NSW Business Chamber

3 April 2014

Mr David Murray AO
Chair
Financial System Inquiry
GPO Box 89
SYDNEY NSW 2001

By email: fsi@fsi.gov.au

Dear Mr Murray,

Financial System Inquiry Submission

Thank you for the opportunity to provide the views of the NSW Business Chamber (the Chamber) on the Financial System Inquiry. We also thank you for the opportunity to put these views forward during our meeting with you on 6 March 2014.

As you'd be aware, the Chamber is one of Australia's largest business support groups, helping around 30,000 businesses each year. Based on its heritage back to the Sydney Chamber of Commerce founded in 1825 and the Chamber of Manufactures of NSW founded in 1885, the Chamber works with thousands of businesses, from owner operators to large corporations, from product-based manufacturers to service provider enterprises. Operating through a network of offices in metropolitan and regional NSW, the Chamber represents the needs of business at a local, State and Federal level, advocating on behalf of its members to create a better environment for industry.

Small and medium enterprises (SMEs) are a fundamental part of the Australian economy, collectively employing around 70 per cent of the workforce and contributing around 60 per cent of private sector gross value added. Accordingly, to serve the needs of the economy a well-functioning financial system must serve the needs of SMEs.

SMEs interact with the financial system in various ways. The most important direct interactions for SMEs are through the payment system and access to intermediated debt finance. Many SMEs also pay significant insurance premiums or hold large cash deposits to guard against variable cash flow, so these areas are also relevant. More generally, SMEs are indirectly affected by the impact of the financial system on the broader economy, most obviously through their customers and suppliers, but also through the capacity of the financial system to support necessary economic infrastructure.

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SME concerns about access to intermediated debt finance include both the price and availability of loans. At present, weak demand means that few businesses are seeking to expand or make new investments, so at present access to finance is a less immediate barrier for most SMEs than it has been in the past. Record low interest rates mean that concerns about the price of finance are at a particularly low ebb.

Nevertheless, the Inquiry should investigate whether the spreads on Australian small business loans are comparable to those paid overseas, especially taking into account the apparent lower level of risk Australian firms present given the better performance of the Australian economy. The Inquiry should also investigate the apparent incongruity in the pricing of a business loan secured by residential property, with the pricing of a personal loan for the same business person secured by the same piece of residential property. Additionally, as recommended by the Henry Review the Panel should consider the reform to the taxation of financial supplies, which currently result in the over taxation of financial supplies to business (in relation to a consumption tax benchmark).

In relation to the availability of finance, the ABS survey on selected characteristics of Australian businesses in 2011-12 found that access to finance was rated as the most common barrier to business innovation, and the third most common barrier to general business activity.

In part, problems with access to finance relate to the difficulty of the loan application process. In December 2013, a survey of 738 NSW Business Chamber members indicated that 33 per cent had sought access to finance in the preceding three months, largely to cover cash flow (19 per cent) or grow (10 per cent), although some also sought funding to develop a new product (3 per cent) or prevent bankruptcy (1 per cent). Within this group, 67 per cent were successful and 19 per cent said the process was ongoing. Of the remaining 15 per cent that were unsuccessful, 13 per cent said the problem was that process was too difficult and 5 per cent said that the opportunity had passed. In this respect, it is interesting to note that the caveat lending industry, which provides quick, fully secured, short-term finance, largely exists because of the delays involved in applying for a standard business loan.

In November 2013, the Chamber published a report analysing the problems faced by small businesses in accessing finance, drawing on contributions from Deloitte Access Economics and Professor Mark Cowling (Exeter University). The report, which is attached to this submission, has three recommendations, which the Inquiry should guide the Inquiry's thinking on this issue.

- **Improve the quality and availability of lending advice to business**: While there are many sources of information for a business to consider when seeking finance, it can be difficult to locate and determine what would best address a business' individual needs. Better co-ordination of information from government, lenders and the business sector itself should be pursued to address this issue;

- **Government examine the implementation of a partial credit guarantee scheme**: The availability of collateral primarily relates to who pays if a business fails, not to the quality of a business idea, so, as used in the UK and many other countries, a credit guarantee scheme to allow banks to lend to businesses that meet all their criteria except sufficient collateral by underwriting part of the loan should be explored by Government;

- **The impact of prudential rules on lending practices need to be examined**: Current prudential rules are impacting on the ability of lenders to lend to small business and should be examined as part of a future financial system inquiry.

With respect to the payment system, the Inquiry should consider whether the fees paid by Australian SMEs are appropriate in comparison to larger Australian businesses, and the fees paid by SMEs internationally. To the extent that Australian SMEs pay higher fees than larger businesses that cannot be explained through cost differences, the Inquiry should consider whether this indicates that a degree of market power may also be at play in the pricing of other business banking products.

The overarching issue in the interactions that SMEs have with the financial system is the level of bank competition. The Inquiry will receive a number of submissions raising general concerns about competition in the banking industry; the competitive deficit in business lending products is even more severe, with the major banks holding a market share of more than 90 per cent. The Inquiry should give fulsome consideration to all proposals to increase the level of bank competition in general, but it should also give particular consideration to the barriers and opportunities to greater competition in individual product markets.

In relation to both insurance and deposits, current taxation regimes are problematic and distort behaviour by penalising businesses for holding cash in reserve or taking out insurance. It is difficult to recommend specific changes in the absence of a more holistic discussion about tax policy. However, this should not prevent the Inquiry from commenting on the inadequacies of current tax arrangements insofar as they impact on the efficient operation of the financial system.

Should you have any questions regarding the issues raised in this submission, please contact the Chamber's business regulation and economics adviser, Tim Hicks, on 02 9458 7259 or at tim.hicks@nswbc.com.au.

Yours sincerely

Paul Orton
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