provides them with the finance. That channel goes to small businesses only—nothing else—and it frees up the funds of the bank. I am really thinking aloud, but it is an issue that needs to be examined in depth to see how far it is appropriate for Australian conditions. That is one of the ways to consider.

Senator HURLEY—I would like to follow up on that point because your table 4 shows that really the banks are providing—and have been providing for some time—a great deal, between 98 and nearly 99 per cent, of loans. We did not hear of any problems with that before the global financial crisis. So it would seem to me that there is not so much a problem getting money, except when conditions are tightening up generally. Is there really a need, given that the economy seems to be recovering, for setting up this kind of re-financing arrangement?

Prof. Sathye—That is an interesting observation. My take on it is this: as far as my knowledge goes in this area, we do not have a regular mechanism available to check whether the access to finance for small businesses is up to what they are really after. In the case of the global financial crisis, because things became very tight in the market, that issue came to the fore. Otherwise that issue hangs in there without coming to the fore. The reason for that is we do not have this kind of statistical data being generated periodically to check whether that access is available and access is available at affordable cost. It has to be at affordable cost as well.

Senator HURLEY—Fine. In your table 2, you were talking about the change in the proportion of credit for small business. I am not sure if it is statistically significant but the proportion of credit to small businesses—as opposed to credit for all business—seems to have started coming down in June 2006. There were a couple of periods before the global financial crisis where it seemed to be trending down.

Prof. Sathye—You can see there that from June 2006 onward the share in the pie available for small businesses was declining. One reason for that could also be that these are the years—2006 and 2007—where we were doing pretty well in the case of large businesses. As a result, it is possible that the banks would have moved their resources to large businesses, reducing the pie for the small businesses. That is what I can read from those figures.

Senator WILLIAMS—Is the reduction of lending to small business because small businesses are not requesting the loans, or are the financial institutions specifically targeting lending to the bigger businesses and not to the smaller businesses?

Prof. Sathye—I will not say that the small businesses are not requesting loans, because if a business needs a loan—if somebody needs the finance—that business is going to go to a bank, tapping for finance. The only source that a small business can tap is a bank. I will not say that the small businesses are not demanding it, but the question arises of what is happening on the supply side of things. On the supply side of things, as I said before, because small businesses involve a lot of risk to the bank compared with large businesses, the risk premiums are higher in the case of small businesses. That could be a major reason why the financing is not going to the small businesses.

There is information opaqueness in the case of small business at the different stages through which they go. This information opaqueness requires the bankers to spend more time on assessing those proposals, as the speakers earlier were saying here. It requires more credit assessment skills on the part of the banks. So the costs of servicing those loans will be higher from the bank's side. One can think of using credit scoring models which can reduce that cost. But, again, they are fraught with some of the issues that are encountered with credit scoring models.

Senator WILLIAMS—During the period of reduction in interest rates I spoke to many small businesses and farmers who were saying that they never had the full reductions passed on to them. That figure in table 1 of yours would confirm that, I would imagine.

Prof. Sathye—Yes.

Senator WILLIAMS—We had a four per cent reduction in interest rates commencing on 3 September 2008. Probably 3.8 per cent of that was passed on to home loans, but in many cases two per cent or less was passed on to small business and farmers. I am suspicious that that was political. A lot more voters have home loans than there are small businesses and farmers et cetera. The government—the Treasurer—had a lot to say passing the reductions on to stimulate the economy. Those reductions were not passed on, in many cases, to small businesses. That would have held the economy back, wouldn't it?

Prof. Sathye—I would share that view. That is probably true. The reason for that is also something that I find very upsetting with the banks. They did not pass on the full reduction from the official cash rate despite the fact that they had a taxpayer funded guarantee. There was a taxpayer funded guarantee available and that means that if I am a bank and I am in trouble I can go to the taxpayer and say, 'Give me the guarantee.' And what happens to the small business then? The small business is also in trouble. The reason the government gave the guarantee was to enable the banks to raise funds so that the credit supply to the market was not hindered. That was the purpose—the intention—of giving the guarantee. If that purpose is not being served and at the same time small businesses have to pay higher costs at a time when they need the oxygen of money, I would probably say that that action on the part of the banks was certainly not desirable.

Senator WILLIAMS—Are you concerned about the lack of competition in the banking industry, or do you think there is enough? We have seen many mergers and takeovers over the years. We have seen many smaller financial institutions fall over as a result of not having their deposits underwritten by the government, whereas the registered ADIs did. What is your attitude towards competition? Do you think it is good enough out there?

Prof. Sathye—As a matter of fact, Australia happens to have one of the most concentrated banking markets in the world. Less concentrated than us was Canada, and even the Canadian banks operated with a margin of two per cent over their official cash rates. Our banks, with more concentration, continued to operate with the 2.8 per cent margin during the crisis when it came to mortgage loans and a greater margin in the case of small business loans. So our banking market is certainly very concentrated.

Senator PRATT—I have a brief question. You note in your conclusion the manner in which both businesses and households were at the mercy of banks because they were the only ones with any liquidity. But we have also differentiated the problem of households versus small business. What is the extent to which you think banks were, I suppose, gouging from a lack of competition in the small business sector when really there was probably still enough competitiveness in the households and mortgages sector? Would you say that banks are seeking to make profits at the expense of small business, or does that go too far? I am really trying to test the depth of this.

Prof. Sathye—The way the scenario looks is that more than 50 per cent, maybe even up to 60 per cent, of the loans of a typical bank in Australia are for home lending. It is considered to be safe business. When it comes to small businesses, where the small business lending is also secured by a mortgage on the house of the business owner, that gives an advantage to the banks when lending for mortgages from the capital adequacy purposes. I am trying to restrict myself less to the technical details of it. If you go into the capital adequacy, you are using the standard model of the Basel committee, then you have a 50 per cent capital risk rate for mortgage loans, while in the case of business loans it will be 100 per cent. The interesting thing that happens, and would be happening if the industry could clarify this, is that when you lend to a small business against a mortgage then that gets classified for the purpose of capital adequacy as 50 per cent risk rate. So the bank accepts at that point of time that this risk is less for the purpose of capital adequacy. But when it comes to changing interest they do not say, ‘If the risk is less, why don’t we charge the same interest as for a mortgage?’

Senator PRATT—Because of what it is secured against.

Prof. Sathye—The security is the same. That will get more accentuated in the case of our bigger banks, which are allowed to use a different model on the basis of their own internal rating of things. I would suggest from what I read in this area that, while it is 50 to 100—so just double, as per standard model—in the internal risk rating model it could be four or five times.

Senator PRATT—So whilst the risk might be higher, the asset that is secured against is no more or less risky, so there is no rationale in that sense for a difference.

Prof. Sathye—Prima facie it does seem like that. What is the rationale there? That is number one. Number two is that from an economy perspective a business is a productive asset; it is a productive loan generating employment, generating goods and services, whatever is there. A mortgage is really not generating anything. So from the economy perspective it does make a lot of sense that the banks provide more finance to small businesses and help the economy. Especially when you are having a publicly taxpayer funded guarantee it is incumbent upon you not from an equity or moral or ethical perspective but from a legal perspective that ‘I have given you a guarantee as a taxpayer, you should give something back to the economy, and that is by financing small businesses.’

CHAIR—Professor, thank you very much for appearing.

[9.30 am]

HEALY, Mr Joseph, Group Executive, Business Banking, National Australia Bank

McINERNEY, Mr Dallas James, Group Manager, Government Affairs and Public Policy, National Australia Bank

CHAIR—Welcome. Would you like to make an opening statement?

Mr Healy—Yes. First of all, we welcome the opportunity to attend this inquiry. We see the whole issue of financing to small business as a legitimate public policy matter. NAB is Australia's largest business bank. We have about a 30 per cent market share of lending to small businesses, with over 5,000 bankers located across the country in 225 dedicated business banking centres. We have total lending to business in Australia of $185 billion, of which approximately $150 billion is to SMEs. Our level of lending has grown 100 per cent since 2005. We very much see SMEs as the engine room of the economy, and therefore the ability of the banking system to finance SMEs is something we consider to be very important. Late 2008 and 2009 was a difficult time for businesses generally, given the uncertainty around the global financial crisis. During that time, we resolved to stand by and support businesses in Australia. The records will show that our net lending to small businesses grew by $5 billion in 2009 when in aggregate the other banks reduced lending by $28 billion. So our claim to be the business bank for Australia is supported by the facts.

We have been very vocal on the issue of financing small businesses. I draw the committee's attention to a speech I gave to the American Chamber of Commerce in February, in which I highlighted some concerns about the way the banking system appeared to demonstrate a bias towards the household sector and was not apparently supporting businesses, particularly small and medium sized businesses. We draw this out as an issue because, to the extent to which small businesses are not growing, there are medium- and long-term economic consequences. For that reason alone, we see this as a public policy issue.

CHAIR—You say that prudential settings favour residential lending and you relate that to banking supervision accords overseen by the Basel committee on banking supervision—Basel I in particular and then Basel II. We have already had some comment about the Basel regulations. With the implementation of those regulations, will small business be permanently disadvantaged in terms of the risk weighting?

Mr Healy—Prima facie, Basel II makes it more attractive for a bank to lend to the household sector than to small business. In fact, we have the perverse situation where it is more attractive to lend for a weekend holiday home than to a small business. That is one of the consequences of Basel II. Basel II of itself does not mean small businesses will not have access to financing, but from a bank's perspective there is more capital involved in supporting small business lending as distinct from household lending, and that creates a bias. In a world where, for example, capital is scarce and funding is scarce, the incentive is to support household lending as distinct from business lending, all other things being equal.

CHAIR—Could you argue that the implementation of Basel II is exacerbating the increase in the price of houses around Australia rather than supporting small business?

Mr Healy—The statistics show that we are looking at a very high level of house prices in Australia and a very high level of household borrowings. Household borrowings today are at about $1.1 trillion, with 85 per cent sitting in mortgages. They have gone up from about $165 billion in 1995. So there is clearly a significant appetite in the banking system to lend to households and a significant appetite on the part of households to borrow. Compared to other countries, we have the highest ratio of household debt to disposable income, and our average house price today is approximately six times average income. That, plus other measures of house prices, has caused some people to raise concerns about the risk to the economy of a potential bubble in the household sector. There is undoubtedly potential there.

Senator HURLEY—We have had quite a bit of discussion about the cost of capital. The ABA's submission says the cash rate is not an accurate indicator of a bank's cost of funds, which I presume you agree with. But we have heard criticism that, particularly with the bank guarantee, the cost of loans to small business does not reflect the cost of funds. Could you comment on that.

Mr Healy—One of the consequences of the global financial crisis is that the cost of funding to the banking system went up significantly. We rely very heavily on offshore markets and wholesale funding to fund the economy. Notwithstanding access to the guarantee, the price went up quite significantly, so the link to the official cash rate disconnected during the crisis. So, certainly, the cost of funds has gone up—that is a fact rather than an opinion. The higher interest rates paid by businesses, in particular small businesses, reflect in part that higher cost of funding. They reflect also the higher level of risk attached to lending to small businesses. We have touched already on the Basel II implication. So the perceived level of risk in lending to small business has been a factor in why interest rates for small businesses are at a higher level than interest rates for mortgage lending.

Senator HURLEY—Was there a conscious decision to restrict lending to small and medium enterprises during the financial crisis, and just after, in order to constraint risk to banks?

Mr Healy—I can really only talk on behalf of the National Australia Bank. I mentioned in my introductory remarks that we took the view in mid-2008 that it was very important that we stand and support business, in particular small businesses, through the uncertainty that was emerging. I quoted some APRA and RBA statistics that validate the position we took. From a National Australia Bank perspective, as a large domestic commercial bank we play a fundamental role in the economy and it was not in our interest to start making it difficult for small businesses to access finance; in fact, it was quite the opposite.

Senator HURLEY—So why do you think other banks took that step? You are saying you did not think it was necessary to constrain lending to small businesses. That implies that other banks took an unnecessary step that provided an unnecessary constraint on small businesses.

Mr Healy—I cannot really talk on behalf of the other banks. But I should highlight the significant change that happened in the banking market as a result of the global financial crisis. Leading up to the global financial crisis, approximately one-third of the bank lending system in Australia comprised non-bank financial institutions, regional banks and foreign banks.

Incidentally, many small businesses had relied upon non-bank financial institutions, regional banks and foreign banks for access to credit. With the onslaught of the crisis, that segment of the banking system shrank significantly and reduced capacity. They made it clear to some small businesses that, when there facilities were due for renewal, they would be instructing them to seek other forms of borrowing. So, suddenly, you had a significant part of the economy looking to seek refinancing and establish new banking relationships, arguably at the worst possible time given the uncertainty that was emerging.

Senator HURLEY—Do have an estimate of what proportion of the small business sector NAB provides financing to?

Mr Healy—The market share statistics say that we have got 31 per cent of market share to small and medium sized businesses. We have just over 20 per cent market share of total business lending, which includes some of our top companies. In terms of market share, we are the largest bank lender to small businesses.

Senator HURLEY—Has that changed over the last couple of years?

Mr Healy—Yes. In the last 18 months we have grown our SME market share by just over two per cent.

Senator WILLIAMS—I want to come back to a point I have raised with earlier witnesses today about how interest rate reductions were not passed on to many small businesses and farmers. You have talked about security—and, obviously, because some borrowers were high risk, you could not reduce those rates. But I have spoken to farmers who have 70 or 80 per cent equity in their property, which is real security. Why didn’t they get a reduction like the home loan borrowers did?

Mr Healy—The risk of lending money is not solely predicated on the form of security, because it depends on the ability of the borrower to service the loan. In my view, the last thing banks should do is lend money predicated on security alone. Security should really be the fallback if all other things do not work. It is really about looking at the serviceability of the borrowings. The environment changed significantly, certainly internationally, for businesses that were dependent on the international markets. But also domestically there was great uncertainty as to just what impact the GFC would have here, so risk went up.

The other thing I would highlight to the committee is that there is a sense that discipline around pricing for risk had been lost in the market in the five years, or arguably 10 years, leading up to the GFC. If you look at the problems other markets or systems have experienced, they have largely been because people have not properly priced risk. We saw bank margins declining by about 170 basis points, according to the RBA, in the seven months leading up to 2009. There was a sense that the discipline around risk had not been what it should be. So I think one of the factors about the global financial crisis is that people reacquainted themselves with the discipline around ensuring that lending was properly priced for risk. So that in large part is the reason why. Notwithstanding security, it is about the underlying riskiness of the cash flow, the ability to pay debt, that really counts. Certainly when I speak to small businesses they are much more concerned today about access to credit and the quality and reliability of the relationship they have with the institution than they are about the 50 or 70 basis points difference in credit. They want certainty and they want to know that a bank that provides credit to them is not going to ask for it back when condition start to get tough.

Senator WILLIAMS—But when conditions start to get tough they also want a lower interest rate, when Reserve Bank cash rates are falling, to help them through the tough times. Obviously if they do not get that lower rate it just makes their situation worse.

Mr Healy—Absolutely.

Senator XENOPHON—In your submission you said that the $13 billion in bad and doubtful debt that the banks reported in 2009 was largely from its business lending activities. How much of that was related to small businesses, and has there been a reassessment of that in the last couple of months?

Mr Healy—The bulk of that would be mid sized and larger businesses, rather than small businesses. During the onslaught of the slowdown in economy, we saw some bigger companies such as Centro get into difficulty. There is often a lag effect with an economic slowdown coming through into the small sector. Small businesses were helped last year by the government stimulus, which helped many segments of the small-business market. Whilst I do not have the exact figures, the majority of that would have been geared more towards mid sized and larger companies.

Senator XENOPHON—If you could take that on notice it would be useful. Finally, there is a real issue in terms of rural and regional Australia, particularly the Murray-Darling Basin, with predictions of a hotter, drier basin. That will have an impact on those communities in terms of productivity. There is a view that it is harder for small business in regional Australia to get finance. Do you have a view on that, given the prediction that things will get tougher in the Murray-Darling Basin?

Mr Healy—Again, I can only talk on behalf of the National Australia Bank. We are very committed to rural Australia. I mentioned that we have over 5,000 bankers located across the country. We have a specialist rural agribusiness branch, which is the largest in the country. All of these people are embedded in their local communities. We do not make decisions about lending from remote locations; we believe greatly in the idea of community and relationship banking and, when you look at the location of our bankers around the country, the evidence shows that we are close to those markets. So we obviously treat those issues responsibly but we are also conscious of our responsibility to our customers and to our communities to support businesses through thick and thin.

Senator XENOPHON—I understand that, but if it is a case of 'more thin than thick', given the predictions that productivity in the basin will be affected by the issue of water, how do you deal with that? Is there a case for saying that, given that those factors are beyond your control and beyond the control of the farmers, there ought to be some special assistance or an alternative approach to ensure that those communities do not see the bottom falling out from under them?

Mr Healy—That is something we can look at. That has been our approach in other regions that have been subjected to impacts from weather conditions over the last several years. We have been consistently supporting rural communities. I do not see any change in our approach.

