Discussion

1. Warren Mundy and Mark Bryant

This paper by Professor Gregory Udell provides an assessment of the existing academic literature on the issue of small to medium-sized enterprise (SME) access to finance. It focuses on the lending technologies that are prevalent in SME lending and the channels through which small business lending is conducted.

The paper begins by noting the renewed interest in the topic of access to finance for SMEs, particularly by policymakers. This is a phenomenon that we have witnessed in Australia with, for example, two parliamentary inquiries into small business finance over the previous five years (Senate Economics References Committee 2010; PJCCFS 2011). Access to finance for businesses has also been an important issue across a range of recent Productivity Commission projects (including Productivity Commission (2012, 2014, 2015)).

The author argues that the unprecedented effects of the financial crisis, developments in empirical techniques and increased access to country-level datasets means that there is once again value in taking stock of the extant literature on SME finance. He then cycles through the most common forms of lending approaches and technologies – many of which are commonplace in Australia. For each lending technology, the author cites key papers to deliver an up-to-date snapshot of academic research in these areas.

By drawing on the existing stock of empirical research, the paper makes a number of interesting points. First, it challenges the notion that all bank lending to SMEs is done so on the basis of 'soft information' and relationships. Rather, the paper argues that other lending technologies, such as equipment lending and leasing, are critically important for small businesses. Second, the author explores the cost differentials among lending channels. He argues that the personalised nature of relationship banking means it is costly relative to transactions-based lending, which is often governed by standardised decision rules. The author argues that these cost differentials can influence the structure of lending markets – because of economies of scale, larger banks are better placed to deliver transactions-based lending products, while smaller banks are suited to offering less standardised relationship lending.

In examining lending channels, the author acknowledges that not all lending technologies are offered by all lenders. Through examples, the author illustrates that these channels are dynamic – external shocks such as credit crunches can change what products lending channels offer, with potentially large implications for where and how small businesses access credit. The paper acknowledges the ongoing debate about the effectiveness or otherwise of credit multipliers such as government guarantee schemes and SME loan securitisation.

One key feature of this paper is to highlight gaps in our knowledge about SME lending. To present these gaps, the paper delivers a 'top 10' list of what we do not know. The author rightly caveats that such a list is largely subjective and will undoubtedly evoke debate about the merits of what is and is not included in the list. Nevertheless, the list provides a useful road map that can guide researchers to areas where they can add value within the SME lending literature.

Several of the topics identified are relevant to Australia, including:

- *Technological innovation and SME lending*. There is often a lack of evidence around the extent to which technology has influenced how banks provide credit to SMEs. However, even if bank lending methods have been largely undisturbed by technology, the Australian credit market as a whole is experiencing a number of upheavals that can potentially change the way SMEs receive funding. One is the growing prominence of crowdfunding. Another is the emergence of purely online lending platforms, with one example of this being PayPal Working Capital (PayPal 2014). The introduction of comprehensive credit reporting represents another innovation that has the potential to change the lending landscape in Australia.
- *Cooperatives*. The author hypothesises that the different governance structures that cooperative institutions employ – compared with private banks – may influence their efficiency and behaviour when it comes to business lending. In Australia, building societies and credit unions constitute only 0.2 per cent of business lending. Research into why this proportion is so low is likely to be valuable.
- *Government guarantees*. Unlike most Organisation of Economic Co-operation and Development economies, Australia does not have a national credit guarantee scheme. Rather, financial assistance to small businesses is provided through a number of other means, such as concessional loans and grants. The costs, benefits and long-term outcomes of this assistance are often not assessed by those implementing these programs. To the extent that data are available, an assessment of these programs would be of great interest to researchers and policymakers.

One lending technology that receives relatively little attention in the paper is crowdfunding. The author notes the lack of reliable data on the amount of crowdfunding either being sought or being provided; this is a challenge shared by researchers and policymakers, including by the Productivity Commission. As an emerging finance technology, crowdfunding has the potential to fill possible funding gaps in the small and new business lending market. However, the challenge for policymakers is to find a balance between ensuring investor protection and making it easy for firms to raise funding through such means.

Although the scope of the paper is deliberately restricted to SME access to debt finance, it is important to remember that equity finance is also important for small businesses. Indeed, for new businesses, equity – rather than debt – might represent the most appropriate or accessible source of funding.

In conclusion, this paper makes a useful contribution to our understanding of SME finance by assessing and summarising the ever-growing body of academic research in this area. The author is frank about what we do and do not know and provides an overview of areas where we would benefit from further research. The issues raised in this paper are very relevant to policymakers, and particularly for the Productivity Commission's work in the area of business set-ups, transfers and closures (Productivity Commission 2015).

References

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2. General Discussion

Discussion centred on whether or not there is a 'funding gap' for SMEs – that is, whether there are significant numbers of SMEs that could productively use financing but are unable to obtain it. Some participants expressed scepticism that such a gap exists because it implied that banks do not pursue a large number of profitable lending opportunities. Moreover, it is extremely difficult to find objective measures of projects that would be profitable if financed but are unable to get finance. Several participants noted that, when surveyed, only a small share of businesses state that they desire external finance, or that obtaining external finance is their main problem. Gregory Udell pointed out that, if the asymmetric information paradigm of SME lending is correct, it implies that banks should decline some positive net present value lending opportunities, because these will be indistinguishable from certain negative net present value opportunities. He also agreed that proving the existence of, or measuring, an SME funding gap is difficult. An easier approach is to examine whether the funding gap widens during financial crises, and one way to do this is by examining the different responses of SME lending channels during crises. This approach has been used to highlight significant credit crunches for SMEs in the United States and Europe during the recent financial crisis. Another participant noted that answers to the funding gap question require better data, including data on SMEs whose applications for finance are rejected, as well as those discouraged from applying.

The discussion turned to the lending technologies used in Australia, particularly the use of outside collateral in the form of an entrepreneur's residential property. As with the funding gap, there were conflicting perspectives on the importance of residential collateral in obtaining small business finance in Australia. Some participants argued that an entrepreneur who is unable to offer residential collateral has little or no chance of obtaining debt finance in Australia, while others countered that debt serviceability and managerial quality are more important criteria in bank lending decisions. Several participants posited that regulatory capital rules affect the profitability of bank lending to different sectors, and thus lending decisions. One participant noted that the current system of risk weights likely encourages banks to ensure there is residential collateral backing some smaller business loans. The recent introduction of positive credit reporting in Australia was highlighted as a change that may encourage the growth of non-collateral-based lending technologies.

A participant noted that firms had moved towards relying more on intangible assets, such as technology and human capital. This move had resulted in a decrease in firms' assets that could be mortgaged, and the participant noted that this could be a potential constraint on business finance going forward. Professor Udell commented that, if relationship lending is declining relative to other lending technologies, a lack of collateral-eligible assets may become a problem for SME access to finance. Another participant commented that relationship lending – and other lending technologies based on information – should theoretically be more productivity enhancing than collateral-based lending.

The discussion concluded with a participant asking Professor Udell for his opinion on the most effective SME finance-related policy intervention. He responded that the ongoing introduction of modern bankruptcy systems and property security laws in developing countries – although not usually seen as a policy directed at SME finance – was likely to lead to the largest welfare gains.