The COVID-19 Outbreak and Access to Small Business Finance

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Photo: Maskot Bildbyrå – Getty Images

Abstract

The COVID-19 pandemic has adversely affected the business sector. Overall, small businesses have been disproportionately affected because they are more likely to be in industries that have been harder hit by the pandemic. Demand for new loans appears to be weak, probably because businesses are reluctant to take on debt given heightened uncertainty about the economic outlook. The various short-term initiatives to support businesses' cash flows are also likely to have dampened the immediate demand for credit. At the same time, access to finance continues to be a challenge for small businesses. Banks have tightened their lending practices in recent years and are more cautious about lending to businesses that have been significantly affected by the pandemic.

Each year the Reserve Bank convenes its Small Business Finance Advisory Panel to better understand the financial challenges faced by small businesses. This year's panel focused on the effects of the COVID-19 outbreak. This article summarises recent developments in small business finance, drawing on the panel's discussions, as well as official survey data and the Bank's liaison with businesses and lenders.

Small businesses have been significantly affected by the pandemic

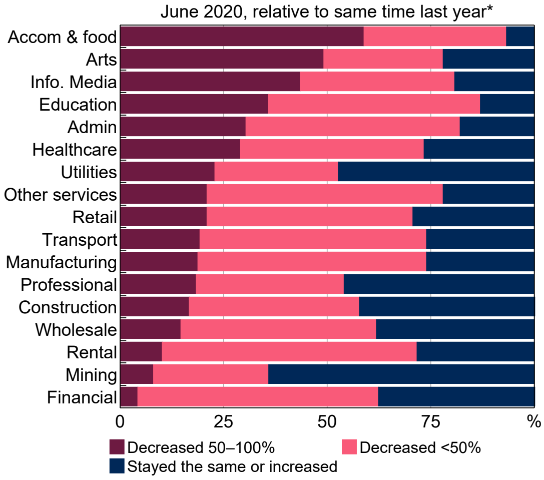
The outbreak of COVID-19 and measures to contain the spread of the virus have significantly affected businesses in all industries, although the extent of the disruption varies widely (Lowe 2020). Around 70 per cent of all businesses surveyed by the Australian Bureau of Statistics (ABS) in mid June reported a decline in revenue relative to the same time last year (Graph 1). Small businesses were twice as likely to record a decline in revenue as large businesses. This is consistent with small businesses being more strongly represented in the industries that have been most affected by the COVID-19 restrictions, such as cafes, restaurants, arts and recreation. Likewise, smaller retailers have seen a sharp decline in sales while larger retailers overall have seen stronger growth in their sales (Graph 2).

Some panellists noted that small businesses experienced a significant drop in demand in March as the effects of the COVID-19 outbreak became apparent in Australia; for some businesses, this came on the back of difficult business conditions resulting from the bushfires.[1] The ongoing effects on demand have been negative for many panellists, although some businesses experienced growth in sales, such as for some goods and services