Senator PRATT—I want to ask about the significance of the international Basel II capital adequacy rules. As you have stated in your submission, these rules encourage banks to favour residential mortgage lending over business lending. How significant are those rules in the situation that small business currently face?

Mr Healy—As I mentioned, Basel II makes it more attractive for banks to lend for household mortgages than to business. If you look at the amount of lending into the household sector over the last 12 months, as opposed to the business sector, that will give you an answer to that question. I do not believe it is necessarily a question of one or the other. You might say, 'Why don't banks lend to both the household sector and the business sector?' That is the approach that we have taken. I mentioned that we have a significant reliance on offshore funding to keep the economy going. Australia is a significant borrower offshore and a relatively small part of the global economy. If there were constraints placed on that, if the offshore markets had limited appetite to continue to fund that, it could force decisions about whether we should do household or whether we should do business. Behaving in a strictly rational way, considering the interests of our shareholders only, the incentive would be to do the household sector rather than the business sector—if that were the narrow view that you took. I do not see that issue as being with us today, but it is certainly something that cannot be discounted for the future.

Senator PRATT—Particularly given our current circumstances, how can we mitigate against that future risk?

Mr Healy—My paper really draws this out. There is a need to look afresh at the role of the banks in the economy and how banks are allocating capital between households and business. In most cases, people do not welcome outside views of how the industry performs. But being conscious of the importance of supporting businesses, being conscious of some of the distortions in the system such as Basel II, are we happy in the long term with the way in which the banks are supporting the business sector, particularly the small business sector, and are we happy with the extent to which the banks seem to have a significant appetite for household lending? What are the risks that might present? I am not necessarily forming a view on these questions, but it seems to me that these are legitimate questions.

CHAIR—We think they are legitimate, too. We thank you for being here this morning.

[9.49 am]

HAND, Mr Mark, General Manager, Regional Commercial Banking, ANZ Bank

NASH, Ms Jane, Head of Government and Regulatory Affairs, ANZ Bank

READE, Mr Nick, General Manager, Small Business Banking, ANZ Bank

CHAIR—I welcome representatives of the ANZ Bank, for whom we have an equally short time frame of 20 minutes. It seems very short indeed for the issues involved. Do you have any comments to make on the capacity in which you appear?

Mr Reade—Mr Hand is responsible for the rural and agribusiness market, including small businesses in rural and regional areas of Australia.

CHAIR—Thank you. Do you wish to make a short opening statement?

Mr Reade—Yes. Thank you to the committee for inviting us to attend today. You have our submission. Given the short time we have today, I will make my opening remarks really short. First, during the global financial crisis and a weakening economic environment, far from turning off the tap, we committed publicly in March 2009 to make available $8 billion in new lending to the SME market for the 2009 financial year. This was equivalent to our new lending to that market in the year before—2008—before the crisis. Of this funding, $6 billion was taken up by our small business customers. There was insufficient demand for the full amount—applications to ANZ from small business customers decreased 18 per cent from 2008 to 2009. Our commitment to continuing to extend finance to small business customers through that period is apparent with approval rates staying above 80 per cent through that time. While demand was down overall, we had solid growth in lending to the smaller end of the SME market. At ANZ we classify small business as having lending underneath $500,000. In that market, business lending volumes grew 10 per cent. In addition, we continued to lend to start-ups. We continued to lend on an unsecured basis as well as secured.

Secondly, we committed to supporting our customers through the financial crisis with options such as extended repayments, deferred repayments, interest waivers and fee wavers to support them when they were facing difficulty. We also committed to employ an additional 130 staff facing small business customers, mainly in our branch network. About 100 of those are on board now with, obviously, a few more to come this half. We have provided a series of free small business workshops, which were really valuable to our customers—about 3,300 of them attended the workshops. The topics ranged from cash flow management to business planning, even to marketing, including online marketing. They were very well attended.

ANZ also provides its small business customers with an online small business hub, which is an online business tool to give them access to lots of information. They can do online courses, see webinars and access information on topics such as cash flow planning, and there is also a chat room. One of the things our small business customers like is to talk to other small business customers. The online chat room allows them to talk to each other and to seek other views. A week or two ago we launched a new tool called ANZ Business Insights, which is a free tool that allows our business customers to view detailed information about their business based on merchant and debit and credit card transactions. This information can be used to compare their sales performance against trends of similar businesses in their local market based on aggregated data. Also, industry level reports are available free of charge for small businesses that are not ANZ customers.

Finally, economic conditions are improving and as a result we are reviewing our lending criteria and relaxing wherever possible. For example, we recently introduced a streamlined process for secured lending to enable access to finance with a reduced level of documentation and certification of financials. ANZ remains strongly committed to serving the small business market and we want to grow our business in this area.

CHAIR—Thank you for that short introduction. It is quite interesting that you have done so much for small business. I notice that in the small business lending criteria section on page 9 of your submission you state:

It is prudent for all banks to review their lending criteria on a regular basis in response to the broader economic climate and, while ANZ continues to lend to small business, we initially implemented tighter lending standards in response to adverse economic conditions …

Have you ended them completely?

Mr Reade—Less than 10 per cent of our business was written in what is called the low-doc space, where there is low certification of financials. That was an area that we pulled back on and that was pretty much it in the bottom end of the market. We did that because the loss rates were unsustainable. They were probably around eight to 10 times higher than the portfolio average. As soon as those trends became evident, it was not sustainable for us to continue with that business. Other than that, there were very few changes.

CHAIR—That is the exact market that we are interested in. You said the loss rates were unsustainable compared to the average. What was the average loss rate?

Mr Reade—As I sit here today, the average loss rate is about 170 basis points and it was 10 times that.

CHAIR—That is significant.

Mr Reade—It was significant. There were one or two other banks in the market offering similar low-doc lending and they also withdrew that from the market.

Senator HURLEY—The Treasury submission talked about the easing of upward pressure on interest rates and said:

Both CBA and NAB recently indicated that they expect their impairment expenses have peaked. Westpac also noted in its December quarter update that its impairment charges had fallen.

Is that your experience as well?

Mr Reade—I think we are seeing that, through the crisis, our delinquencies and loses doubled in this segment, which is a significant increase. But, since probably early this year or even at the end of last year, we started to see a plateau. Currently we are seeing our forecasting around delinquencies starting to flatten out. It is still at significantly higher levels than we had seen prior to the crisis. The answer to your question is yes. We see it stabilising and, with fingers crossed, lowering. The possible impact of the events of the last few days makes you start thinking about your forecasts again. Fundamentally, we are not out of the woods, but there are some better signs.

Senator HURLEY—You would expect in the nature of things that small business and business generally would be in a better situation if that trend does continue. We are looking at a gradually improving position.

Mr Reade—Definitely. We are seeing that in demand. Demand for lending is picking up. Our application numbers had fallen through the crisis. They are back up above where they were. Our numbers for March 2010 are the highest they have been for a number of years—in fact, ever. So it is a good sign that demand is coming back into the market. We have not changed anything dramatically and it is good to see that customers are getting some confidence again. They are probably borrowing a fraction less than they used to. They may be a bit cautious and are dipping their toes back in the water, so to speak. It is not dramatically less. Average lending size has dropped a little bit, but not much. They are good signs.

Senator HURLEY—Getting on to another topic, you made an interesting point about the wholesale funding guarantee. You were saying that the global financial crisis made it difficult to borrow in international financial markets. The guarantee underpinned that and facilitated access. There has been some criticism from some quarters during this inquiry that banks had this guarantee that gave them cheaper finance but it was not passed on to small business. It seems to me, from your submission, that you are saying that underpinned your wholesale funding and enabled you to keep on lending at a reasonable rate.

Mr Reade—It certainly helped. As my colleague from the NAB mentioned, it really did not change the fact that the absolute cost of funding had gone up dramatically. In addition to that, the risk had gone up dramatically and the cost of retail deposits, which is the other source of funding, had also gone up dramatically. So we had this triple whammy of key factors that were impacting on our business. You are right and it could have been even worse without that, but at the end of the day the costs were significantly higher. That was a factor in some of the pricing decisions that were made both from a credit risk perspective and from a funding perspective.

Senator HURLEY—Will the removal of the guarantee have an impact?

Mr Reade—I guess we are getting back to some sense of normality, although the absolute cost is still expensive. The way we fund our books means there is a lot of three- or five-year term debt. Because that started before the GFC and is now ending after it, when we renew that debt, it is at a much higher cost. That is still there, but there certainly are some signs of improvement. We hope that whatever is happening in Europe stabilises and does not create another impact.

Senator XENOPHON—I should disclose that I am an ANZ customer. You have not called in my loans yet, so that is good!

Senator WILLIAMS—You pay them, don't you?

Senator XENOPHON—Further to Senator Hurley's line of questioning, you said earlier that we are not out of the woods yet. Is there are a risk that we will be in the woods a fair bit longer if Europe does not get its act together, to put it bluntly?

Mr Reade—I do not know. This is only a personal view. It is hard to know. We expect the events to play out and we are monitoring it closely. I honestly do not know. I would think that the issues would be similar to what we have seen before around funding et cetera. Hence, it would have an impact on our business. It is really hard to tell and I really do not know.

Senator XENOPHON—I know it is hard to tell but, if there is a scenario where things go pear shaped in Europe and do not work out, that will have an effect on global financial markets and it will affect us, won't it?

Mr Reade—You would assume so.

Senator XENOPHON—I know that your bank has a strong network in the regions. There is a concern with forecasts that the Murray-Darling Basin will become hotter and drier, which has all sorts of implications in terms of productivity and the knock-on effects in regional communities. Is there a case for government or some other assistance to allow those communities to plan for the long term? It is beyond your control and the control of farmers who have to deal with less water, lower productivity and the like.

Mr Hand—I will take that one as I look after the agribusiness for ANZ. There is absolutely no doubt that any bank that banks the agriculture sector or regional Australia knows that you do not bank the sector for one or two years. You have got to bank it through the cycle. It was pleasing to see the headlines this morning that the drought is over. I am not so sure, but we have certainly had a lot more rain. A lot of that rain is still to flow through the system. The level of delinquencies we have seen has certainly peaked in our view, but in the agriculture sector it is probably still at a high.

Senator XENOPHON—I understand the issue about the cycle but, if it looks as though the long-term cycle is going to be much less favourable that it has been in the past, does that suggest that we need to think outside the square and that it cannot be business as usual? This is not the fault of the banks; this is because of climatic or other circumstances.

Mr Hand—I think that is right. Right across our whole small business division we have got ways of helping customers who hit difficulties. Whether it is the bushfires in Victoria, the floods in Queensland or the drought, we have to put special assistance packages in for those customers and treat them very differently to the way we have. I think the customers are smart enough to know that they need to do things differently and we are some of the first people they talk to in those situations.

Senator WILLIAMS—When you do have to give extra assistance, is it usually at a higher price?

Mr Hand—No. In fact, it is quite the opposite. With floods and the like, we have actually capitalised interest and put increases aside for those customers when other customers may have faced increases. We have reduced rates in some cases.

Senator WILLIAMS—Good. So it is not the normal practice to increase the margins on people who are getting desperate, so long as they have got ample equity left in their asset?

Mr Hand—No, quite the opposite. The Queensland floods are a good example. While it is causing them short-term grief, we give them holidays on their repayments. In the long term, they will be a lot better off for the rain and they will be lower risk customers in the future.

Senator WILLIAMS—I commend you on your attitude that agribanking cannot be a one or two year thing. It is a 20-year cycle. We are having the dry times now, but we know the wet times will come. Hopefully, there will be water available for irrigation to make the local communities in the Murray-Darling area sustainable in time.

Mr Hand—We all hope so.

CHAIR—On that subject, one of the specific issues that has been raised with us—I am from Western Australia and I have heard this from Western Australia—is that farmers are finding it difficult to raise finance at the moment. Would you like to comment on that? Have you changed your lending practices to farmers?

Mr Hand—We have no difference in approach across the country. We have a segment approach—so, we have an approach to the wheat sector and the meat sector. Geography is relevant: there has been less rain in WA than there has been in other parts, but it is certainly no dryer than New South Wales has been. So we do not have any specific policies that make it any different for a Western Australian farmer to borrow than for a New South Wales, Queensland or Victorian farmer.

CHAIR—Most of the complaints have come from the wheat sector. They are saying that wheat farmers are finding it difficult to borrow to put in their crops. I believe the anticipated price of wheat is a lot lower than it was, which I suppose increases the risk of a bank lending if the return is not there. Is that an issue, do you think?

Mr Hand—It is an issue. Joseph Healy from the NAB talked about the first decision you make being whether a customer can afford it, and a lot of people believe that the wheat price is headed towards $150 a tonne. It costs them around about $160 to produce that wheat. So they are resorting to on-farm storage, which they have not done for a long time, and the result of that is that customers will be sitting on their stock and not selling, so they will have no cash flow through the business. So the industry is going to be a tough industry for the foreseeable future.

CHAIR—Would it change the attitudes of banks in deciding to lend to a wheat farmer who wanted to borrow between $500,000 and $1½ million to put in a wheat crop?

Mr Hand—If the risk profile of the customer changes, it absolutely does change our approach to that customer.

CHAIR—Okay. As there are no further questions, are there any other comments you would like to make?

Mr Reade—No.

CHAIR—Thank you very much for coming.

[10.09 am]

DEGOTARDI, Mr Mark, Head of Public Affairs, Abacus—Australian Mutuals

PETSCHLER, Ms Louise, Chief Executive Officer, Abacus—Australian Mutuals

CHAIR—We welcome you here today. Would you like to make an opening statement?

Ms Petschler—Thank you, we would. Given the time available, we will make just a short statement. We represent the customer owned banking institutions in Australia. So we represent 105 credit unions and nine mutual building societies which operate around the country. We also represent the friendly societies, which are not as relevant for today's hearings.

Between them, our credit unions and mutual building societies have about 4½ million members around the country and assets of about $70 billion. They are the fourth-largest holder of household deposits in the country. They operate more branches than the Commonwealth Bank of Australia and they operate the second-largest ATM network in the country. So while individually they are relatively small institutions, particularly compared to our friends who have just preceded us, collectively—and the system does operate as a bit of a collective system to compensate for scale—we are systemically important.

Generally speaking, credit unions and mutual building societies are retail banking institutions. Our focus is very much on consumer banking. That is our core market and our small business activities tend to be the small to microbusiness activities—so, very small business activities. But there is a lot of diversity amongst our membership. Our largest institutions are around getting close to $10 billion in assets and include very large regional brands, and they have significant population penetration in areas like the Hunter in New South Wales or South-East Queensland. At our smaller end we have still got credit unions that are around $10 million in asset size and serve a few thousand members, perhaps linked to a particular workplace or a particular community.

With that amount of diversity we obviously we talk in averages, but if we think about some of our large regional members they actually have quite significant small business and small commercial business lending, particularly in the regional areas that they operate in. Those institutions, as you would expect, have invested in the expertise and capacity that is required to manage those books. It is a higher credit risk area. It is an area that requires a different skill set to our traditional market—of savings and loans, essentially—and APRA, our regulator, is obviously very keen to see if any credit unions or building societies move into that lending space where they have made those investments, as are we as the industry body.

Our book in terms of what we classify as commercial lending is about $2.2 billion at the moment, and that has grown probably about 8.5 per cent over the last couple of years. That is not insignificant if you consider most of that is small-business lending when you hear the figures from a large institution such as the ANZ. But our figures are a little disguised because out of our $55 billion mortgage book a reasonable amount of that—it is difficult for us to quantify but we are happy to take that on notice and we are attempting to get clearer figures—will include small sole trader businesses that are operating business overdrafts secured to a mortgage, and that is particularly the case in some of our country and regional areas where we operate, less so in the capital cities, particularly Sydney, Melbourne and Brisbane.

Our interest rates are highly competitive where we are active in the small-business market. According to Canstar Cannex, five of the 10 lowest interest rate overdrafts you can get in Australia at the moment are offered by members of Abacus and three of the five highest interest rate products that are targeted specifically at small or micro businesses are offered by credit unions and building societies. But we do face a number of constraints in terms of our capacity to grow that market. You would have noticed in our submission we included some anecdotal comments from a few of our members. You see there some members are talking about 30 per cent growth they have experienced and some are talking about getting their toes into that market. Again because they are very conservative and prudentially managed organisations they want to make sure they have got that skill set. But the common constraint that we see across the sector, from large to small credit unions and building societies, is the access to diversified funding sources that will enable us to hit the accelerator a bit stronger in terms of growth. We see that in terms of home lending as well as our small-business lending and micro business lending activities.

We have got a number of ideas that we have been in discussion with the government about in terms of options that would improve our ability to compete. As I am sure you are aware, we pass on a greater degree of interest rate benefit to our members and our customers, including our small-business customers, and you see that from those Canstar Cannex figures. Of course, we will always be majority retail deposit refunded; that is the nature of our business. But the global financial crisis and the difficult wholesale funding markets continue to constrain our capacity to provide a greater degree of growth into this market, which we believe, based on the feedback we get from our regional members in particular, is one where there is a role for increased competition, particularly with the non-bank lenders having exited the market. So we have got a range of constraints that include the fact that we are unrated, we do not tend to raise debt in our own right and we are small balance sheets. Senator Pratt, you were asking the National Bank about Basel favouring residential home loans. We are treated as riskier debts for the major banks than a residential home loan in Australia despite the fact that we have come through that financial crisis as the strongest mutual banking sector in the world and our delinquency rates are 10 times lower than the major banks on both our small-business books and our home lending and personal lending books.. We do face a number of other constraints that I guess are more policy driven that we believe over the longer term would increase our capacity to offer millions more Australians hopefully a competitive alternative to the options of the major banks, particularly while we are constrained in the current consolidated market. I will pass to my colleague Mark Degotardi.

