Australia's Economic Recovery and Access to Small Business Finance

Joel Bank and Michelle Lewis[*]

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Abstract

Economic conditions for many small businesses in Australia began to improve in the second half of 2020 alongside the broader recovery from the severe economic disruption caused by the COVID-19 pandemic. While small businesses' access to finance from lenders tightened in the early stages of the pandemic, various policy measures were provided to help support the provision of credit. However, lending to small businesses remains little changed. Businesses have been reluctant to take on more debt in an uncertain environment and, at the same time, many have been able to make use of a range of temporary measures that have supported revenues or allowed for deferral of payments.

The COVID-19 pandemic has adversely affected the business sector. Small businesses have tended to have been disproportionately affected because they are more likely to be in industries that have been hardest hit by the pandemic. This article provides an update to Lewis and Liu (2020), summarising how small business finance has evolved over the course of the past year or so.

Economic conditions for small businesses have improved to some extent

The economic recovery underway in Australia is flowing through to an improvement in conditions for businesses of all sizes. However, conditions are still somewhat uneven (Lowe 2021). Improvements in conditions have been more pronounced for larger businesses compared with smaller businesses. Small businesses have been disproportionately affected by the pandemic because they are more likely to be in industries that have been harder hit by the associated restrictions on movement, such as cafes, restaurants, arts and recreation. Indeed, while larger retailers overall have seen strong growth in their sales throughout most of the pandemic, sales at small retailers picked up noticeably only in late 2020, returning to be around the level where they were leading up to the pandemic.

Small businesses grew more confident about their outlook in the second half of 2020, alongside the broader economic recovery (Graph 1). In an ABS survey conducted in February 2021, around a quarter of small businesses reported that economic uncertainty was a factor influencing their upcoming capital expenditure plans; in August 2020 the share was around two-thirds (Graph 2). Consistent with this, non-mining firms upgraded their investment plans for financial year 2020/21 according to the ABS capital expenditure survey in the second half of 2020. And the increases in job openings and employment growth observed in late 2020 were particularly pronounced in industries with a high share of small businesses. Nevertheless, the level of employment remains below pre-pandemic levels in the industries most affected by COVID-19 restrictions. In addition, while conditions have improved overall, some small businesses remain in a tenuous position and are vulnerable to any further economic disruptions (RBA 2020).

Many small businesses have benefited from support measures, some of which are ongoing

Policy responses to COVID-19

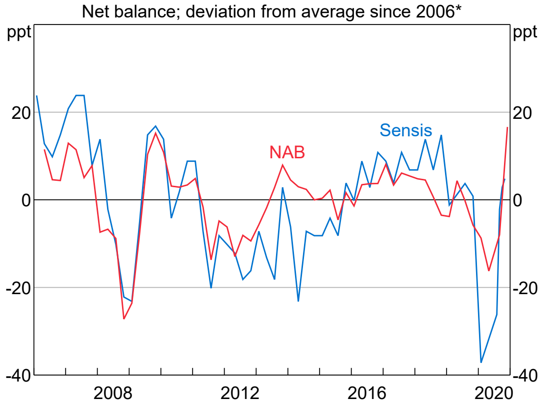
Temporary initiatives introduced by the Australian Government, lenders, and landlords have supported the cash flows and balance sheets of small and medium-sized enterprises (SMEs) during the pandemic. Government initiatives – such as JobKeeper, Boosting Cash Flow for Employers and temporary enhancements to the instant asset write-off scheme – reduced labour costs and provided direct cash subsidies. At the same time, lenders and landlords provided relief from loan and rental payments. Most of the temporary cash flow and balance sheet measures have begun to be phased out or will be phased out in the first half of 2021.