Graph 1

Changes in Revenue

June 2020, relative to same time last year*

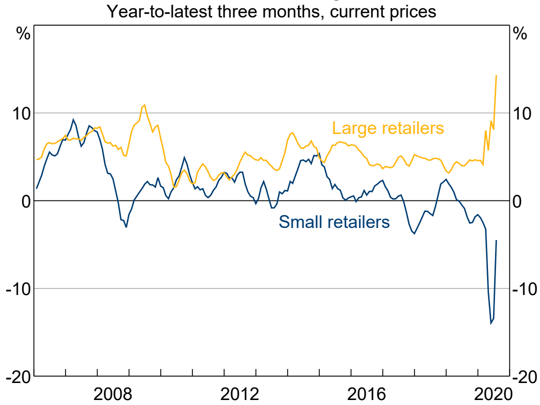


* Share of businesses; excluding responses of 'don't know'
Sources: ABS; RBA

Graph 2

Retail Sales Growth by Firm Size

Year-to-latest three months, current prices



Sources: ABS; RBA

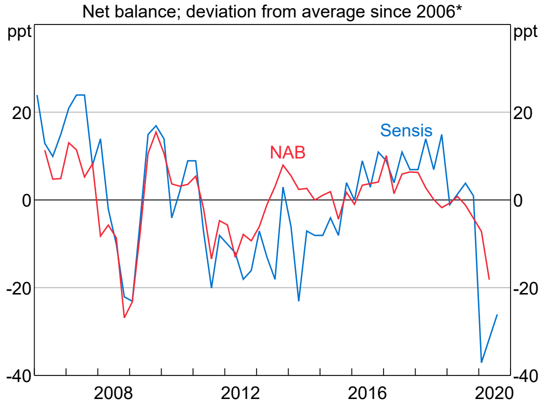
distributed through supermarkets and online channels. Survey data suggest that business confidence has fallen and many panellists confirmed that businesses are very uncertain about the future, which is a key factor leading many businesses to delay or cancel investment (Graph 3). In an ABS survey conducted in mid August, about 60 per cent of businesses identified uncertainty about the future state of the economy as a significant factor influencing investment decisions. Consistent with this, the ABS Capital Expenditure survey, which was conducted in July and the first half of August, suggests that non-mining investment will decline significantly over the next year or so.[2]

To assist small and medium-sized enterprises (SMEs), the Australian Government has introduced a number of measures aimed at supporting cash flows and encouraging lending (Table A1 in the Appendix). This includes the JobKeeper program, which provides cash payments to workers through their employers, Boosting Cash Flow for Employers, which offers tax credits, and the SME loan guarantee scheme, which supports the flow of credit to businesses (Frydenberg 2020). Commercial banks and landlords have also provided support, in particular through deferred payments and rent reductions. In mid July, about 40 per cent of businesses surveyed by the ABS reported that they were accessing the various support measures at the time; businesses in the accommodation and food

Graph 3

Small Business Confidence

Net balance; deviation from average since 2006*



* The net balance is the difference between the percentage of positive responses and the percentage of negative responses
Sources: NAB; RBA; Sensis

services industry were the most likely to report doing so (Graph 4).[3]

The Australian Government had been providing a range of assistance measures to SMEs prior to the pandemic. Recent initiatives have included the $2 billion Australian Business Securitisation Fund, which invests in securitisations that are backed by SME loans and issued by smaller banks and non-bank lenders. The first investment through this fund (worth $250 million) was announced in April 2020. Legislation to establish a $540 million Australian Business Growth Fund to provide longer-term equity funding to small businesses was enacted in March 2020; the initiative is to be jointly funded by the Government and a number of banks.

Demand for bank-based finance appears to be low …

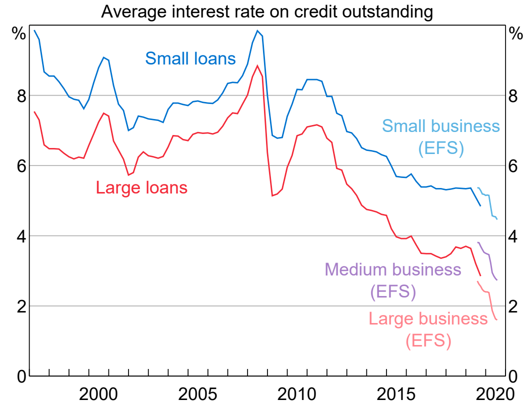
Interest rates on loans to SMEs have declined to historically low levels as the recent easing in monetary policy has flowed through to lending rates.[4] Variable interest rates on SME loans have declined by an average of 70 to 75 basis points since the end of February, a little less than the 80 basis point decline in interest rates on large business loans (Graph 5). At the same time, lending to SMEs has remained little changed overall, though lending for agriculture has picked up recently (Graph 6).