Mr Degotardi—I will quickly add to Louise’s comments. We look at the government guarantee on the wholesale side of the funding and, whilst that was absolutely necessary and had a good outcome for the banking market as a whole, it has clearly given access to $220-odd billion worth of funding that simply was not accessible to us. One of the reasons it was not accessible to us was because of the differential pricing put on that wholesale guarantee. It was not about our riskiness per se but there was a premium placed on us that was not placed on the major banks. So that constrains our ability to grow our funding and that constrains of course our ability to lend. Despite our scale, despite our inability to access that guaranteed government debt, we are still competitive on interest rates. What we would like to do as a sector is become larger participants in that small-business market, particularly for our members that are in regional and rural communities. Our members are the only representative in town in about a hundred postcodes across Australia. When we talk about small-business lending, in some cases we are one of those businesses in the community who live and die on the wealth and welfare of the community.

Our view is that the government probably needs to investigate whether there is some merit in allocating some funding specifically for small business lending and specifically in regional and rural communities, and we would argue that we are one of the people that are best placed to put in that funding. For us, certainly, there is no question that if you fund small businesses, you fund employment. When you fund employment and small business in a rural and regional community then you help that community to live. So we want to be a part of that and obviously we would like to talk to the government about accessing some greater funding there.

CHAIR—Thank you. Just speaking more generally, in your submission you say:

Major banks continue to benefit from entrenched misconceptions about the regulatory framework and the perception that there is no real choice in the banking market.

Your case, of course, is that there is, but we as a committee have been concerned about lack of real choice out there and the fact that there has been a consolidation of the banking market. What do you see as the future for your own sector? Do you see that expanding?

Ms Petschler—We are ambitious about the opportunities ahead for our sector. Clearly, with two of the large second-tier banks being taken over by the major banks we have now got an incredibly consolidated market. Again, the majority of our business is in home lending and savings and we saw Westpac and CBA between them write half of all the mortgages in Australia in the December quarter. That is quite a startling statistic when you step back and have a look at it.

We have been pleased to see not just an increase in our books, which on both sides has grown about 10 per cent over the past 12 months, but also an increase in membership, which is an exciting opportunity for us. We have seen membership growth in credit unions, excluding the building societies who we do not have the same accuracy of figures for, of about the equivalent of the population of Toowoomba, and net growth about the equivalent of Bendigo, over the past four months. To us, that is a sign that more people are aware of the difference we offer.

But every bit of market research testing we do, and all our dealings with commentators, show us that in particular credit union and building society brands are perceived as less well regulated than the major banks. There is very, very limited understanding of the fact that we have got a harmonised prudential system in Australia. There is very little understanding that on all the risk measures you look at—and it is not just here in Australia but under the Basel Framework globally—the credit union systems have come out as particularly resilient because they are particularly conservative and do not have access to the same kind of risks that internationally operating and complex businesses do, and all the complexity around their balance sheets.

So we have had a number of suggestions based on market research we have done that are alive before the government at the moment. One of them is that our common regulatory term under the Banking Act is ‘authorised deposit-taking institution’. I think you could poll pretty much anyone outside this committee room and you would find practically no-one understands that that means you are part of the most regulated and sound banking system in the country. So one of our suggestions is that we change that to something that means what it should, which is ‘authorised banking institution’. Even a simple change like that, we believe, would assist our member institutions in explaining more easily to the community what it is they offer and continue to place us in a competitive position for deposits.

We have also encouraged the government to do a bit more work around promotion of the prudential system generally in terms of watching the flight of funds, particularly from the regionals to those large major banks during the GFC and that astronomical deposit growth that the major banks experienced. In the market there is a clear misunderstanding of risk based prudential systems and we are keen to see any kind of change that we can effect.

Another suggestion that you would have noticed in our submission was around the capacity for our institutions to call themselves mutual banks. Personally I am not madly keen on my institutions calling themselves mutual banks, but if I look at Europe or the United States where organisations of similar or smaller sizes with less well regulated systems operate as cooperative or mutual banks with exactly the same principles of member ownership, democratic control and profits back to members, I do think in the Australian context that that is an option we want to place on the table for our members, particularly those that operate effectively as large regional banks around the country.

Senator PRATT—Can I begin by asking you about the sector’s lending criteria. We have had considerable evidence about the manner in which banks have tightened their criteria and I am wondering if mutuals have confronted the same policy changes or whether they are continuing to operate as usual.

Mr Degotardi—Obviously with 120 institutions their lending policies are their own, but across the sector, as a generalisation, we have always been really responsible lenders in the first instance. We have taken no different stance to our small business lending during the course of the crisis. Of course, as different risks arise for different customers they are assessed, but as a general blanket policy none of our institutions have indicated to us that they have changed their stance on small business lending.

Ms Petschler—If I can just make another comment on that, we are conservative lenders. When you saw a lot of the non-bank lenders exit the market, we did not become the lender of last resort, because we have traditionally had higher credit requirements than the banks have, particularly those non-financiers. Perhaps our lending criteria are too strict. I mentioned our losses, which are minuscule, and that would suggest that we as an industry need to increase our appetite for risk in that area. I would say that APRA is very cautious about us doing that in terms of commercial lending. While we want to be cautious about it, we do not want to kill our opportunity to fund small business in the communities that we operate in.

Senator PRATT—Can I ask, in that context, about the interest rate attached to such loans. Many small businesses in Australia have seen not only tighter criteria but higher interest rates.

Has there been considerable change, or are they largely attached to mortgage overdrafts and the like, which would see those interest rates perhaps being a little bit more competitive?

Mr Degotardi—Again, it is difficult to answer for each institution, but certainly small business lending is a higher risk category than other asset classes, so generally speaking it will have higher interest rates. I would like to take on notice the question about whether ours have escalated faster, but my view is that no, they have not escalated faster in the course of the GFC.

Senator PRATT—Lastly, given that lack of competition in the banking sector has been cited as a key reason for small businesses failing to gain access to finance, and given the significance of mutuals in competition in the sector but, in turn, the relatively small role that you have played historically in small business lending, do you think that that is part of what is exacerbating difficulties for small business in this country?

Mr Degotardi—From our point of view, we certainly have played a small part, but as our institutions grow and mature, as you would expect, we want to take on a larger role in that small business space. APRA has said to us, and we agree, that if you want to do small business or commercial lending you need the skills to do so. I think there is probably a natural tension between us and APRA. Banking is a risk-taking business and some of our institutions want to expand that risk and take on more. We feel that if we can overcome some of the other constraints, around funding particularly, we have a really vital role to play in small business banking, particularly in those communities where we are well represented, in those regional and rural communities. We are not just another bank in town. We are one of the local businesses. We are owned by the local community, so we think we have a really important role to play there.

Senator HURLEY—In your submission you talk about wholesale funding and the UK government convening an expert group of key stakeholders to advise on strategic issues affecting mutual societies. Have they made any recommendations yet? What is happening there?

Ms Petschler—No, they have not as yet. Their report was anticipated in the next three months, I believe, but I think we will have to wait a little while longer and see whether whichever form of government it is will back it. The UK with its building societies is similar in a way to Australia with its credit unions, in that they are large and they are well regulated. They are not tiny institutions that are just run out of small communities. They are systematically important. The interesting thing, we felt, from that report was the fact that the government recognised that, in the absence of other competitors, the mutuals sector needed some assistance in terms of being able to do a deal with the constraints on raising capital and, secondly, the funding constraints that came out of that market. We are keen to see a similar focus in Australia. The strength of the mutual banking sector that we have in this country is a bit of an unrealised gem.

Senator HURLEY—Did the UK government provide any assistance to those building societies in the UK during the global financial crisis?

Ms Petschler—None of the mutual building societies in the UK required a bailout. There were some mergers between building societies. This initiative is more of a policy framework. One of the things that it is particularly concerned with is capital, because obviously our capital base is largely retained earnings. Because we are mutually owned, we cannot issue to the market for capital. That is a constraint in Australia, but we have seen more innovation amongst Australian credit unions in raising other forms of capital and also continued strong retained earnings over a 40-year period that has built us up a very solid capital base.

Senator HURLEY—You also talk in your recommendation about a pro competitive public awareness campaign about the prudential standing of regulators. Are you talking about the government running a public awareness campaign?

Mr Degotardi—Yes. We think there is a new role for government there and certainly a role for us as well. We think, as Louise mentioned earlier, that the concept of ADIs is simply not understood and probably more work needs to be done to make sure general consumers understand their choice. We have put this to government and encouraged them to look at it in a positive way to put it out there and say, 'If we have indeed got the best regulated banking system in the world, why don't we tell our own electorates about that? We certainly would like to see consumers well informed. We see ourselves as having a role to play, but we also see government as having a role to play.

Senator WILLIAMS—Would you say that the institutions you represent simply are not on a level playing field compared to the two big banks?

Ms Petschler—Our assessment of the funding environment at the moment is that it absolutely favours the major banks. In fact, the concentration of the banking market in Australia means that almost all our wholesale funding options are funded at one side or the other by the major banks. That is a difficult environment for us to be operating in. Clearly, we still have the strength of our retail deposit book. That is a big focus for us. The combination of funding is hard for government to fix. I want to emphasise that we are not expecting that the government can solve global wholesale funding markets nor advantage credit unions or building societies over other competitors. That is one of the reasons we think a regionally based funding pool that could go to all the ADIs to target a particular segment of the business community—we would say small business—would be a useful intervention. It would be targeted and it would deal with one of those constraints on operations.

As Mark has outlined, the other issue that we have is that people do not know who we are. We have to do a better job of explaining that. We think that with some simple amendments to some of the legislation definitions we would be able to do that also.

Senator WILLIAMS—If you had access to cheaper funds, you could then become far more competitive in the small business world of finance; is that correct?

Ms Petschler—That is absolutely right.

Mr Degotardi—We are already competitive in the sense of having decent rates. The bit that is constraining is how much we can grow that portfolio. Without certainty of funding at one end, we cannot make long-term lending commitments to the sector.

Senator WILLIAMS—What is your solution to the problem?

Mr Degotardi—Our solution is to look at where we get our funding from, which is twofold. The first is growing household savings in Australia so that we have a greater deposit pool. We have put a couple of suggestions for that forward to government in our submission. The second is to look at specific funding pools for the regional communities. We would like to be able to both access those funding pools and support our communities in that way.

Senator WILLIAMS—Even though time is against us, can I just thank you for the way you have committed to many regional communities. When the banks pulled out, the credit unions were there to fill the gap. We do really appreciate it in regional areas, I can assure you.

Mr Degotardi—I will certainly pass that on to our members. Thanks.

CHAIR—Thank you very much appearing this morning.

Proceedings suspended from 10.29 am to 10.49 am

KREITALS, Mr Jock, Manager, Policy, Real Estate Institute of Australia

LIDDELL, Mr David John, Senior Policy Officer, Queensland Tourism Industry Council

McGREGOR, Mr Scott, National Councillor, Pharmacy Guild of Australia

PAYNE, Mr Richard John, Principal Policy Director, Motor Trades Association of Queensland

SIRIANNI, Mr Frank, Consultant, Pharmacy Guild of Australia

WOLFE, Mr Graham, Chief Executive, Association, Housing Industry Association

Evidence from Mr Payne was taken via teleconference—

CHAIR—We welcome the Pharmacy Guild, the Real Estate Institute of Australia, the Housing Industry Association, the Motor Trades Association of Queensland and the Queensland Tourism Council to this hearing on the access of small business to finance. This segment has been allocated an hour and a quarter, so there is plenty of time for you all to have your say. At the beginning we should get each of you to make an opening statement of up to five minutes and then we will ask you questions. Unfortunately, some of our senators have had to go to other meetings at Parliament House. We will start with the Pharmacy Guild.

Mr McGregor—On behalf of the Pharmacy Guild I would like to thank the committee for the opportunity to address you on this important matter of small business access to finance. Let me first say that the guild supports the need for responsible lending standards by financial institutions and acknowledges that the standard set by our banks have assisted in part to help Australia's economy weather the global financial crisis. That said, the guild believes that there needs to be a balance between responsible lending and ensuring that small businesses such as community pharmacies have access to finance on reasonable terms.

In preparing our submission on the issue of small business access to finance, the guild contacted members asking them to outline their experiences in dealing with financial institutions since the global financial crisis. The case studies in our submission highlight numerous issues across businesses in different stages of their business cycle. Pharmacies with existing facilities in place found that they were subjected to increases of over 100 per cent in annual fees for these facilities and increased margins of up to two per cent. They also found a change in attitude to their business from the lenders they had been dealing with for many years. There were changes in expectations for their performance and in some cases requests for additional security. Businesses looking to obtain start-up finance have been faced with increased security requirements and in particular very complex cross-guarantee situations.

A common issue, regardless of the business need, has been a lack of available financing options. Prior to the economic downturn there were 13 banks and financial institutions with a pharmacy lending policy who were all relatively active. Following the global financial crisis there seems to be only one major interested lender throughout Australia and a few less interested lenders as options to pharmacy. This lack of competition has prevented borrowers from negotiating rates and fees and removed alternative funding sources in situations where a lender makes it clear that they are not interested in providing finance to the business, often for what seem to be internal policy reasons. The increasing costs and tightening credit policy applied to small business finance has made it difficult for small business growth and investment to occur. This lack of growth in investment not only impacts the small-business owner, this investment is necessary for small business to play its role in driving the economic recovery and jobs growth which is essential in a recovering and fragile economy.

The guild proposes that the Senate committee recommend a Productivity Commission investigation into issues such as the state of competition in the market and changes to the cost and availability of finance to small business, also some form of review of security documentation, and perhaps establishment of a code of conduct around this.

CHAIR—Thank you. It is very interesting that you picked up on the Productivity Commission because this committee is thinking about that too in terms of competition policy.

Mr Kreitals—Thank you. REIA as well welcomes the opportunity to be part of this process. The real estate industry of Australia or its agents are certainly very much a member of the small business community. Our professionals, of which there are about 77,000 people, work in agencies of less than 10 employees. The REIA submission addressed three aspects of this inquiry: access to funding, the cost of terms and conditions of finance, and, thirdly, the state of competition in small business lending. To supplement its submission the REIA conducted a survey of real estate agents across Australia and for this hearing I would probably like to highlight some of the outcomes of that.

With regard to the first term of reference of the inquiry—access to funding—many respondents to the REI's survey stated in their comments that they felt that the financial sector did not understand the small business sector and, furthermore, tended to group all small businesses in the one basket without any differentiation of the factors affecting a particular segment or of the outlook for that segment. An example of this for the real estate industry is the treatment of rent rolls, which have been used as security against borrowings. A number of respondents indicated that financial institutions did not recognise rent rolls as an asset despite low vacancy ratios in the rental market and the cash flow stability offered by the rent rolls. Even when rent rolls were considered as an asset, the loan evaluation ratio had changed markedly since the global financial situation, despite the risk associated with the rent rolls remaining unchanged. This lending ratio had dropped from around 90 per cent before the GFC to about 65 per cent in more recent times. The REI survey also indicated that three-quarters of respondents felt that access to finance was more difficult than it was before the global financial crisis. This was despite the fact that two-thirds of respondents felt that their financial position was either the same or better than it was 12 months earlier.

With regard to the second term of reference—that is, terms and conditions of finance—the REI survey found that four-fifths of respondents believed that the requirements by financial institutions, such as loan evaluation ratios and asset-backing mortgages over personal assets et cetera, were more stringent compared with the period before October 2008. Two-thirds of respondents also felt that the cost of finance for small businesses relative to official interest rates is more expensive than it was before October 2008.

In terms of the third term of reference that the REI addressed—competition in small business lending—our submission detailed the decreases in competition that have occurred in the small business sector, for example, the big five banks increasing their share of the market from around 60 per cent in 2004 to around 75 per cent in 2009. This was reiterated in the survey response in which respondents indicated that decreases in competition in the finance market are having a debilitation effect on many real estate agencies. It is for those reasons that the REIA made several recommendations aimed at improving the availability of finance, addressing the cost of finance for small businesses and increasing competition in that sector.

CHAIR—Thank you very much for your comments. We will now go to the Housing Industry Association.

Mr Wolfe—The Housing Industry Association, as the voice of Australia's residential building industry, welcomes the opportunity to address the committee. HIA's 42,000 membership nationally includes builders, designers, trade contractors, manufacturers and suppliers, land and property developers and specialist service providers. Each HIA member represents a business, from a small business or a sole trader up to a large multinational corporation. Our builder members, for example, include small-scale renovation building operations; low-, medium- and large-volume building operations and businesses; medium-density builders through to multilevel and high-rise apartment builders. However, the vast majority of our members operate as small operations and small businesses.

