SUBMISSION TO THE FINANCIAL SERVICES INQUIRY

This submission relates to the issue of SME access to and cost of finance. For the purposes of clarity, "finance" in this context means "debt". This submission does not concern itself with the related topic of SME access to equity. It comprises three sections:

1. General comments on the SME banking market.
2. Commentary on the possible policy options highlighted in the Interim Report as potentially being able to address the challenge of SME lending.
3. Additional suggestions the Inquiry might consider.

By way of background, I am a former senior career banker having spent over thirty years with the NAB Group in various roles including business banking and credit. I left NAB in 2008 to establish Slonim Consulting a banking advisory and advocacy practice. We perform the role of "the banker in your corner" by providing independent banking advice to business owners. In 2013 I founded theBankDoctor a free online resource centre that helps SMEs better understand and deal with their bank.

GENERAL COMMENTS ON THE SME BANKING MARKET.

1. For various structural reasons the unfortunate reality is that there are no quick or easy answers for the challenges facing SMEs in accessing affordable debt finance. If there were, they would have been implemented by now.

2. Whilst there are numerous participants in the banking sector it does not automatically follow there is a high level of competition in all banking segments. For instance, there is strong competition for credit cards, home loans and deposits but the same cannot be said for SME banking. It is much harder for smaller or new participants to make inroads into the SME banking sector as they are have been able to do in more standardised product based areas of banking.

3. Emerging technology based business models will continue to drive change in the banking industry. This, as much if not more than any legislative or regulatory changes, poses the biggest threat to the standing of Australia's dominant Big 4 banks.

4. Many SMEs do not understand the significant difference between the role of debt and equity in establishing and growing a business. Banks provide debt, it is not their function to provide equity capital although a number of banks have tried (unsuccessfully) in the past.

5. Removal of the Four Pillars Policy is likely to see further consolidation of market share between the Big4 banks and accordingly is not likely to be viewed by the SME sector as helpful for competition.

COMMENTARY ON THE FOUR POSSIBLE POLICY OPTIONS.

The FSI Interim Report identified a number of possible policy options including:

1. Government intervention by making loans, providing subsidies for loans or guarantees on loans.

Recently the South Australian government announced its intention to partially guarantee loans to SMEs. The Premier Jay Weatherrill noted "a partial stage government guarantee for a loan from a bank which may have only been wiling to back the small business with a lower amount of funds without it, was a commonsense, practical approach".

This effectively involves taxpayers taking risks that the investments the Government picks will be profitable ones. Going back some twenty five years, state owned banks of NSW, Victoria and South Australia cost respective taxpayers $billions due to the bad business loans they wrote. Other state government owned bodies such as the Victorian Economic Development Corporation and the merchant bank Tricontinental tried to pick winners in business with similar disastrous losses.

It is easy to reject such proposals on the basis that "it's been tried before but didn't work". Leaders in states like South Australia and Victoria which have been hard hit by the closure of manufacturing businesses need to consider all options to create jobs and generate economic growth. Certainly, if the SA initiative succeeds, other states and possibly even the Federal Government will look more favourably on such schemes.

2. Encouraging superannuation funds to invest in securitised loans and venture capital funds.

The massive flow of money into super funds will continue and these funds are always looking for new and diversified asset classes to invest in so this might be a good way of injecting new funds into the SME sector whilst giving investors a better return on a diversified portfolio of loans and investments.

Tax benefits could provide a further incentive for super funds to support new and emerging SMEs but this need not to be limited to super funds. Fund managers, companies and individuals could also be supporters of such an arrangement.

3. Develop the broker market for SME lending.

A number of submissions to the Inquiry suggested a more well developed broker market for SME lending would be likely to lead to increased competition between lenders although we question whether enhancing the broker market would make any real difference to the Big 4 banks that dominate SME lending. It is not that we need more introducers, we need more competition between the parties to which the deals are introduced. This suggestion would be helpful if it was coupled with the introduction of new lenders into the market.

4. Establishment of an SME finance database.
The Inquiry noted that initiatives to reduce information asymmetries such as the establishment of an SME finance database might enable existing and new lenders to more readily access information and therefore better assist them in making lending decisions. To the extent that inability to readily access current and accurate financial information is an impediment to SMEs being able to get access to competitively priced debt, any initiatives which could alleviate this problem would be helpful. New lenders are more likely to support this although the Big 4 banks are likely to resist any changes that could enhance the ability of smaller or newer lenders to gain market share. Then of course there is the cost of such schemes given that these tend to be passed onto the consumer. Privacy considerations would be another hurdle to overcome.

ADDITIONAL SUGGESTIONS.

1. Encourage shareholders and Boards to appoint SMEs representatives as non-executive directors.
There are a total of 33 non-executive directors on the boards of our Big4 banks but not one has a background in small business. Banks talk a lot about diversity particularly in relation to gender and over the last decade the percentage of female bank directors has risen from next to nothing to 27 per cent. Whilst this still falls short of where we need to be, it does demonstrate that with focus and commitment diversity goals can be achieved. Perhaps a similar approach could be applied to representation of SMEs on bank boards?

2. Enhanced Role For Australia Post.
Whilst we have highlighted the challenges in a government entity becoming involved directly or indirectly in business lending, one option worth closer consideration is for Australia Post to emulate New Zealand's Kiwi Bank. Formed in 2002, Kiwi Bank is a wholly owned subsidiary of the government owned New Zealand Post Ltd. It operates from post offices across the country mainly as a retail bank but it also has a successful and growing business banking division. Australia Post could potentially do the same.

3. Financial literacy.
Throughout the Interim Report, particularly in regard to superannuation and investment, financial literacy is recognised as a necessary condition for better outcomes. The report notes "consumers, like other participants, must take responsibility for both the risk and reward of financial decisions".

Financial literacy is also a big issue for SMEs. For instance, we regularly come across SMEs that lack a clear understanding of the difference between the role of debt and equity in establishing and growing a business. We believe it would be good for the banks bottom lines and reputations if they took more time and effort to explain to SMEs the different role equity and debt play in the creation and development of a business. Often banks are unfairly criticised for not giving an SME a loan when in fact that SME needs equity not debt. We don't believe SME financial literacy should be left to market forces to resolve. In fact, there is an important role for borrowers, lenders and regulators to work together to ensure this happens.

4. Encourage competition in SME space.
Technology, innovation and consumer attitudes, more so than government intervention, will drive more genuine and sustained competition in SME banking. So rather than becoming directly involved, perhaps a more effective role for government is to encourage and enhance new competition. Fast tracking approvals and reducing red tape so that new providers can establish themselves quickly would be helpful.

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18th August 2014