Overall, there appears to be little demand from SMEs for new loans given the heightened uncertainty about the economic outlook. Survey data and liaison with businesses and banks suggest that few business are seeking additional bank credit in response to the pandemic; rather, they are reducing expenses and investment, seeking to reduce debt burdens and making use of government initiatives to shore up their balance sheets and have sufficient liquidity to withstand a temporary downturn in demand. A survey conducted in mid May by the ABS showed that only 5 per cent of businesses identified access to credit as an important requirement to return to normal trading conditions. Only around 1 in 10 businesses reported seeking additional finance more broadly as a result of the pandemic. A subsequent survey

Graph 5

Variable Business Lending Rates*

Average interest rate on credit outstanding



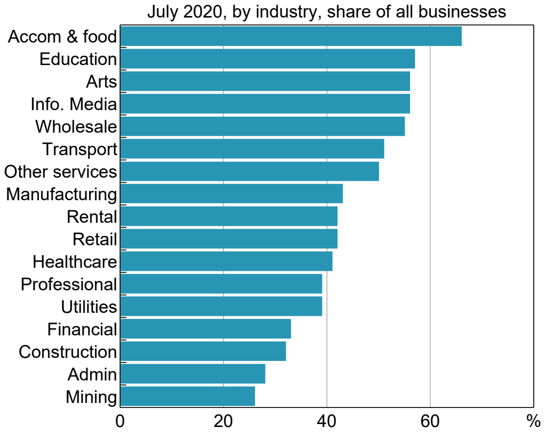
* Small loans are loans less than $2 million; large loans are loans $2 million or more; new series from July 2019 are from the Economic and Financial Statistics (EFS) collection (see Statistical Table F7)

Sources: APRA; RBA

Graph 4

Currently Accessing Support Measures

July 2020, by industry, share of all businesses

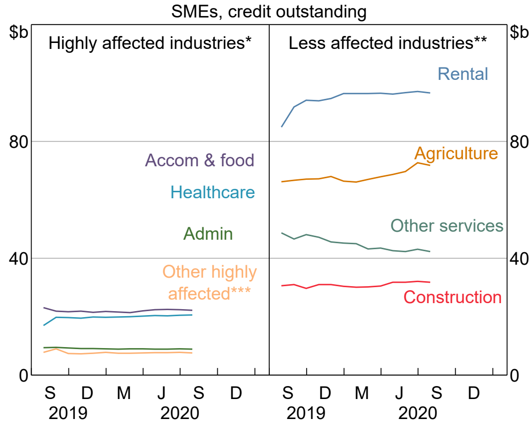


Sources: ABS; RBA

Graph 6

Lending to Selected Industries

SMEs, credit outstanding



* Industries with the highest share of businesses reporting a fall in revenue of greater than 50 per cent in June ABS survey

** Top four industries by value of SME lending

*** Education and training; arts and recreation services; information media and telecommunications

Sources: APRA; RBA

conducted in mid July showed that one in three small businesses that received additional funds through a tax credit reported using some of the funds to repay debt and a similar proportion reported putting funds into savings. In contrast, around 15 per cent reported using the funds for capital investment (Graph 7).

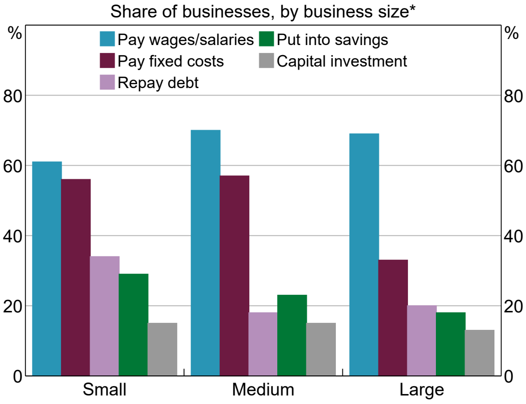
Income support policies, such as the JobKeeper program and initiatives that offer tax credits, have helped to alleviate pressures facing businesses following the COVID-19 outbreak. These policies have reduced the need for some businesses to seek additional funds through debt finance.