HIA members are involved in the construction of 85 per cent of Australia's $70 billion-plus per annum residential building industry. There remains an acute shortage of financial services and finance available to small residential builders and developers. A survey of HIA members in mid-March this year found that 75 per cent of small business members surveyed face greater difficulty obtaining financing than was the case before the advent of the global financial crisis. HIA is therefore strongly supportive of the Senate Economics References Committee's inquiry into the access of small business to finance. The lack of access to finance for residential development is restraining the supply of new housing across Australia. In the second half of 2009, Australia emerged from the longest down cycle in home building activity in its postwar history. The first stage of a recovery is underway, due highly to stimulus monetary and fiscal policies that were introduced in 2009.

However, these policy settings are now reversing in the case of higher interest rates and waning in the case of financial policy. A lack of access to finance is a principle obstacle to a sustained new home building recovery emerging in 2010-11.

The crux of the problem is the banks are rationing credit to small residential developers, placing an enormous pressure on their cash flow while, at the same time, banks are extending a normal stream of credit to households in the form of mortgages. The end result is a substantial demand from creditworthy homebuyers for a constrained level of housing supply. With housing stock growing significantly slower than population-induced demand, inevitably, there is unnecessary upward pressure on existing home values and therefore, ultimately, on the extent of future interest rate rises.

The key issues for the residential sector, arising from a lack of access to finance are, firstly, the level of pre-sales required by Australian banks for detached house and low-density development.

This is substantially higher than normal and unachievable in many instances and that is causing complexities in terms of going forward for new development. Banks are lending a reduced share of finished value of a project. There are prohibitive costs of equity that are generating unlevel playing fields. The reduction in the share of unfinished value of a project that the banks are willing to finance is lowering the rate of return for potential residential investors and diverting investment to sources other than new residential dwellings. Banks are asking for a higher or larger proportion of a loan or asking for an entire loan advance for a project to be paid back prior to all stages of the project being completed. This leaves developers requiring more capital to advance to the next stage of a project, even though the original loan was for the entire project. Banks valuations of residential projects are often too conservative and are preventing viable projects from proceeding. There are reports of conditional approvals being given to residential land development but the land valuation is subsequently being revised downwards. The length of time it takes for banks to process and make progress claims and progress payments for residential developers has increased substantially, generating uncertainty and cash flow difficulties and an unbudgeted interest rate bill for new development.

Small business rates have deteriorated by about 85 percentage points relative to home loans over the GFC period and, at the same time, the banks tightened access to business finance access to supply a credit insurance also tightened. Material suppliers either removed or reduced credit arrangements with builders and contractors, resulting in shorter credit terms and, in many instances, payment in advance. Relying on timely payment of client progress claims which, in many instances, were less reliable, small businesses found themselves back at the bank, asking for additional financial capacity to absorb the cash flow implications. That was not always received very well.

Going forward, it will be small business across a residential building industry that we will rely upon to supply the housing stock to meet our growing population. It is small business that we will call upon to grow if we are to increase supply to meet our current requirements. In New South Wales, for example, where housing starts were less than 50 per cent of the state’s underlying demand in 2009, it is small business capacity that we will need to grow in order to meet our housing needs. So, from our perspective, access to finance for small business in the residential sector is a critical component of our go-forward, in terms of the industry, the flow-on effects to the economy and our capacity to meet housing supply demands over the next two to three years. So again we thank you for the opportunity to be here this morning.

Mr Liddell—On behalf of the Queensland Tourism Industry Council, I welcome the opportunity to address this Senate Economics References Committee today and will use this opportunity to amplify the major arguments expressed in our submission. The Queensland Tourism Industry Council, QTIC, is a private sector membership based tourism industry organisation. We represent the interests of the tourism industry, including business operators, regional tourism organisations and tourism sector associations. We are owned and governed by our members through membership based councils, boards and committees and believe we truly reflect the views of the industry at all levels throughout Queensland.

With a significant majority of our members being small to medium sized enterprises, QTIC also proposes that it is well positioned to provide feedback to this inquiry. The information provided in the submission was obtained from feedback from our membership through various requests for information and one-on-one interviews. With the bulk of all tourism businesses being small to medium sized enterprises, any impediments to small business growth, such as difficulties in accessing finance, have a significant impact on Queensland's and Australia's tourism industry. Consequently, in such a labour-intensive industry as tourism, which employs over 850,000 Australians, or 8.3 per cent of the workforce, any impediments to tourism growth will impede the industry's ability to create vital employment opportunities, particularly in regional areas.

When small-business cash flow is volatile or at best variable, even good small businesses will struggle to service debt—and cash flow is volatile in the tourism sector in Queensland, as small-business operators are occasionally exposed to single incident shocks, such as cyclones and flu epidemics, which impinge on the capacity and bottom line of operators. In this financial year alone, operators have had to deal with Cyclone Ului, swine flu, the *Pacific Adventurer* oil spill in Moreton Bay, extensive flooding and declining consumer confidence, all of which have impacted on the financial sustainability of tourism operators. Government tourism bodies have responded to such crises by implementing targeted marketing campaigns aimed at attracting tourists back to specific markets. While these campaigns are to be commended, there are generally no government financial assistance programs available to deal with the supply-side issues that such events also create.

Through its membership, QTIC has also identified that the internal costs associated with obtaining finance have increased, as banks require more documentation and information in relation to lending. This has meant that increased preparation, both time and money, is required by small business operators prior to applying for finance. QTIC proposes that banks adopt a more flexible approach to lending to small business. This may involve banks looking outside their usual indicators of assessment and acknowledging that small businesses can generally be as innovative and just as adaptive to market conditions as large businesses. This was exemplified during the recent global financial crisis, when many small businesses were able to cut their overheads while continuing to supply their products and services.

QTIC is also aware that it remains extremely difficult for small businesses to obtain finance to start their operations. This is due to potential small business operators having limited assets and no financial records to demonstrate their capacity to service debt. Private lending provides some options to potential small business owners but usually on terms no better, and in some cases worse, than those offered by banks.

Finally, QTIC recognises and applauds the federal government's acknowledgement of the importance of small business and suggests that it is prudent not to starve the sector of the funding required for investment and productive growth which will in turn contribute to the nation's growth and wealth. Thank you.

CHAIR—Thanks very much. Now we have, by teleconference, Mr Richard Payne from the Motor Trades Association, Queensland. We invite you to make an opening statement and then we will have a roundtable discussion.

Mr Payne—Thank you very much. Our association represents approximately 2,500 members. They range from, typically, the owner-operator, small business, mechanical type operation or body shop operation to the very large franchise dealers, and everything in between that is automotive related. That extends to farm and industrial machinery and also motorcycles.

Our submission was based on input from members. We did not actually survey them at the time, although at the beginning of the global financial crisis we did a survey on wholesale funding difficulties that subsequently resulted in the OzCar scheme being set up—and we thank the government for taking that initiative because that provided relief for new vehicle funding through the various financiers to the automotive dealer group.

Our submission was based on, as I say, input from member groups that came to us saying it was difficult to obtain financing in three particular areas: first, in the smaller groups with regard to things such as getting funding for working capital; second, was the spread of rates for finance—as rates began to increase it seemed if a business could get set that the interest rates were much higher than, for example, in the housing area—and, third, the major banks were asking for increased collateral to support loans as their scaling factors changed as a result of the global financial crisis. In our paper, we identified that as the economy starts to recover it is in three particular categories. The first is in commodities, which typically is the mining sector and export sector, which is experiencing far more rapid growth than many of our member groups are experiencing. The second category extended to services and banks, and they likewise seem to be recovering at a much greater rate. The third category is the one that is of great interest to us, and that is the small to medium businesses.

At the time of the global financial crisis, I think you are all aware that many of the major financiers pulled out of the market in providing wholesale funding. At this stage there were really only two major players left in the market to provide wholesale funding, and that is ESANDA through support from the ANZ Bank and St George, which is now owned by Westpac. Our members are required to go to the financial institutions for wholesale funding. They have found that the scaling factors provided by those financiers have ramped up and, in the case of St George, we were told that they were not taking on any new business at this stage. So that has created some problems in the marketplace for the franchise dealers.

In our submission we identified five recommendations that we believe would provide great assistance to the members as the economy starts to recover. We believe the first and most important factor is the lack of real competition in the marketplace at the moment. As I mentioned, as far as automotive finance goes there are really only two players in the market at this stage and certainly all the major businesses typically have a relationship with those financiers. It is very difficult for new businesses and existing businesses that want to expand to obtain finance in the marketplace at the moment because of the lack of competition.

The second most important factor, we believe, is the increased collateral asked for by the lending institutes in securing existing loans as scaling factors have changed. We are finding that members are being asked now to provide collateral in the form of their own homes, whereas previously they have not been asked for this by the financial institutes. The next important factor that we recommended was that the lending institutes' model should not be based on a blueprint that essentially one size fits all because each and every business is going to be different. We ask for flexibility to provide loans where they are required in the marketplace.

The next major thing we recommended is that there would be adequate time in the transition. If there are new guidelines being established by the lending institutes, there should be adequate time for businesses to adjust so that they can meet the requirements of the lending institute. That sums up the background to our paper and the recommendations as we go forward on behalf of our member groups.

CHAIR—Thank you very much for that. What we will do now is have a roundtable discussion about issues. Firstly, we are told that in the UK and the United States the governments have agencies which provide financial support to small business. What do you people as a group think of that kind proposal? Do you know a lot about these things? Have you heard of that arrangement?

Mr McGregor—I have not. We would welcome any sort of examination that would lead to a broadening of competition. It seems to me that the banks are channelling into certain areas and you are left with one bank which seems to have an interest in your categories. That leaves you exposed to all the things that we were talking about before; you do not have any ability to negotiate, because there is nowhere else to go. So we would welcome anything that broadens competition.

CHAIR—When we mentioned this to earlier witnesses they supported the concept of competition but not government involvement in the form of guarantees or loans—broadening competition between the banks. There has been great consolidation in the banking sector in Australia in recent times. We have just heard from the building society group, who are willing to get into a broader field of banking but find that it is difficult.

Mr McGregor—Because it is difficult to find the funds to do so?

CHAIR—No, it is because of the constraints. People do not seem to regard them as banks, but they are under the same regulations as any other financial institution. That does not seem to be getting much response from you—the UK and US model of support for government business.

Mr Sirianni—One of the issues that we have certainly confronted in small businesses is that the cyclical impact has been so dramatic. We went from having 13 institutions providing lending to pharmacies to a situation where we have one major player and a number of regional players. The reaction has been extraordinary in terms of its speed and application. The other issue is that, if small business is to be a long-term engine driver for the Australian economy and for employment, we really need to put in place some sort of structure to ensure that a certain proportion of bank lending continues to go to the small-business sector. Whether that is a policy issue or whether it is a government instrument or facility is something that needs to be considered. We are in a situation now where people's long-term ability to get access to finance is extraordinary.

CHAIR—This committee certainly supports your views about the decreasing competition in the banking sector, which has concerned us for a long time. We heard this morning that the Basel conventions have emphasised residential mortgages over business lending. That is one of the underlying reasons why the banks prefer to lend for housing than for business.

Mr Sirianni—That convention was signed a long time ago and I do not know that it was necessarily—

CHAIR—This is more recent.

Mr Sirianni—Yes. Basel II, from my recollection, was signed in 1995. Ultimately, because of the competition issue, there is an opportunity to extract a high premium for a supposedly higher risk—and, because you can, you will. That is what we are confronting. There was never any suggestion in the convention that finance would not be available to business, it was really that finance should be financed appropriately so that the housing sector was not supporting the business sector, or vice versa.

Mr McGregor—It is not just the cost. Security is a common issue that we have seen. If you are acting with no competition, you can tie up everyone. You can tell people they still need to provide security for any business in any other form, of which you may not be aware. If you look at such a document, you will not want to sign. That is very restrictive—as well as the costs and the lack of availability. I think that is driven through competition: if you cannot go anywhere else, what can you do about it?

Mr Wolfe—From a housing perspective, there has been a bit of a pull back from banks more generally due to concerns about exposure in the housing market. That is partly related to observations of banks overseas. But certainly we have seen a tightening up of finance requirements for people who are looking to borrow to purchase, for example, apartments. The LVRs have been reducing quite significantly, so that looks at the amount of equity that a person brings in. It is risk aversion. They have downgraded inventories for small businesses that are looking to work on capital to increase their financial capacity. Banks have looked at inventories and downgraded that. We know that a bank will ordinarily have allocated a certain valuation to a property for the purposes of further financing, and they have downgraded the valuations on those properties. So there are three examples: LVRs, valuations and inventories have been downgraded. There is no doubt that those banks are looking to mitigate their risk and exposure. That is affecting small business, which does not have the capacity or flexibility to respond to that.

Senator XENOPHON—I want to follow on about the loan to valuation ratio for apartment dwellings. Apartments are a policy imperative because of land shortages. It makes more sense for people to go into high-rise or medium- to high-density living. Do you think it is reasonable that the banks have done that? On what basis have the banks tightened up on the LVRs? Mr Kreitals is smiling! I do not know whether he has a comment on that. That seems to be a significant issue in the real estate sector. It is much harder for developers to get finance and for people to buy into apartment living.

Mr Wolfe—It is very much risk aversion. The fourth component, which I did not include, is the number of pre-sales off the plan. Banks have increased the number of pre-sales.

Senator XENOPHON—From what to what?

Mr Wolfe—Our survey shows that it was in the order of 40 to 60 per cent off the plan. That changed in 2009 to be anywhere between 60 and 80 per cent off the plan at a time when it was very difficult for people to gain access to finance to be able to purchase off the plan.

Senator XENOPHON—The bar was so high that it was very difficult to get a project off the ground.

Mr Wolfe—The bar was pushed up high. It was very much risk aversion.

Senator XENOPHON—Mr Kreitals, do you have a view on that?

Mr Kreitals—My comments are probably more from the demand side point of view than the supply side. The HIA are talking from a developer's point of view. I think it has been fairly well documented in the media that LVRs, particularly for first home buyers, have increased in recent times. I could not put a number on it because I think it has varied from bank to bank.

Senator XENOPHON—But it is much stricter for apartments than it is for the traditional house and land package.

Mr Kreitals—From the information we have, I cannot comment on that. That is certainly something I am happy to take on board to get some reaction. But, in terms of the work we did for this inquiry, we did not split it up into market segments.

Senator XENOPHON—The banks have tightened up the LVRs, particularly for apartments. Is that because they have been bitten on a few large projects? Is it because they have done their dough? Are there any high-profile examples where they have missed out and therefore have tightened it up? Or do you think it is an unfair tightening up relative to other parts of the real estate market?

Mr Wolfe—I can say that we have received feedback from developers on new product that have ordinarily looked at people who already own existing product that will use the equity in that existing product to mortgage and purchase, off the plan, more product, allowing them to get more off-the-plan sales and then move into that development. However, those people who ordinarily would have found greater equity in their property and would have been able to get a valuation that reflected that and therefore borrow against that have had that declined by banks—the banks have not recognised the higher equity because their valuation of the existing stock has declined. The short answer is that valuations by banks have decreased relative to what the market might otherwise have said, and that has affected people's ability to draw down on their equity and that has affected the capacity of developers to move on.

CHAIR—What about tourism projects? Have the banks decreased their willingness to support new developments after the GFC?

Mr Liddell—My understanding is that, yes, they have. I would just like to go back and make a comment on something you mentioned earlier. From my understanding, there is a small business administration in the United States. It does not directly provide funds but it certainly provides lenders with guarantees on the repayment of loans to small business. I know they do a lot of financial assistance training, counselling and disaster relief. From a tourism perspective, especially with regard to disaster relief, such an agency is certainly something we would like to see implemented. We would see a benefit to our operators from such an agency.

Senator PRATT—As a panel, you represent quite a diverse array of business interests. Clearly in the government's policy settings a range of things happened during the global financial crisis to support small business and the housing sector—and there were a number of other things. I am interested in the difference between those business interests that have on the one hand struggled with small business finance but have in turn been supported by things like the first home owners grant. I am interested in the differences between the sectors that are represented here in terms of the issues you have struggled with in finance. For example, I would have thought that, with real estate and housing, whilst the small business finance side suffers, it would have been much worse if we had also seen a drying up of consumer access to finance. In a sense, that would be the same with the motor trades as well. So I would like you, if you can, to unpick some of those issues. I expect that that the would contrast quite strongly with where the Pharmacy Guild sits on those issues.

Mr McGregor—Speaking for the Pharmacy Guild, it is hard to relate to that question. From the viewpoint of particular programs that would have driven changes in pharmacy business, I do not see that there has been anything that would impact that, other than the difficulties in introducing new programs and introducing finance to develop health outcomes and succession and so on. So I think I will pass on that.