The take-up of the Government's SME guarantee scheme has been modest, despite the relatively low cost of these funds. Around $1.7 billion of loan commitments have been made under the scheme (equivalent to around ½ per cent of SME lending outstanding) to around 18,000 businesses. The scheme provides unsecured loans and the average interest rate on these loans has been similar to that of secured small business loans. In July, the Government announced changes to the scheme that will make it more flexible and extended its availability until June 2021 (from September 2020 previously). From October, under the new rules, the loans can be used for a variety of investment purposes (rather than limited to working capital), loans can be secured (but not against commercial or residential property) and SMEs will be able to borrow up to

Graph 7

Business Use of Income Support

Share of businesses, by business size*



* Survey taken between 15 July and 23 July 2020 of 997 businesses asking how they used additional funds received through the Boosting Cash Flow for Employers measure, a tax credit of up to $100,000; businesses could nominate more than one use; shares are of businesses that reported receiving the tax credit

Sources: ABS; RBA

$1 million for up to five years (up from $250,000 for up to three years, previously). In addition, a repayment deferral period will no longer be required.

… but small businesses continue to report that access to finance from banks is difficult

For many years, small businesses have reported that they have found it challenging to access finance (Connolly and Bank 2018). Notwithstanding apparent low demand for new loans in the current environment, small businesses continue to report difficulty in accessing finance. Survey measures of small businesses' perceptions of their access to finance have deteriorated sharply over the past couple of years (Graph 8). Following the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, many banks have erred on the side of caution and applied responsible lending obligations for consumers to smaller businesses. Banks have noted in liaison that these standards are applied because there is often a blurred line between the personal and business finances of small business owners. These standards reportedly continue to be applied despite the Australian Securities and Investments Commission (ASIC) reiterating that these obligations should not apply to lending for business purposes.

Businesses often need to provide collateral or personal guarantees to receive finance from banks. The share of lending to SMEs that is secured is high relative to lending to larger businesses. Over 90 per cent of SME loans are secured and about half of small business loans are residentially secured. About two-thirds of large business loans are secured. Of the loans extended through the Government's SME guarantee scheme so far, about 60 per cent have a personal guarantee. Small businesses have previously highlighted that they find it difficult to borrow more than around $100,000 on an unsecured basis (Connolly and Bank 2018). This is also consistent with data from the SME loan guarantee scheme, where three in four loan commitments are for $100,000 or less.

More recently, in response to the pandemic, the availability of credit to businesses has tightened a little further. Banks have indicated in liaison that much of this reflects the application of existing lending standards in an environment of weak economic conditions and great uncertainty. In addition, banks are requiring a greater degree of verification of borrowers' information, and some banks are cautious about lending to new customers and to sectors significantly affected by the pandemic (such as smaller retailers, tourism and commercial property).

Another reason that smaller businesses, in general, find it harder than other borrowers to access finance is their relative risk profiles. Modelling by the major banks, which draws on historical experience prior to the pandemic, suggests that SME loans are around twice as likely to default as standard mortgage customers and large corporations (Graph 9).[5] This modelling suggests that in recent years SMEs have become a little more likely to default (the estimated probability of default has increased by around ¼ of a percentage point to 2½ per cent), while the default probabilities have been little changed for large businesses. This helps to explain – at least in part – why interest rates on loans to SMEs are higher than those for large businesses or mortgage holders. That said, a lack of alternative finance options is also likely to be a contributing factor to SMEs paying higher interest rates than large businesses, which have access to a broader range of funding sources.

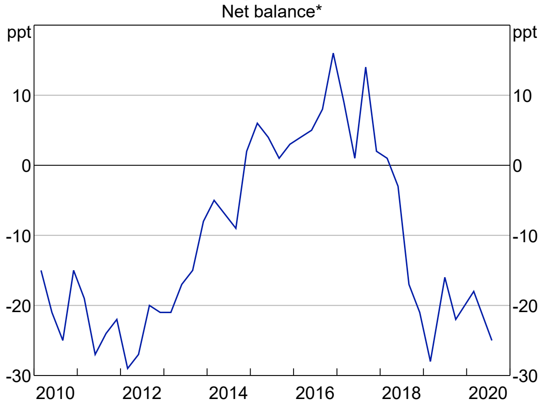
The use of non-traditional finance has increased but from a low level

Available data show that Australian small businesses have increased funding from non-traditional sources since earlier in the decade, although – based on the most recent survey from 2018 – these sources are a very small share of overall funding for SMEs, at less than 2 per cent. At that time, the largest sources of non-traditional finance were balance sheet lending and marketplace lending (Graph 10). Balance sheet lending is where an online platform lends directly to borrowers with funds from its own balance sheet. These platforms can use a large amount of customer information, such as transactional data from sales or payments platforms, to identify creditworthy borrowers, and then provide financial services. Marketplace lending is a type of alternative finance that uses new technology to connect fundraisers directly with funding sources (peer-to-peer). The aim is to avoid the costs and delays involved in traditional intermediated finance. This lending may be secured or unsecured.

Although much smaller than traditional finance, Australia was the largest non-traditional finance market in the Asia Pacific region after China, and the seventh largest globally as of 2018 (the latest available data). Institutional investors, such as banks

Graph 8

Small Business Perception of Access to Finance

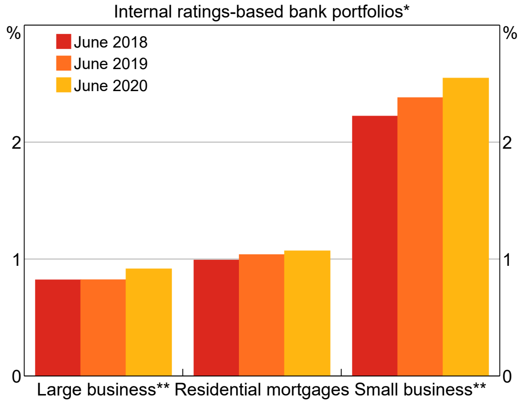


* Net balance is the difference between the percentage of firms indicating access is relatively easy and the percentage of firms indicating access is relatively difficult; from July 2019, survey asks about change in access relative to a previous period

Sources: RBA; Sensis

Graph 9

Default Probabilities



* On-balance sheet exposures of major banks

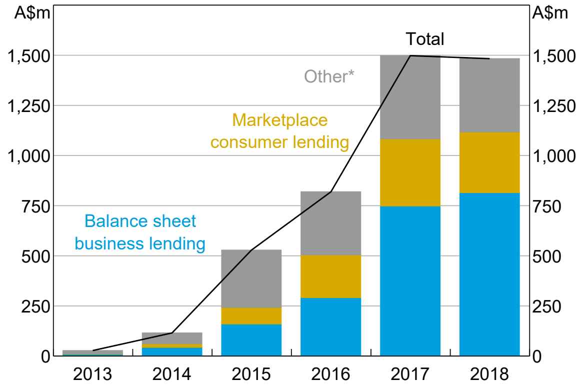
** 'Small business' is SME retail and SME corporate categories in APRA's capital framework; 'Large business' is the corporate category

Sources: APRA; RBA

Graph 10

Non-Traditional Finance

Transaction volume



* Includes balance sheet consumer lending, marketplace business lending, property lending, invoice trading, crowdfunding, and other models

Sources: Cambridge Centre for Alternative Finance; RBA

and venture capital firms, are a significant source of funding for the transactions of non-traditional finance entities. The growth in the Australian market is likely to have been supported by access to funding from institutional investors and a receptive regulatory environment. Available data show that funding from institutional investors represents around 60 per cent of funding for finance provided by non-traditional finance entities in Australia, compared with a global average of around 50 per cent. Through its Innovation Hub, ASIC has provided informal advice to new technology companies developing financial products or services on the licensing process and key regulatory issues (Australian Securities and Investments Commission 2020).