Mr Kreitals—Senator, you did not use the word 'paradoxical', but perhaps that is where you were going. I think your question highlights one of the points we were trying to make in our submission. Real estate agents have benefited from the stimulus package and also from low interest rates, particularly at the lower end of the market. But when banks were lending to the businesses concerned, the real estate sector, as I said in my introductory remarks, was not seen as having good prospects. It was seen as part of a bundle of small businesses which were having difficulties under the global financial crisis. Therefore, LVRs were going down, and rent rolls, which previously had been considered as a good asset backing, were either not considered or were marked down. So, yes, that seems to be paradoxical or an irony.

Mr Wolfe—I would like to make a couple of points. Small businesses—whether we are talking about a carpenter who is doing $200,000 worth of renovation work to a house, a small builder who might do two or three projects in a year with a turnover of half a million dollars, or even some of the trades working on site—have various contractual arrangements. Quite a lot of those are supply and install arrangements. A supply and install contract means that the small business needs to procure the materials—whether it is a wall frame, a roof truss, bricks or whatever—and do the work. They then make a claim for payment. It is important that they get that payment in a very timely fashion.

The fact that there has been work out there is a plus. The fact that they have had the opportunity to continue with the activity levels that we experienced during 2009 was definitely a plus. But in that situation people have a business to run and a cash flow that they need to manage. If they are spending more money, faster, because the credit arrangements require them to pay for their procured materials sooner, but they are receiving the payments from the consumer—their client or the contractor—slower, that leaves them in a very difficult cash flow position.

And the banks have not been there to support them in that situation. There is an interest rate differential between the person who is providing the funding in the first instance—the client, who is benefiting from a lower relative mortgage rate—and the business's mortgage rate. That dynamic has been going on and it has made it very difficult for small business to expand. That is the big issue going forward: the capacity of small business to grow so that housing can also continue to grow to meet the underlying demand in our housing supply.

That brings me to the second issue: whilst this has been going on and there has been activity, we have a forward pipeline that says that we need to be working five or 10 years in advance of ourselves. If it is land development, it is between five and 10 years; if it is an apartment building, it is somewhere between three and six years. That is, unfortunately, the process of getting applications through councils. In that environment there is obviously a significant cost impediment in the holding charges to go from one stage to the next, because you invest money and then you wait for things to happen. But in an environment where we need to invest in the delivery of land, we need to make funding available—not necessarily just to big businesses but also to small businesses that might be involved in the bringing together of development projects, whether they are units rather high rise apartments or small bundles of land rather than large master-plan green-fields developments. We need to make sure that there is funding to other groups to enable them to bring that to market to increase the competition of supply, in terms of units, apartments and land. From a go-forward perspective we have not seen that. We have seen tightening of arrangements. As I said that has been because the banks have been averse to risk. We need to mitigate that risk or do something about that so that the banks are far freer in lending to small businesses.

Senator PRATT—Because we have such a diverse panel of business interests here, I am interested to ask about the extent to which banks have the capacity to identify real risk within your sectors. We have heard that lending has tightened. I imagine that there are a range of different risks that are quite separate, depending on the sector that you are in. It appears that previously banks were lending in far more general terms, without necessarily understanding the issues confronting each sector to the extent that they are now seeking to do. Is that a correct assessment? It may not be. What can industry bodies such as yours do to make sure the banks are really tackling the risk assessments in a justifiable way?

Mr Sirianni—I have not specifically seen any greater level of intelligence from the banks in terms of risk issues. Our relationship with the market is that we do valuations. Just to go back to the LVR issue, in 2007 the average lend ratio for pharmacy was around 80 per cent. There were banks that were very aggressive in the marketplace and they were lending 90 to 95 per cent. There were no issues in terms of valuation and there were no issues in terms of market perception of risk. In 2009, the average lend ratio, LVR, was 70 per cent. So it has come down from the high of 90-plus, and the reason for that is competition; it is not any perception of risk per se. The pressure on valuers to actually reduce their values is much greater. The banks' credit departments are restricting the way valuations are done, so to some extent there is that issue. There is no perceived relationship between the risk and—

Senator PRATT—There would be no inherent reason in pharmacy for that to be the case, particularly if you were to compare that to apartments or tourism, but nevertheless building and tourism might also be suffering from a lack of capacity of the banks to justifiably assess what is going on?

Mr McGregor—There are examples of long-term businesses with very low gearing and lots of difficulties. There seems to be minimal risk in the cases that I am seeing.

Senator PRATT—Notwithstanding that, are the banks that do seem to have said, 'We've tightened up because of the riskier environment at the moment,' just doing that in a generic sense without actually going through the business cases for each sector, and indeed the business case for individual businesses, as they are approached for finance?

Mr Liddell—Certainly anecdotally the information we are getting from our members is that, yes, there is some sort of broad, overarching assessment and it does not really recognise the diversity of the different tourism operators and their unique operations.

Senator PRATT—Do you have any examples of that? You do not need to name businesses, but can you give some contrasting examples?

Mr Liddell—No, I do not, but I could certainly provide you with some.

Mr Payne—From Motor Trades' perspective, we would support the comments of the previous two speakers with regard to LVRs. Typically, prior to the global financial crisis the leverage was 80 per cent whereas typically we are now seeing it as low as 60 per cent and therefore asking for additional collateral. Yet we do not know of any major problems that have affected businesses.

I would also add to the previous comment, in regard to assistance, that the assistance that was provided through the investment allowance of up to 50 per cent certainly gave the industry a major kick in the business sector, and that is seen in the figures that have flowed from the middle of last year even through to the first quarter this year for new vehicle sales. From the buyer profiles, the major purchasers that have been missing are the private buyers. We are still seeing that that particular purchaser profile is very much out of the marketplace. We are hearing that they are having difficulty in getting finance. As you know, GE Money, GMAC and Ford Credit have all pulled out of retail financing, and the fact that they are no longer in the marketplace provides difficulties to the private purchaser in getting funding at the moment.

Senator WILLIAMS—Do you know why GE Money, GMAC and Ford Credit pulled out of financing the motor vehicle industry? Was there any particular reason?

Mr Payne—I know that in the case of Ford Credit it was very much the difficulties that have been experienced in the US. They found that in the retail sector it was just not profitable, given the volume that they had in Australia, to continue with retail financing. What is left on the books they have passed over to Macquarie, but going forward it was just not economical for them to continue. GE Money and GMAC pulled out earlier on wholesale funding. Again, I believe it was because, given the size of the market in Australia, it was just not economical for them to continue here. That has left just two of the major players in the marketplace: St George and Esanda.

Senator WILLIAMS—Do you find that because there are only two left, the lack of competition means that the rates are higher?

Mr Payne—Yes, they are.

Senator WILLIAMS—So, your industry is definitely in a situation where it requires more competition?

Mr Payne—Yes. That is the factor that we identified as the most important factor, both in terms of retail financing of vehicles and for the small businesses to obtain loans for things like working capital and expansion projects. We understand that it is fundamental that the lending institutions will rate for risk, but we do not know of any major collapses that have caused them, in their current structure, to be asking typically 80 basis points over what can be provided in, say, housing and also asking for additional collateral.

Senator WILLIAMS—Thank you, Mr Payne. Mr Wolfe, I am very concerned about the statistics on housing starts in New South Wales increasing the population. I think Australia's population is growing at 400,000 people a year, yet we have housing starts in New South Wales going down. No doubt this is contributing to the huge increase in rentals for home rentals and the property scare, if I can put it that way—the increase in city house prices. What is the answer to this? Do we reduce immigration, do we release a lot more land for housing or do we have incentives to move into the regional areas like where I live, where there is plenty of room? What is the solution to this?

Mr Wolfe—I think I have about four minutes to answer that question, but if I can very quickly—

CHAIR—You have until 12 o'clock.

Mr Wolfe—Well, then I will take the whole 15 minutes. It is a very serious issue, and I do not wish to reduce it—

Senator WILLIAMS—It is probably the biggest issue facing Australia at the moment as far as people's dream to own their house et cetera.

Mr Wolfe—It is a very concerning issue, particularly for New South Wales, with an underlying demand last year of around 48,000 to 50,000 new homes and less than 24,000 new homes built. It was not a one-year phenomenon. It has been happening in New South Wales for the past eight years—since about 2001-02, when the number of starts was over 47,000. So there has been a continuing decline in the number of starts. There has been an increasing underlying demand, and it reached record proportions last year. Australian population growth is not always attributed to New South Wales. In fact, New South Wales has a net state deficit in terms of migration movement in between states. Nonetheless, it has very significant growth—in the order of about 1.3 to 1.4 per cent last year. But it still fails to build enough homes.

The reality is that we have a combined effect of inadequate supply of affordable land in the outer areas of Sydney. We have the situation that in the established areas of Sydney there is a great reluctance to provide for modest or other increases in density of housing. I think you mentioned Ryde. We have areas in established suburbs of Sydney that have an old fibro house or an old brick house sitting on a 700- or 800-square-metre block of dirt, and there is a reluctance to increase the density in those areas where there is established infrastructure, facilities for public transport and access to services and facilities.

We need to have a combination of attitudes towards accommodating a growing population—which may mean some modest increases in density in established areas—a supply of affordable land in the growth areas and also a very strong consciousness towards providing the infrastructure necessary to facilitate a greater population in our regional centres and townships. It is a combination of those but the reality is we are seeing a tightening in attitudes towards density in established areas. The issue of nimbyism is just overriding throughout established areas. Provided you own a home and you are in your own suburb then the attitude is, ‘I’m right Jack and I don’t want anyone else coming in.’ Unfortunately that is going to continue to plague us until such time as there is a social discussion—a community discussion—about how we are going to house our population.

Senator XENOPHON—Following on from that, is there perhaps a need to have a broader, more comprehensive approach? Is there frustration with some local councils taking so long to get approvals through? There does not seem to be an integrated policy about building up our inner city areas, which would seem to make sense given land shortages. Is there a frustration that under the current rules small businesses cannot get finance because the planning rules and other laws are stacked against them?

Mr Wolfe—A small business moving into a small development—whether it is a land development or a unit or an apartment development—and having to wait to get approvals through a council will incur holding charges on their investment, and they simply do not have the capacity to invest a certain amount of money. They are not able to access that sort of funding and then sit back for one, two or three years or even longer for the council approval process to allow them to turn the first sod and start that development working. The banks have obviously tightened up their credit and their requirements on the number of units or blocks of land they have to sell off the plan. Unfortunately, that means that everything is conspiring against a small business entering or participating in the environment of supplying—a smaller volume but certainly supplying—new housing, whether it is in land on an apartment, to the marketplace. A lot of it goes to the financial restrictions but a lot of it goes also to the holding charges that are associated with waiting for councils to issue an approval; and also obviously there is the uncertainty. You hope that you are going to get it through but there is an awful lot of investment risk associated with a small business taking that punt: putting in an application and hoping it gets through the council.

Senator XENOPHON—Sure. Mr McGregor and Mr Sirianni, I found your submission particularly helpful because of the case studies you included.

Senator WILLIAMS—Likewise.

Mr McGregor—Thank you.

Senator XENOPHON—I was having a private discussion with—and I hope he does not mind me saying so—Senator Williams, who I think was quite taken with some of the figures. How did that come about? Were there many other case studies that came forward? How did you get to this set of facts?

Mr McGregor—We sent a circular to Pharmacy Guild members across Australia. We had been hearing about these figures in any discussion we had, so when this inquiry came up we asked for examples. I cannot give you the total number of respondents.

Senator XENOPHON—Obviously this was just a selection of them.

Mr McGregor—We just picked a few out.

Senator XENOPHON—Were there dozens or hundreds of responses?

Mr McGregor—No. There were more than a dozen and fewer than a hundred. It was somewhere in that region. I am sorry; I could find out afterwards.

Senator WILLIAMS—You have a dozen or so here.

Mr McGregor—There is a marked consistency, when you see them, and I am familiar with some of the cases.

Senator XENOPHON—I found it quite useful to see the take-it-or-leave-it attitude of some of the banks.

Mr McGregor—Effectively that is what we are facing and that is what we fight.

Senator XENOPHON—This leads to another question—to the panel as a whole including, of course, Mr Payne. What would be the top two or three things on your wish list of things that could be done to make a difference for your various sectors? Would it be more competition; setting up guarantees for small business finance, as Senator Eggleston has referred to and as they do in other jurisdictions such as Canada; or stronger trade practices laws? What are the practical measures that we as a committee can implement to try and convince government to get on side to make life more equitable for the small business sector?

Mr McGregor—I would be saying all three of those are very sensible measures from the viewpoint of improving our current situation. As I mentioned earlier, the problems of thinking you have got finance under control and thing should be okay and then no delivery or late delivery, then delivery with conditions that you could not agree to, made it very difficult. 'Well, if you don't like it, don't sign that, there you go.' For people trying to expand their businesses, young people coming in or succession, we found a very large contrast from where we were pre-GFC where there were lots of players in the market and you could talk about the margins they were offering and there certainly was not any question of guaranteeing people's activities in other areas in which you have no control. Something that improves the competition primarily would alleviate it in that you would have someone else to go to but also whether there is a form of code of conduct or some examination of what goes into those securities so that you are presented with those in advance and they cannot be too unreasonable, or some other activity, as you mentioned, would all help us.

Senator XENOPHON—Your case studies were very helpful.

Mr Kreitals—I think number one on our wish list would be an increase in competition because we have seen concentration within the marketplace in recent times. If we could address that, that would be our number one.

Senator WILLIAMS—On that competition issue, I have known finance businesses that fell over during the global financial crisis because they were in that sector that were not underwritten by the government's bank guarantee. They were not registered ADIs and hence investors pulled funds out of those debenture issuing companies and small finance companies, especially in regional Australia, and put them in those credit unions or banks that were underwritten by the government, to feel safer as the global financial crisis came upon us. Hence we have lost competition there with those of other smaller companies falling over. And we have seen the amalgamations of the banks, the takeovers of the banks, Commonwealth Bank with BankWest, Westpac with the Bank of South Australia and St George et cetera. Is this a job for the ACCC to address the competition issue here? What should we be doing?

Mr Sirianni—It certainly appears anecdotally that the whole structure has imploded because of the competition issue. Both the pricing margins and the access to finance have been in part restricted because you have fewer players, first, competing for market share and, second, able to provide funding. So whether it is the ACCC that is going to provide that or whether it is a market force issue that can be seeded by the government, it is really something that needs to be looked at.

Senator WILLIAMS—Would you have concerns if there were more amalgamations and takeovers in the Australian banking industry?

Mr Sirianni—Certainly.

Mr Wolfe—On the issue of competition, at a smaller level and thinking about small business, I have mentioned before that we have seen the advent of progress claims being delayed. It does not happen across the board, it happens in some examples, but we get enough feedback from our members saying, ‘I can’t move forward to my next project until I get paid for the past one. I just don’t have the capital or the financial capacity to be able to do it.’ So some form of transparency and reporting about how banks are delivering in terms of timely payment of progress claims would help, because that certainly does tie up small business in their capacity to move forward. The comment has been made about new entrants. We have got reports from people that have less than two years experience and less than two years operations and the banks have declined to provide them with some form of finance. That is not good as a go forward for new entrants and for small business.

CHAIR—Mr Payne, do you have any further comments to make?

Mr Payne—We have identified competition as the major factor causing some of the difficulties we are experiencing in wholesale funding, retail funding and business loans. We recognise that overcoming that would probably be put into the longer term category. In the shorter term, we would support a model—and it was suggested before—that puts aside specific funds to support funding by small businesses and, in particular, retail financing.

I touched on the private sector before. It makes up about 50 per cent of the market in Australia. To quantify what has happened there: last year we saw the private sector go backwards by nine per cent while the general business sector recovered because of the action taken by the government through the stimulus package’s provision of a tax break of up to 50 per cent. Again this year, for the first four months, we have seen the private sector only increase seven per cent against the general business sector going up 19.8 per cent. So we are still not seeing any recovery there at all. Part of it is lack of confidence, but part of it is also people having difficulty in getting retail financing for their vehicles.

CHAIR—Are there any other general comments? Is there anything you want to say as a final statement?

Senator XENOPHON—Have any of the various industry groups or the REI given any consideration to people getting together to set up their own credit union? Have you thought of trying to do your own thing—sourcing your own finance? I know it is not an easy task but, given the size of the real estate sector, for instance, you would think that you would have a pretty good market. If there are police credit unions and other industry specific credit unions, could it not be done? Is that something that has been looked at?

Mr Kreitals—The short answer to that is no, we have not looked at that.

Senator XENOPHON—Is it something you would consider if things got any worse with the banks?

Mr Kreitals—I do not know if I can answer whether it is something we would consider. It is something, perhaps, we should explore, but we are in the business of selling real estate.

CHAIR—What do you see for the future? Do you see the situation improving or remaining static?

Mr Sirianni—At the moment we do see things starting to come back to the sector and LVRs starting to edge back up, but there are still only two players that are really playing in the pharmacy lending marketplace. The sense is that they do understand they have overreacted in pulling out of the market so dramatically. Just to give you some idea of the dimensions: the volume of sales in the pharmacy landscape has gone down to 40 per cent of what it was in 2007.

CHAIR—Is that right? That is amazing.

Mr Sirianni—We are not talking about a minor adjust—

Senator WILLIAMS—Volume or value?

Mr Sirianni—Volume. We are talking about dramatic changes. The access to funds for small business was just shut off. It was not that they pulled out. They just basically shut it off entirely.

CHAIR—In your case studies, I noticed you referred to the ANZ, I think it was, walking away from pharmacy or deciding not to support pharmacy, but are you talking about customer driven volume of sales or—?

Mr Sirianni—No, I am talking about the sale of businesses. That is what has gone down.

CHAIR—Very interesting.

Mr Kreitals—Unlike the pharmacy area, within our sector we have not seen any easing up of banks' willingness to lend.

Mr Sirianni—Yes, I was talking about the LVR starting to creep up.

CHAIR—Thank you all very much.

Proceedings suspended from 11.59 am to 12.08 pm

BURKE, Mr Charles, Vice-President, National Farmers Federation

HILL, Mr Alan, Director, Policy, Western Australian Farmers Federation

McELHONE, Mr Charles, Manager, Economics and Trade, National Farmers Federation

NORTON, Mr Mike, President, Western Australian Farmers Federation

WYHOON, Mr Chris, Executive Officer, Farm Business, Western Australian Farmers Federation

Evidence from Mr Hill, Mr Norton and Mr Wyhoon was taken via teleconference—

CHAIR—Welcome. I invite the National Farmers Federation to make an opening statement.

Mr Burke—The National Farmers Federation is the peak national body representing farmers and, more broadly, agriculture across Australia. The NFF's membership is made up of many and varied other organisations, but essentially we end up representing most of the agricultural commodities across Australia. By and large, Australian banks have been very supportive of Australian farmers in the last 10 years, in particular through, as most of you would be aware, one of the worst droughts that this country has ever seen. Bank practices are now a lot more balanced and considered. The horror stories of the eighties and early nineties of mass foreclosures are now the exception rather than the norm. So the relationship between the finance sector and agriculture is good one; however, there is always room for improvement.

Like many sectors of the economy, credit access has tightened for farmers since the global financial crisis. We have seen a noticeable impact on banks' treatment of loan security requirements, with a clearly increased sensitivity by the banks to their financial exposure. This issue has been heightened for those farmers who have sought finance and had finance provided through the non-bank lenders, which were ineligible for the government's deposit-underwriting guarantee. In combination with those effects, we have also seen an impact on investments in on-farm capital works which had been vital to enabling farmers to improve productivity, which is where the majority of our gains in the sector have come over the last 30 years. In relation to the global financial crisis, we have also seen a tightening of monetary policy, which has an impact across the rest of the financial sector as well.

We have provided a submission to the committee, so I will leave my opening comments there. We are more interested in providing answers to any questions that senators may have. We are happy to elaborate on any of those aspects and certainly on options for a way forward. We are happy to provide further discussion on the points we made in our submission. Thank you.

CHAIR—Thank you very much. I invite the WA Farmers Federation to make an opening statement.

Mr Norton—Thank you for the invitation to appear. Certainly farm finance is quite critical, and we thought it was very well worth while putting a submission in. Obviously farm debt has been escalating at a fairly rapid rate. As has been pointed out in the NFF submission—and we have data to support this—since 2003 farm debt has increased by 83 per cent, and there are reasons for that. On-farm productivity growth has maintained a very high level of around about 2.3 to 2.5 per cent per annum to keep ahead of the productivity treadmill, and a lot of that has been done on borrowed capital. The big problem for agriculture has been that, whilst we have incurred substantial debt to maintain that productivity growth, the profits to underpin that investment have not necessarily come back to the farm sector. The profits that productivity growth has generated have been captured by other parties, probably banks included, in the money stream that flows back to growers.

Obviously credit and money has been relatively easy to obtain over the last four to five years and farmers have invested in that environment quite substantially. As current finances are starting to tighten up, we are seeing in agriculture a three-tiered system—that is, the banks, the investments by Landmark and Elders or the stock firms, and other commercial interests—whilst bank rates are increasing. The current dilemma of having two main stock agents in this state, being Elders and Landmark, after they have sold off their loan books to banks, is certainly tightening up the financial market to growers. Whilst the stock firms are somewhat more generous with their credit and their loan facilities than banks are, there is certainly going to have to be a rejigging of farmers' attitude to borrowing money and how they manage their overdrafts, and the amount of money that is required to put in a crop and run their businesses.

Until they readjust to the new rules with a shortage of finance—tight money—things are going to be fairly tight in a lot of agricultural enterprises, especially the grains industry bearing in mind that the grains industry is the dominant factor in Western Australian production, bearing in mind we have come off some very high grain prices to very low grain prices, and very high input costs. Of course, finance is the key to all that. I think that is about where we sit. In a farm input survey that we were involved in about 18 months ago, finance was the second highest input cost—fertiliser was the highest, followed by financial inputs, followed by a number of other key input costs. We are pretty concerned about what is happening and we are looking at ways and means of how we can minimise and iron out those finance input costs to our farm businesses. I think I will leave it at that. Any other comments, Alan or Chris? No. Alan shakes his head and Chris shakes his head as well.

CHAIR—Thank you very much. One of the reasons we are very interested in the rural sector was that we had information from Western Australia that wheat farmers in particular were having trouble borrowing money to plant their crops. Would you like to comment on that?

Mr Norton—The information that we have been given is that most farm crop budgets were cut by about one-third to one-half. That would have to be confirmed by farm consultants and banks but that was the information that was given to this office—that, in general, farm budgets were being slashed across the board. If you asked for $100,000 they gave you $50,000. But just how that will be played out remains to be seen. We have spoken to the ANZ and other banks. They have maintained that they are going to stand by their farm clients but that will remain to be seen, bearing in mind weather conditions are starting to tighten up over here and it may well be with the international grain price that the area that is put into crop may reduce fairly dramatically. The window for canola planting is almost closed, so now we are down to just being able to plant wheat and with the current international price of wheat it may well be that wheat plantings perhaps will be reduced quite substantially.

CHAIR—That last point regarding the price of wheat was certainly put to me as a reason why the banks might be less willing to fund the crops of wheat farmers in this particular year. You are actually confirming that by what you are saying. You suggest that some farmers are able to finance their crops. Is that not necessarily through the banks but through other means, or because they are able to self-fund?

Mr Norton—Farmers are fairly articulate people. In Western Australia they do all their budgets in February. They go to the banks in early March and then the agronomists, economists and consultants sit around the table. Even though you have less money—like a reduction in your overdraft—you then need to look very closely at your input costs to see how you are going to apply that to your cropping program. As I said, farmers are fairly articulate. They will look at ways and means of maintaining their cropping area and their cropping program with the moneys that they have available. Sheep prices are extremely high. We have seen record numbers of sheep going through Katanning and I believe that farmers are liquidating some of their high-asset inventory by way of sheep—and, to a lesser extent, wool—to finance their cropping programs. We have had record numbers of sheep going through both Midland and Katanning saleyards, which is most abnormal for this time of year, but I think that is in order to plant the crop. There was going to be a very high planting of canola. It is getting rather late for lupins and canola so that is starting to drop out of the cropping rotation. People will be just starting to look at wheat and I think that will cause another rethink of just what their acreage is going to be. I am already starting to hear that people are going to reduce their cropping area.

CHAIR—In your submission, you talk about setting up a lender of last resort for agricultural businesses and refer to the fact that in the past, in WA, there has been a rural adjustment finance corporation, which filled that kind of role. Would you like to make any further comment about that?

Mr Norton—This is something that I, as a member of NFF, have been talking quite extensively about with Charlie McElhone and the policy council of NFF. We had the RAFCOR, the old rural adjustment corporation, which finished up somewhat out of favour. The NFF set up a banking arm back in the early eighties, called the Primary Industry Bank. That was very successful. Once you go to a full corporatisation of the banking sector, people in agriculture who do not have a lot of high equity tend to get left behind. We have plenty of information that demonstrates to us that farmers with low equity were being slugged with some very high interest rates. They were almost double what people with reasonable equity could obtain. As your equity is diluted, your costs of finance can increase by anything up to 100 per cent. We have plenty of information to back that up. And that is a real concern. We have been talking with NFF and our Minister for Agriculture and Food about a lender of last resort to try and keep the banks and the moneylenders honest—as we had to do in the eighties, as we did with RAFCOR and as we may well have to do in the future.

Mr McElhone—Mike is right. There has been a real move away from asset securitisation providing the basis behind loans for the rural sector towards a more cash flow basis. That is undeniable. We are looking at a range of options and Mike talks about the need to ensure that there is competition within the marketplace. I think that is one of the key elements here. That is one of the key recommendations that the NFF has brought up in its submission.

There are some concerns now particularly around some of the issues in the non-bank lending sector. They have copped a bit of a hit in recent times, particularly around the bank loan deposit guarantee. We have seen a lot of finance shifting away from the non-bank lender sector towards the bank sector. We want to make sure that that competition in the marketplace is maintained, because there has been a real escalation in the non-bank lending sector in the last 10 or so years and that has provided a welcome level of competition within the marketplace. It is no surprise, as Charles Burke mentioned earlier, that we have seen a real lifting and improvement in the behaviour of the banking sector compared to where it was 20 years ago, in the way it deals with its rural customers. That has been welcome. That coincided with a time when we saw more competition. So we are looking at a range of things we can do as farmers and farmer organisations but also I think there is a role for the government to play to ensure that the competitive elements are retained within the sector.

Senator XENOPHON—I have a question to the NFF about the issue of the Murray-Darling Basin. With the predictions of a hotter, drier basin, that will impact on the productivity of the basin and impact on communities. The response from the banks, and they were not being unhelpful, was, ‘Well, we don’t treat finance for farming communities as a year-by-year proposition. We understand that there could be years of drought.’ But if we are looking at a scenario where things will be much grimmer for all the basin, based on the CSIRO and other experts having said that, what impact does that have for long-term financing of communities, particularly in the basin, that are dependent on rainfall? I guess it is a broader issue as well but in particular for the basin, given the forecasts. Do we need to have intervention of a primary industries bank and a restructuring of the basin, otherwise those communities will not be viable in the longer term?

Mr Burke—It is a very difficult question to answer with a decisive and conclusive response—

Senator XENOPHON—You could take some of it on notice as well because I think it is a key issue for my constituents and people throughout the basin.

Mr Burke—Absolutely. If we go right back to the beginning, some of the predictions of weather patterns and what is going to happen, we have to look at that and whether it does manifest in that. We have got to a point where all businesses involved in agriculture are much more acutely aware and managing for risk and risk management, and I think banks to a large extent have gone down that path with many people. It is very difficult and we would have to give that consideration, particularly for a specific area like the Murray-Darling River. We represent farmers all across the country and there are other risks in other parts of the country that might have equally as catastrophic an impact.

Senator XENOPHON—I singled out the Murray-Darling Basin because of the forecasts being made by the CSIRO and others that it is going to be hotter and drier and less productive, which surely must have implications for viability and financing for those communities.

Mr Burke—Yes, and they are the sort of things that progressively we have to work through and the relationship between the business, the farmer, the bank or whatever has to be a strong one and you have to use the information you have got. Sure, it will have an impact, but sitting here today it would be very difficult to give you a definitive answer on how that will be other than to say that we have to roll with that as we go, as we do with any climate impacts, whether it is drought or excessive rain—in Queensland we have had to deal with impacts of far too much water in more recent times, and from a financial point of view that has different impacts on cash flow. So it will have an impact, there is no doubt, but how we measure it today and how we manage it I cannot give you an answer. But it will have to be part of a good risk management going forward both for the farming community, the financial sector and indeed the government. All three of those stakeholders have to play a role. We look to be part of that and work through it on a progressive basis.

Mr McElhone—Can I follow on from that. We talk about the scientific risk about lower water flows through the Murray-Darling or other river systems. There is also the sovereign risk element too. We have seen a lot of movement in the policy space relating to water entitlements and that creates real uncertainty with the farming community and it creates real uncertainty with the finance sector lending money to the farming sector. In many instances the water entitlement is a significant portion of the asset securitisation formula.

Senator XENOPHON—Sure, but in South Australia, for instance, you have a situation where high-security water licence holders in the Riverland, for instance, are still a bit over 60 per cent. Last year it was a fraction of that.

Mr McElhone—Yes, and that is what I am saying about there being not only the scientific issue of the actual water flow but also the policy risk on top of that. It all affects the finance sector's decisions on how much they are prepared to lend the farming sector, and if there is uncertainty around that that creates more and more angst. But I agree with Charles. It is very hard to generalise across all farmers in that system. Each has adopted different ways to deal with that risk. We would hope that that will be taken into account by the finance sector in the way that they can potentially access loans.

Senator XENOPHON—Do we need to have a primary industries bank, given that a commercial entity could not reasonably be expected to carry that risk? It may need the assistance or the intervention of a primary industries bank type organisation.

Mr Burke—It may or it may not need that. We are happy to explore the necessity for that, but I think one of the keys is to maintain competition in the sector so that we are not creating policy decisions that will negatively impact on the non-banking lending fraternity. There may in fact be a whole host of opportunities through community type instrumentalities. We may not be able to say, for each of those opportunities, whether it would or would not work, but we certainly would not dismiss a primary industries bank related entity. Again, however, if you maintain competition to give people the choice, in some cases the market will respond and you will get some financial institutions specialising in that—and those institutions would become, by default, the primary industries banking type arrangement.

Mr McElhone—I think we do acknowledge that the banking sector has an acute awareness about all these factors for irrigators. They are aware of the policy issues; they are aware of the scientific issues; they are aware of CSIRO reports. A lot of the feedback we have had from our members is that, in the last 10 years in particular, there has been much better engagement and involvement by the bank sector about the actual issues faced by the farmers.

Mr Burke—A lot of the banking institutions now have dedicated agribusiness sections, whereas 10 or 15 years ago it might have been consumed in a small business entity or a normal business entity. They are more acutely aware—some of the bank staff involved in those sections are sons and daughters of long-term farming families and are acutely aware of that issue.

Senator XENOPHON—I commend that and I appreciate what the banks have been doing. If the forecasts are right, or even half right, that there is going to be significant contraction in the basin, with lower inflows, and with the impacts that implies, do we need to be looking at a bigger picture approach? Do we need an approach with the Commonwealth or the states being involved, saying, ‘We need to rejig the basin so that it can be viable in the longer term.’?

Mr McElhone—This is a much broader issue than just looking at access to finance.

Senator XENOPHON—But it impacts on finance, doesn’t it?

Mr McElhone—Absolutely and they need to be very much engaged within that whole decision-making process because it impacts them.

Senator WILLIAMS—One problem I have—and it has been around for a long time—is that when you see a small business or a farm doing it harder due to drought, low commodity prices, frosted wheat or whatever, the banks raise the margins on them when they start to get towards the danger zone. I just find it hard to take that, when people do it tougher, the banks raise that margin more and make it even tougher for them. In other words, it seems to eliminate any chance of recovery—it turns out the light at the end of the tunnel.

Mr Burke—Part of what we discussed in our submission was creating more transparency in the setting of rates and the adjustment of rates—almost putting a little bit of pressure on the banks to provide reasonable justification why, say, an orthopaedic surgeon can get an infinitely different margin than a farmer can.

While we understand that, while we realise the logistics of that, I think in this current environment where people are looking for equity right across the board it would be nicer to think that we had a more transparent approach to that by the banks which would be responsible. You would not get a farmer to argue about that frustration. It is almost counterintuitive when a bank looks to support a business and seeks then to increase the margin and bleed it that little bit more that, over time, they should probably be looking to reduce the margin for a period of time that allows some breathing space to get the business back to full production at a lot quicker rate.

To us, it is counterintuitive and that is why we would like to think that there is a little bit more peer pressure through a transparency arrangement. That might just allow a little bit more competition in that area.

Senator WILLIAMS—I was very interested Mr Burke to look at your submission regarding the Reserve Bank. In your last sentence you said:

> The NFF also encourages the Government to ensure that an appropriate representation of agricultural interests is maintained on the Board of the RBA.

Do you now have representation on the board of the RBA?

Mr Burke—Not as a direct input but there are people on the current board and there have been people on the board over the years who have had some experience and exposure to farming, farming representation and agriculture policy development. We meet with the RBA on a regular basis and at times we struggle to create a reasonable environment of providing information about the impacts of monetary policy on agriculture.

Senator WILLIAMS—We have had about six interest rate rises in the last eight months. I repeat to you again, I thought the small business sector and farmers were hard done by during the period when interest rates were going down because they did not get the full flow-on of the interest rate reduction when those buying their homes did, overall. I can go back to June 2002 when I was driving into Trundle on my job and the Reserve Bank put interest rates up. I thought ‘this is crazy—look at the drought setting’ and I phoned John Anderson’s office. He wrote to the Reserve Bank and he said, ‘Would you please take into consideration the massive drought’ that had just kicked off in mid-2002. The Reserve Bank did acknowledge it. For the next few months they said, ‘We are not going to put rates up. We have taken the drought into consideration.’ I think it was not until November 2003 that we had the next rise in interest rates. This is where I see the unfairness in Australia. We have seen these interest rates rise. I live at Inverell and at Bundarra, south of Inverell, they have had a woeful drought for the last two years yet they are now paying the high interest rates while the economy is supposedly booming along. It just does not seem fair. We have two economies. We have got a rural economy that really has not recovered since the rug was pulled out from under the wool market back in the nineties, yet we have had the boom in other sectors—especially minerals, et cetera. How do we get some fairness into it when you have got the sufferers having to pay high interest rate because other sectors are doing very well?