Appendix A

Table A1: Selected Policy Responses to the COVID-19 Pandemic targeted at SMEs[(a)]

Announcement Date	Agency	Measure	Timeframe
12 Mar	Govt.	Cash flow assistance to SMEs (<=$25k; expanded to <=$100k and not-for-profits on 22 Mar)	From 28 Apr 20
	Govt.	Increased scope and size of instant asset write-offs (extended 7 Jun); earlier deduction of depreciation	Until 31 Dec 20 (assets) Until 30 Jun 21 (depreciation)
		Wage subsidy of 50 per cent to retain or re-employ apprentices and trainees (program expanded and extended 16 Jul)	To 30 Mar 21
19 Mar	RBA	Term Funding Facility (can borrow up to 3% of total credit outstanding for three years at 25bps, allocation to rise if increase lending to business, especially SMEs)	From 30 Mar 20 to ~31 Mar 21
20 Mar	Banks	Defer SME & household repayments for those affected (initially for six months, extended for additional four months for those who continue to experience financial difficulty)	From ~23 Mar 20
	Govt.	Six month exemption from responsible lending obligations for lenders providing credit to existing small business customers	Immediate for new credit
	Govt.	SME Guarantee Scheme of 50% (up to $20b) to support $40b in new SME loans (program expanded and extended 20 Jul)	From ~01 Apr 20 to 30 June 21
	Govt.	Increasing bankruptcy and insolvency thresholds and response time for creditor action; temporary relief from insolvent trading provisions (extended 7 Sep)	From 25 Mar 20 to 31 Dec 20
29 Mar–7 Apr	Govt.	National Cabinet announces common SME leasing principles forming a 'Mandatory Code of Conduct' during COVID-19. Applies to SMEs with annual turnover up to $50m that are eligible for the Commonwealth JobKeeper program	SME leasing principles to be defined by each State and Territory Government and apply from 3 Apr 20 for the period that the JobKeeper program remains operational.
30 Mar	Govt.	JobKeeper wage subsidy of $1,500 per fortnight per eligible employee for six months to Sep 20 (program extended with modified payment rates from 28 Sep)	From 31 Mar 20 (payments received from early May) to Mar 21
1 Apr	Govt.	International Freight Assistance Mechanism announced to subsidise air freight exports of perishable goods and imports of medical supplies (program extended 3 Jul)	To end 2020
24 Apr	Banks	Dedicated hotlines to expedite lending to cover wages for businesses that are eligible for JobKeeper	From 24 Apr
4 Jun	Govt.	HomeBuilder grant of $25,000 to encourage new home builds and renovations	From 4 Jun to 31 Dec 20
25 Jun	Govt.	$250 million package of measures to support the arts sector, including grants and concessional loans	Varies

(a) Fiscal responses outline initiatives announced by the Australian Government only

Sources: Media reports; RBA

Footnotes

[*] The authors are from Domestic Markets Department.

[1] See Nguyen and La Cava (2020) for a discussion on a new real-time indicator of developments in the Australian economy.

[2] See Reserve Bank of Australia (2020) for further discussion on the impact of the pandemic on the domestic economy.

[3] See Reserve Bank of Australia (2020) for recent developments in these initiatives.

[4] For further details of measures that the Reserve Bank has undertaken in response to COVID-19, see www.rba.gov.au/covid-19.

[5] These probabilities reflect long-run averages of default rates and are not tailored to an event such as the current pandemic, and so are not likely to be a good guide of default rates in the current period.

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