Mr Burke—It is an unfortunate situation and we agree. We raise that exact same issue and frustration with the RBA when we meet with them on a semi-regular basis. It is one of the problems of using averages to start setting policy. Once you start providing an average of economic growth and you have got some serious outliers in your information and your data sets, that tends to cancel out the lower end of the market. There are a lot of people not only in agriculture but also in other small businesses and other industries who are astounded at what is described as the two-speed economy in which there is this exceptional growth currently, which necessitates the interest rates going up on a regular basis, whereas a lot of those people and industries are still endeavouring to recover from the negative impact of the global financial crisis. Again, there is no silver bullet, but it is certainly our desire to make sure that what agriculture and the associated industries represent to GDP, to employment in Australia and to exports in monetary policy, through the Reserve Bank—and the figures speak for themselves——are recognised as significant contributors to monetary policy settings.

Mr McElhone—Absolutely. A lot is made about keeping the core inflation rate between the two and three per cent target range, but let us not forget about the impact that rising interest rates have on the Australian dollar and the impact that that in turn has on very export-dependent sectors such as the Australian farm sector. We export two-thirds of what we produce. Clearly that is one of the largest impacts of monetary policy on a sector which provides 15 per cent of our merchandise export earnings.

Mr Burke—And traditionally, when we had a high currency value, it generally was offset to some degree by the reduction in costs of imports such as fuel, fertiliser and machinery. I am sure that this committee and various other stakeholders are aware of the frustration at the escalation in fertiliser and fuel prices over the last few years and their negative impact. It is not that long ago that a one per cent increase in the Australian currency cost Australian agriculture about $117 million. It now costs $190 million every time the dollar appreciates by one per cent—not one cent but one per cent—and a lot of that is attributed to fuel and fertiliser prices. The dollar goes up, fertiliser does not come down, fuel fluctuates—although it depends on what day of the week it is—but essentially that net fact that we used to get from a higher valued currency has long been negated.

Senator WILLIAMS—I am perhaps off the track a bit but you are saying one per cent. So if we had a 70 cent Australian dollar and it went up one per cent, seven cents is 10 per cent, so one per cent is 0.07. It wipes out about $190 million out of the rural sector.

Mr Burke—Yes, that is the net effect.

Senator WILLIAMS—That is huge, isn't it.

Mr Burke—I do stress whenever I talk about this that it is one per cent, not one cent.

Senator WILLIAMS—Okay, so coming back to the subject of competition and access to finance for small business—and of course farmers are part of that small business—how do we get more competition out there? If someone with 50 per cent equity is suddenly reduced to 40 per cent and the bank says, 'Okay, your rate was 10 per cent but we are now putting it to 15,' how do we get someone to keep them at 10 per cent to provide competition? How do we achieve a climate where there are no exit fees? You need to be able to walk away without having to pay exit fees because exit fees just change you to a bank. You are tired, and you paddle up to the bank with exit fees and it removes competition. What is the solution? What should this committee recommend when it comes to those people who are doing it tough?

Mr Burke—I do not think I can give you a definitive answer on that. Obviously if I did, perhaps we might have made a bit more about—

Senator WILLIAMS—Do we need to establish a rural bank?

Mr Burke—Certainly there needs to be further in-depth viewing of whether provide not there is a barrier for competition for other entrants into the financial market. We have a prudential review authority, or regulatory authority, which probably created surety in the Australian economy through its financial sector in the last two years when we had uncertain times, but perhaps we need to be looking at some of the regulations for competition. Perhaps we need to be looking at some of the government imposed costs that the banking sector incurs. I, for one, changed our financial institution about 15 years ago after our family had been with them for a hundred years, and it was not an insignificant cost to us with all the extra things such as stamp duty and all that sort of activity which made what seemed a simple business decision at the time start to look like maybe we should not be doing it because there was going to be a direct out-of-pocket cost. So I suppose there are a number of things that we should be doing. As I said earlier, I would not discount looking at a primary industries bank, but I think we need to explore some other avenues through various legislation, through various competition and transparency issues, to see if that rectifies the problem.

Senator WILLIAMS—The committee has heard from NARGA and other witnesses that one of the problems we have is getting young people into industries—whether that is the retail industry, the agricultural industry or whatever. If you want to sell your grocery store and you are 60 years old, how do you get a 25-year-old to buy it when they do not have any money? What is the average age of a farmer these days? Is it 58 or thereabouts?

Mr Burke—Fifty-seven.

Senator WILLIAMS—It is a frightening age, anyway. So, what do we have to do to make the finance available to get younger people into these vital industries that our nation needs? We come back to the point that if the current system does not provide these facilities then perhaps the government needs to look at a newer system to provide them.

Mr Burke—Certainly we have often talked about needing to provide incentives. As I get a bit older I tend not to talk about young farmers anymore; I tend to talk about new entrants to agriculture, because I am not exactly sure what constitutes a young farmer. A new entrant to farming is probably the best way to talk about it, because there are a lot of people who perhaps are not, in the old-fashioned sense of the definition, young anymore, but they are new entrants. These are the sorts of things we need to explore. We need to explore the ability of those people to access finance. There may be an opportunity for governments to play a role in that. A trial has just been announced for new drought policy. Perhaps you should take the word ‘drought’ out of it; it should be risk management. Part of that could be looking at alternative finance arrangements for agricultural new entrants or those looking to exit. There are a whole host of things that we can do. As I said, we are not opposed to the concept of a primary industries or a rural bank, but I think we need to explore some of the other market-driven issues first to make sure that the barriers to entry or the barriers to operation are kept to a minimum so that there is competition.

Mr McElhone—I will also quickly add that, in looking at the policy settings around the banking sector, we need to take into account those competition issues as well. I think they tend to be forgotten with the bank deposit underwriting guarantee. We did not really fully consider some of the potential competition issues that might emerge from that, and I think it needs to be forefront and centre in any regulatory decisions that we make surrounding the banking sector. Let us be honest: the big four are now deemed to be too big to fail. That is all well and good, but we need to look at what the implications might be for others in the sector.

CHAIR—Do you have any comments, Mr Norton?

Mr Norton—Yes. I have been listening, and I think there are alternatives. If you talk to the bankers, the new divisions that most of the majors have set up to look at agriculture tend to try to cherry pick the accounts. It is not necessarily their debt to equity ratio that they look at; what they primarily look at is their capacity to earn, or make money, and service the debt. The operations that have the ability to negotiate with a number of banks can usually extract a pretty good deal with one or two of the banks. In our own case, we deal with two banks. When we want money we basically play one off against the other or we go around the circuit to see what deals the various banking institutions are paying. A lot of these fellas, when they start to run out of equity for whatever reason, lose the ability to play one bank off against the other. As soon as you fall into that category your margins start to get ratcheted up. Once the banks know that you cannot go and play them off against somebody else they very quickly move those margins up.

That is the group of small businesses or primary producers you need to look at. We need to find a way of making those operations more competitive so that they can trade out of trouble and not into trouble. The banks do not necessarily want to sell them up, because, if they have fire sales—and we think a large number of farmers are in that category in Western Australia—they bring the value of farmland down. That starts to affect the equity of everybody. So the banks are fairly cunning and fairly clever about how they deal with these particular accounts. They certainly milk as much money out of them as they possibly can, without necessarily having a fire sale, because that affects everybody. Perhaps you could get the banking community to come together and put together a pool of money to put these difficult accounts into, where they would not be exposing an individual bank but would work with them as a group.

That is basically what RAFCOR used to do and is, up to a point, what the old Primary Industry Bank used to do—try and trade these fellers out of trouble or quietly get rid of that land when prices are high. But to just leave it in a cutthroat situation like we are in at the moment is going to make it very difficult to bring new farmers in. It is going to be very difficult to deal with those particular farmers that have for whatever reason, be it frost, drought or poor management, got themselves into a low equity thing. Once you get onto that treadmill there is virtually no way out.

Senator PRATT—I would like to turn to a couple of issues raised in the WA Farmers Federation’s submission, one of which was in relation to farm management deposits. The submission outlines the fact that the Productivity Commission has looked at this and believes that the current cap is appropriate. The WA Farmers Federation says this should be lifted and that it would be helpful to do so. I hope that the committee, in due course, will get to ask the Productivity Commission about this issue. You raised the fact that the Productivity Commission does not support changing the current gap and I wonder if you might critique the reasons why it does not support this and its justification for its position?

Mr Hill—We looked at the Productivity Commission’s review maybe 12 or 15 months back and they were critical then. I recall that FMDs were not widely used and therefore they drew some sort of line to the fact that perhaps tinkering with the format may not have addressed that issue. Our position on that is slightly different. We believe they are a very good tool for those who are in a situation to use them. We are not saying that every farm business out there is in a position where they can put money into an FMD and then bring it back out at an appropriate time, but certainly our position would be that, if the cap were increased, it would be more attractive to those businesses and more able to be utilised in between times when there might be a need for reasonably short-term finance.

Senator PRATT—So in short you are saying that the Productivity Commission did not support them because no one was using them, and you would contend that no one can use them because they are capped at too low a rate? That might be an oversimplification on my part.

Mr Hill—Yes. I think you are right. My position on it is they were saying that they were not working, and not really looking at why they were not working. They were just saying, 'They were not being used and therefore we will not make any attempt to try and increase their coverage into the rural sector.' I tend to support what you are saying. Perhaps if they were more applicable to a wide range of businesses, a wider range of businesses would then take them up, particularly in Western Australia with their larger farm sizes. As we go forward, and I suspect it is the same for all Australian farms of larger farm size, the $400,000 figure is not going to be adequate on a multiyear scale. And yet, out of the same report, came a heavy emphasis on preparedness, the capacity to respond and a farmer's need to be resilient.

Senator PRATT—I see.

Mr McElhone—Can I just follow on from that? Farm management deposits have been a really successful mechanism for the farming community and we believe they have been a very effective risk management tool to adjust to those big fluctuations in annual income that the farm community experiences. Any way that we can build up the support behind those farm management deposits is very welcome.

The misconception is that it is tax-free income, but you pay tax on those farm management deposits when you withdraw them. So it is not tax free; it is just to take into account those fluctuations. The other thing they do come into criticism for from time to time from people who are not informed about them is the fact that in some instances farm management deposits can actually go up during times of drought. You have to take into account that many cattle producers, for instance, can be forced into selling their livestock because of drought and therefore their income might go up despite the fact that they are in the midst of drought. It can be perceived that they are not effective tools for reasons such as that, which is very misleading. As Alan said, I think any way that we can further the uptake and provide better options for financing for farmers to spend the money when it is most effective to spend that money on their farm, as opposed to when it might be tax effective to do so, should be endorsed.

Mr Burke—I believe, and the NFF has believed for a long time, that one of the bigger limiting factors on the use of FMDs is the fact that they can only be utilised by an individual. Many of Australia's farmers still operate under a family regime. Some of them have partnerships. Some of them have trusts. There is in a lot of cases a complex beehive of ownership within those family organisations. If a partnership is doing the trading on a property that has individual owners, generally the partnership is the entity that provides and gains that income. If you then distribute the funds to individuals to invest in an FMD, when they withdraw it those individuals have to reinvest it into the partnership. It would be far simpler for the trading entity to be able to invest the money, which would eliminate a whole host of complexities that have fallen out of the fact that small and medium sized enterprises are not eligible to invest in an FMD. So that is another limiting factor. It is certainly something that should be viewed as an opportunity to look at alternatives and other ways to access finance. In this particular instance it is people's finance option based on some good years that have allowed them a cash flow.

Mr Norton—I think you will find they have much larger properties over here and the average loss that we are hearing from the majority of consultants this year for grain farmers is around about a quarter of a million dollars. Some of those losses were over $1 million and there were quite a few at half a million dollars. Some farmers incurred losses last year as well. Whilst

$400,000 sounds like a lot of money, in terms of the size of some of these cropping operations over here where you need $1 million plus to put a crop in, it is seen as not being enough. Really we need to perhaps look at raising that level with some of the operators to use it more cost effectively when you are having these big fluctuations in profits and input costs.

Senator PRATT—Thank you. We have already touched on the question of ANZ and Landmark. Clearly, the more the banking sector understands the nature of farming businesses, the better it can be at lending. It does appear here that we are at risk of losing a specialist service, resulting in further consolidation to the four big banks from the loss of expertise and emphasis on it at the ANZ. Whilst we have looked at these issues in general, I wonder if it is something that this committee should be commenting on directly. Do you have a view on that?

Mr Norton—That is my point to deal with again. I will give you some of the practical information we have. Elders was the problem last year, when the Adelaide Bank and the Bendigo Bank started to take back the loan book of Elders. There were a lot of clients of Elders—members of ours—who started to have their budgets trimmed and, in some places, rejected. We had meetings with Adelaide Bank and Elders. The Adelaide Bank were very happy with the way their loan portfolio was going and really did not have any problems. The reason, of course, was that they were charging some of these fellows 11½ per cent for their operational accounts and 12½ per cent for their loan accounts when, for instance, our business could borrow money for 6½ per cent. So you can understand why the Adelaide Bank were pretty happy with their loan accounts. It was Elders, the stock agent, that had got all these fellows into trouble, though. Elders lent money on a fairly liberal basis to these fellows for chemicals and for fertiliser and, when the bankers moved in and took over, all of sudden the rug was pulled from underneath these fellows and their equity basically vanished.

The same thing is starting to happen this year with Landmark, where ANZ have taken over the loan book. Exactly the same thing is starting to happen with those producers who were overcommitted through Landmark. They have had the lending rules changed quite substantially by ANZ. We have had meetings with ANZ and their story was very much the same as that of the Adelaide Bank, which tends to make a lot of us a little bit cynical about the way bankers and stock agents have dealt with this issue. At the end of the day, it is the farmers that are going to suffer financially, quite dramatically, and some of them have already lost their farms.

Senator PRATT—Clearly we would not want to prevent lending books being taken over by other banks if it meant that that lending was no longer viable, so where does the balance actually sit?

Mr McElhone—We would have problems if the reason they became unviable was government regulation or government involvement, such as the government's underwriting guarantee. If that were the reason they lost equity, suddenly became uncompetitive in the marketplace and were more reliant on offshore financing for their own credit access, then we would have a problem with that.

Senator PRATT—Is there evidence that that is what has happened in this case?

Mr McElhone—There is clearly evidence from the non-bank lending sector that a lot of equity has flown out of that sector. There was a lot of uncertainty in the general marketplace and it is undeniable that a lot of equity moved out of that sector.

Mr Burke—And any financial institution that sat below that AA or AAA rating—whatever the internationally recognised rating is that only the four big banks have—found it more costly to access finance. Basically it was just a net flow-on effect.

Senator PRATT—I can see that, but the price of that should not necessarily be the loss of services that specialise in how they assess finance. That seems to be one outcome that we are currently confronting.

Mr Burke—You are right. It should not be, but unfortunately it is—or it can be.

Senator PRATT—This is perhaps one of the more tangible examples of that. It is good to have it on record.

CHAIR—As an overriding question, do you think there is a problem in the rural sector for farmers obtaining finance or are there means of dealing with this? That is the question we started with.

Mr Burke—Obviously our colleagues in Western Australia have pointed to a number of examples. I think you would be able to go to most states and find people within various commodities who, perhaps, will experience that. Probably each and every one of them would have a slightly different story to tell. So obviously there are examples of finance being difficult to obtain. I would not suspect that it was a national epidemic. I would suspect that there was still the ability to obtain finance, but there have been some negative impacts from what has happened over the last 12 months—from, as we pointed out in our opening statement, various changes and a tightening of monetary policy and credit. So obviously there are examples of credit and business finance being difficult to obtain in agriculture.

CHAIR—Do you have any other comment, Mr Norton?

Mr Norton—I think it has been covered fairly well. We are currently at a little bit of a watershed. Having been around agriculture for 40 or 50 years, I have been through plenty of these watersheds. Finance has been pretty easy to get for the last five to 10 years. Obviously, things are tightening up. We just need to plot our course as we go through this difficult period and make sure that we do not lose too many farmers through some unscrupulous financiers. We just need a little bit of help and a little bit of protection from the legislators and the political process to make sure that certain individuals do not make a welter out of some people’s more unfortunate financial decisions that perhaps they should not have made.

Senator WILLIAMS—I have to ask all of the witnesses here: have you ever seen financiers send receivers or administrators onto farms?

Mr Norton—The banks have become much more reluctant to do that than they used to be in the past. You will find that a banker in this day and age is very reluctant to send a receiver or hold mortgagee sales. They do it as a last resort, because if you have too many of them they tend to bring down the value of the whole district’s assets. Banks have been fairly responsible in recent years in this area, but that does not mean that there are not a few problems there and that we should have systems in place so that when people lose equity they do not just get stitched up.

Senator WILLIAMS—You make a good point because, if there were a mass sell-off of farms, that would have a domino effect on the value of the land, no doubt.

Mr Norton—Very much so, and that affects the banks’ portfolios. The banks have become fairly clever as to how they deal with this predicament now.

Senator WILLIAMS—I am pleased to hear that.

Mr Burke—Certainly, in our discussions with banks, they are taking a far more responsible attitude and are aware of the market implications of doing something hastily. I think it is safe to say, if you talk to an agricultural banker, that they would take more of a medium- to long-term view on a business than one would if they were buying a takeaway shop or something like that. There is certainly an acknowledgment on the banks’ part that agriculture is not a flash in the pan, 12-month-only view and that in the planning, risk management and risk assessment they need to take a view that is a lot longer term than that.

CHAIR—Thank you, witnesses, both here and in Western Australia.

Proceedings suspended from 1.08 pm to 1.12 pm

RADISICH, Ms Jaye Amber, Chief Executive Officer, Council of Small Business of Australia

CHAIR—Welcome. We invite you to make an opening statement, and the senators will ask you questions.

Ms Radisich—Thank you. I realise that I am the last presenter, so I am sure you have heard a great deal over your two separate hearings in Sydney and Canberra. I would like to be as brief as possible. If there are any unanswered questions about the small business sector I will focus on them because, by and large, everything I have to say is covered in our submission and the appendix that I forwarded to you, which was something that we wrote in March 2009 in response to the minister's round table on banking and finance.

Perhaps the most critical thing I have to say to you is 'thank you' because this issue is the No. 1 issue for small businesses in Australia. Everything to do with the cost of credit and finance, and access to it, fundamentally impacts on how small businesses do their business and carry on their business in difficult times, including in the period of the GFC and arguably in the period that we may well be about to face, which many commentators internationally are calling the 'double-dip recession'. If anyone out there thinks that this is over then I would be so bold as to say that they are wrong, although I am not an economist so I will qualify my comments.

All of that goes to the point that access to affordable credit and finance is the No. 1 priority for small business. When COSBOA conducted a joint survey—I think the research was done in January this year and it was released in February—with Telstra Business, it was very clear in that survey, which is statistically significant, that banking and finance remained the most important issues for small businesses. I was a little bit surprised at those results because we have had so many changes, in particular the introduction of the Fair Work Act. There has been a lot of hype in the media post 1 July—what are the implications for small business, and how important is the Fair Work Act in the industrial relations regime?

Some commentators all but said small business would essentially stop if the new Fair Work Act was put in place. Sure, there have been hurdles and there continue to be hurdles in relation to modern awards and so forth, but our study and our anecdotal evidence collected by the council all points to banking and finance being the No. 1 priority for small businesses.

We have made a range of recommendations which are outlined in our paper, and the message that I would like to give is that the government and the parliament does have a very important role to play. The banking sector is clearly a highly regulated sector and its impact on small businesses is absolute. There would be very few—perhaps two handfuls—small businesses in Australia who would operate without some sort of heavy reliance on the banking and finance sector. Whether that is organisations like the big four banks, NBFIs or community banks and credit unions and so forth, irrespective of the products that they might need, whether they be overdrafts, lines of credit et cetera or something as basic as credit cards, all of these products play a big role in how small businesses start up and how they carry on and, importantly, how they carry on during tough times.

The recommendations that we have made have all been around the fact that access to affordable banking and finance is important; government has an important role to play; and banks and other financial institutions are highly regulated and need to be accountable within that framework. Despite the decreasing profitability of many enterprises around Australia and overseas during the last 18 months, its banks have in fact increased their profits considerably. Our view is that the profits have been generated by small business. There is a point of view that some gouging has gone on. I do not have any evidence to give you about that, but I am sure others have thus far. I could run through some of our recommendations or have a discussion with. Mr Chairman, I am happy to continue or take your lead.

CHAIR—We might ask you some questions because we have a fairly tight time frame. Recommendation 4:

Reconsider the introduction of the proposed Australian Business Investment Partnership with a specific focus on small business, such as exist in the UK, China and Singapore—

do you want to discuss that a little?

Ms Radisich—Sure. It is really interesting. The Ruddbank proposal, as it is colloquially known, was conceived in light of the problems that the commercial development and property development sector were having accessing finance. Many of them are in fact small businesses. It so happens that their projects are big dollar projects but many of them are small operators. There was very little talk at the time of the introduction of Ruddbank about the potential benefit that would accrue to small businesses through that particular piece of legislation. Obviously, it did not go ahead; however, that piece of legislation, whilst publicly was talked about in terms of commercial property developers, actually had enough scope in it to support other funds to support activities such as helping out small businesses. I realise it is quite controversial but, given that I think you would agree that your role is to assess the entire array of options that might exist in support of small businesses going forward, this is one which potentially could be revisited or be in a modified format. So in countries like the UK, China and Singapore they all established particular funds in recognition of the fact that many of the larger banks simply stop lending or change the goalposts when it came to lending to small businesses.

We have to remember some key facts: small business employs about 4½ million people, is the largest private sector employer and is responsible for about 30 per cent of our GDP. These are very significant. The analogy that I like to use—being from WA, you would understand this as well, as would Senator Pratt—is that 30 per cent of Australia's GDP comes from mining, so everyday, without fail—

CHAIR—We are very conscious of that at this very moment.

Ms Radisich—Exactly. The attention given by policymakers, government, parliamentarians, media and various other commentators to the importance of mining to the Australian economy is massive. Small business does not get the same attention from any of the aforementioned parties, and I think that balance needs to be redressed. Potentially, reinvesting some profits—this might be a bit controversial—that come from one segment of the economy to help out another is good for employment and good for the tax take ultimately. I would argue that, given the massive number of people employed in small business compared with the mining sector, which is just one example, there is a really strong case for the government to direct its attention and resources towards supporting the growth and development of small businesses in Australia.

CHAIR—Other witnesses have said they would prefer to see more competition in the industry for the provision of finance rather than something like this. Do you have a comment about that?

Ms Radisich—Those commentators would have been the banks themselves perhaps. Maybe some of them were not.

CHAIR—Some of the non-banking lenders I think.

Ms Radisich—The NBFIs need a fairer go. If they get a fairer go, small businesses will get a fairer go. The playing field for them is not fair. If we take a look at the deposit guarantee that was put in place, there was a disparity between the costs charged to the big four versus the others. That meant that the small guys were not able to be as competitive as the big ones, which simply was not fair, in our view. We made that point to government but obviously it was not taken up.

Senator PRATT—In relation to recommendation 1, which is actually about the issue that we have just been discussing, I would like to ask about the extent to which COSBOA feels that the lessening of competition has contributed to a loss of specialist services and services that are geared to different sectors within small business. It would certainly appear that, for example, there do not seem to be products that are well suited to pharmacy, motor trades and farming and that the process of consolidation within the banks, and the fact that they have drawn in a lot of their competitors, means that there has been a loss of specialist services where people are able to look at what makes a small business tick and whether or not it is profitable.

Ms Radisich—The answer to that is yes and no. There clearly has been a decrease in competition, with CBA and BankWest, St George and Westpac et cetera plus the exodus of many of the foreign banks post-GFC. Whether the number and type of products that you suggested actually existed then, I am not fully aware of, but I would say absolutely that there is a massive opportunity in the market for them either to be reintroduced or to be introduced. Many of the big banks and some of the smaller ones are going down those pathways, particularly by introducing and employing a lot more small business specialist lenders, people who actually travel to the businesses and work out of the branches, rather than businesses having to deal with a teller and explain some complicated business matter that they might have. So there is some movement towards personalising and tailoring those services.

As for the nexus between the reduction in competition and the loss of those services, COSBOA has not received specific evidence to that end. The Real Estate Institute, the Pharmacy Guild and so forth are all members of COSBOA, but our approach and reason for being is to take a global view of all small business issues. So those member organisations of ours would be best suited to comment to you on those exact industry based financial products.

Senator PRATT—Recommendation 6 talks about the introduction or tightening of regulations governing the transparency of fees, terms and conditions et cetera. I really wanted to ask you what in fact a recommendation like that looks like.

Ms Radisich—Encourage the banks!

Senator PRATT—Yes. It might look quite attractive to consumers. Unit pricing is the parallel example that you have drawn in this recommendation.

Ms Radisich—Not necessarily unit pricing, but whole-of-contract pricing.

Senator PRATT—Yes. I asked Treasury this morning: how difficult is it to do? Is it something that is adequately being dealt with by the private sector in terms of websites where you can compare things? This is what Treasury was saying: you can go to a website and there are already places where you can compare. Or is this something government should be taking responsibility for, as has been done with things like unit pricing?

Ms Radisich—I would be fascinated to know what websites the Treasury is actually referring to. The only website that I am aware of that in fact compares small business loans was set up by the Victorian government, the Office of Small Business in Victoria. It was so good that it was essentially borrowed and shared more broadly by the Commonwealth government, and it is promoted through business.gov.au. But, as far as I know, it is the only impartial, independent source of point of comparison. So I would be interested to know whether they provided you any references. I raised this particular recommendation when I was having a private discussion with one of the big four earlier in the week. You can imagine they were not in favour of such a proposal.

Senator PRATT—I would not think so!

Ms Radisich—But if we, as a community, and the government, are serious about transparency and fairness, and giving as much choice to small business as possible, and making it as easy for them as possible to make these very important decisions—which could ultimately make thousands, to tens of thousands, to hundreds of thousands of dollars difference over the course of taking on such a product—I would argue that we need to make this whole segment of our economy much more clearer. When I suggested to this particular big-four bank that, if we can do it for mobile phone contracts, why shouldn’t we be able to do it for one of your loans? Of course, there was a litany of reasons why it could not happen—that is their job. Their job is to run their business, to make their profit; my job is to ensure that the playing field for small businesses are in is level and fair and gives them the best chance of making a profit. So we agreed to disagree. But, as senators, respectfully, you do not have to agree, so I think that puts you in an excellent position to interrogate the evidence you have been given to see what would be more beneficial to support the prosperity of small businesses going forward.

Senator WILLIAMS—Thank you for your attendance today. Competition in banks. You point to any recommendation, two of my pet hates in banking are exit fees and establishment fees. We are talking variable loans only. You cannot expect with a fixed loan to walk out of an institution at any time; you cannot do that with a fixed loan. But, with a variable loan, surely it would bring better competition if exit fees and establishment fees were banned and the banks could factor those costs in to some other part of their margin. Then you could actually walk out of a bank and go into the next one without cost, except perhaps for your stamp duty on your mortgage. That brings proper competition. And while I have an exit fee, they might charge you a monthly account keeping fee of $10. The next thing you know it is $12. Then next thing you know it is $15. But you cannot walk out, because to exit out of your loan would cost you more than the few extra dollars a month they are charging you. Surely, if it was brought in where exit fees and establishment fees were banned, wouldn't that bring in proper competition—or at least better competition in the banking industry?

Ms Radisich—I am hesitant to bandy around the word 'ban'. Given that my members are essentially participants in the free market capital economy that we have, they would want the right at all times to charge whatever fees they want in their own businesses. So I think it would be fair to say that, rather than dictating what fees and charges an institution could or could not charge, the key is transparency. The government has an opportunity to promote transparency, as it has done in mobile phone contracts, for example, so that consumers—and I am including small businesses in the consumer category here—can be much more aware of exactly what they are getting into.

There are another a few key points. Up to half of small business owners in Australia have not had education past year 12. So, whilst we have the benefit of being able to access quite detailed in-depth information about legislation and so forth about our financial sector, most small business owners simply do not have the capacity nor the time to interrogate the material that we might have at our disposal. So I think my job as an advocate and, with respect, your job as representatives—we are all representatives—is to make sure that the playing field that we create is as transparent as possible. I cannot sit here and say no, I do not think banks should be making profit. That would be disingenuous. But the way in which they generate their profit and the ease with which a small business can compare and contrast the products that are available is the real key here.

Senator WILLIAMS—I agree with you totally about the transfer of funds. When I had my small business, on a Saturday morning I had the bank page on my computer and I put $5 through my EFTPOS machine, all with the same bank, and it appeared in my account the following Wednesday. The $5 had gone from my account in a matter of one or two seconds—

Ms Radisich—Yes, so where does the money go?

Senator WILLIAMS—but it appeared in my business account on Wednesday. This has been one of my pet hates for many years. Where does the money go? Why the delay? Why can't the small business get that money quickly? They can get it out of your account straightaway but have a lot of difficulty putting it into your account. It is a very valid point you make there.

Ms Radisich—Yes. It is a very, very big bugbear of most of our members, particularly those involved in retailing. We put this question to the Australian Bankers Association when they presented to COSBOA in February 2009. The response was not satisfactory. We have since received a response in writing which, frankly, did not explain the question. I put it to them that the money was used on the short-term money market, which was denied. So I do not know where the money goes; you do not know where it goes. I think that is a problem for all of us.

Senator WILLIAMS—It is, because where is that transparency you talk about? The money went out of my account in a matter of a second but it did not land in my other account for another five days. So that is a huge problem in itself. The point you make about the reduction in competition because of the bank guarantee I think is a very valid point, because I know many businesses in that industry were not registered ADIs and did not get the bank guarantee. People withdrew their funds and put them into the big four, the credit unions and whatever. Those companies fell over and we lost competition, especially in small business finance, because a lot of those people I know, in the Probus group et cetera, focused on farm finance and small business finance. The government's bank guarantee on one side—the ADIs—basically reduced the amount of competition, so the government should really fix that up. They messed it up; they should fix it up. Would you like to add to that at all?

Ms Radisich—Is there a particular question?

Senator WILLIAMS—How do you feel about the reduction in competition because of the government's bank guarantee?

Ms Radisich—As I said, I do not think the bank guarantee was fair. It favoured ADIs. We advocated for that at the time.

Senator WILLIAMS—So did I!

Ms Radisich—But I think it is now time to look forward and see what we can do. We cannot necessarily control competition. I do understand that within Treasury there is a discrete unit which has been put in place to support and essentially hold the hand of institutions who want to enter the Australian banking market, whether they are NBFIs who want to upgrade to ADIs or others. I think that is a good step. I am not sure of the time frame that applies for those who want to become a bank in Australia, but at least something is there.

I did not really touch on the switching costs, but you did mention it a moment ago. The idea that we should have bank account portability is something that we advocate. It was raised in September 2008 at the Prime Minister's forum in Queensland. I believe there were about 500 participants there, and it was one of the key agenda items. I am having a great deal of trouble wading through truth and fallacy in this particular regard. I speak to the big four banks and they say: 'No. It absolutely can't be done. It's not possible.' Then I speak to some friends in IT and they say something which I will not repeat in front of the good senators.

Senator WILLIAMS—That it is not true.

Ms Radisich—But they do not believe it is true. I do not have the resources to delve much more deeply into the question. If bank account portability existed, it would provide more fairness and promote choice for small business. As a lay person, given the amazing things we can do with technology with relative ease, I do not necessarily agree with the position of the big banks. I understand that they could well be protecting their own interests, which is their prerogative.

Senator XENOPHON—You have a number of case studies there, and I know the Pharmacy Guild provided a number of case studies which I found very instructive and useful. Was this part of a phone-in, or are these complaints you have received? Have you had a specific phone-in or a survey that has gone out to your members on small business finance?

Ms Radisich—Yes. The case studies which you were presented with were essentially collected between February and June or July 2009. They were given to COSBOA by its member base, and some of them were given to us directly by small businesses in the community after they heard me commenting.

Senator XENOPHON—Is there a plan to have a more comprehensive survey?

Ms Radisich—Yes. A survey has been conducted, and I refer to it in my submission. I need to send that through to you.

Senator XENOPHON—That would be useful—including further case studies.

Ms Radisich—I do not have any further case studies. It has essentially been left to our member organisations to give you those. Our survey is quite general and essentially looks at what kinds of financial institutions small businesses use, why they use them, their level of satisfaction, things that they would change and what they would do if they were the government. The thrust of the feedback is they want to be heard and they want the playing field to be fair. They do not mind paying for services, but they want to know what they are paying for. They want transparency.

Senator XENOPHON—From my perspective, I find those case studies quite valuable, so if your constituent organisations are looking at—

Ms Radisich—I could certainly ask them for more.

Senator XENOPHON—I think those individual stories are quite powerful.

Ms Radisich—I will get the questionnaire and all the findings to you by the end of the week, if that is timely enough.

Senator XENOPHON—That would be good. Thank you.

CHAIR—One thing that we have covered is the New South Wales chamber’s suggestion of a temporary, appropriately priced government guarantee of 80 per cent of the value of business loans below a certain size. I suppose that was covered in your earlier answer about Ruddbank and its extension to small business.

Ms Radisich—I think there could be a lot of value in it for the community and it would be worth exploring. There are obvious risks associated, but I am quite sure that Treasury has the nous to mitigate those, as long as there is political will to try something different.

CHAIR—Thank you. As there are no further questions, we thank you for appearing this afternoon.

Ms Radisich—Thank you for having us.

CHAIR—I would like to thank Hansard and the committee secretariat.

Committee adjourned at 1.40 pm