Other policy measures by the Reserve Bank and the Australian Government have supported the supply of credit to SMEs. The Reserve Bank announced a package of monetary policy measures in 2020 to lower funding costs for households, businesses and governments (Kent 2020, Lowe 2020). The Term Funding Facility (TFF) – which provides low-cost funding to banks for terms of 3 years – includes incentives for banks to increase their lending to non-financial businesses, especially SMEs (Alston *et al* 2020). The Australian Government established a $15 billion Structured Finance Support Fund (SFSF) to supplement private sector investments in debt issued by smaller banks and non-banks. The Australian Government has also introduced an SME

Graph 1

Small Business Confidence

Net balance; deviation from average since 2006*



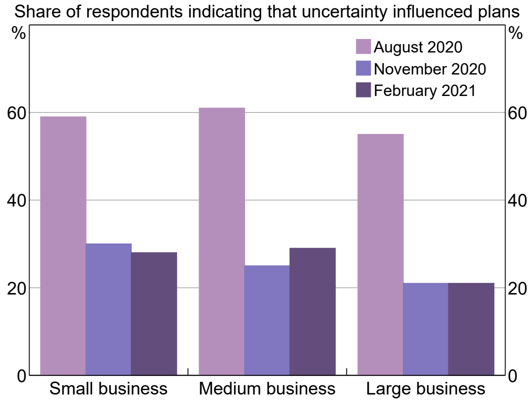
* The net balance is the difference between the percentage of positive responses and the percentage of negative responses

Sources: NAB; RBA; Sensis

Graph 2

Uncertainty and Future Investment Plans

Share of respondents indicating that uncertainty influenced plans



Sources: ABS; RBA

loan guarantee scheme to enable participating lenders to issue cheaper loans to SMEs (Treasury Department 2020). These measures will continue to support lending to SMEs throughout at least to the end of 2021.

Ongoing measures

Some other government initiatives will provide ongoing support to small businesses. Most of these initiatives focus on improving the operating environment for small businesses in Australia rather than providing direct financial support. Some were introduced or announced prior to the pandemic.

- **Permanent reforms to insolvency laws for small businesses** should help more small businesses survive insolvency proceedings. The reforms allow businesses with total debts of less than $1 million to more easily restructure their debts and continue operating instead of winding up. The new framework commenced in January 2021, following the end of the temporary insolvency relief that was introduced in response to the pandemic.[1]
- **The compulsory Payment Times Reporting Scheme,** operational since January 2021, requires larger corporations to publically report how quickly they pay invoices issued by small businesses. The increased transparency and the prospect of greater scrutiny should help to improve payment times by large businesses. Small businesses have consistently reported that some large businesses require them to accept lengthy payment terms, disrupting their cash flow (Connolly and Bank 2018).
- **The proposed removal of responsible lending obligations to consumers** should help to simplify the loan application process for small businesses seeking finance. Although the Australian Securities and Investments Commission (ASIC) has stated that these specific lending obligations do not apply to lending for business purposes, many lenders have nonetheless applied the existing rules to small business customers. Banks have noted in liaison that this is because it is often difficult to distinguish between the personal and business finances of small business owners. Legislation to enact removal of the rules is currently being considered by parliament.
- **Other initiatives announced before the pandemic should help support small business financing**. In October 2020 the $540 million Australian Business Growth Fund was formally launched; the fund will provide longer-term equity funding to established small businesses looking to expand. The $2 billion Australian Business Securitisation Fund (ABSF) was established in 2019 to invest in securitisations backed by SME loans and issued by smaller banks and non-bank lenders. The ABSF has invested $250 million so far and recently invited lenders to submit proposals for further investments.
- Although not a measure targeted to SME's access to finance, **the Australian Prudential Regulatory Authority recently announced new capital rules** for some banks that, in part, will lower how much capital banks need to hold against unsecured SME loans. This will help to lower the costs for banks to fund SME loans, which should make small business lending more attractive at the margin. The new rules are currently scheduled to take effect in early 2023.

Lending activity has been little changed

New lending to SMEs has been little changed since the onset of the pandemic (Graph 3). This is despite interest rates declining to historically low levels in response to the package of measures introduced by the Reserve Bank, and the pick-up in economic activity in the second half of 2020. Lending to large businesses increased sharply in the early stages of the pandemic, as large businesses drew down lines of credit, but these funds were repaid over the rest of 2020.

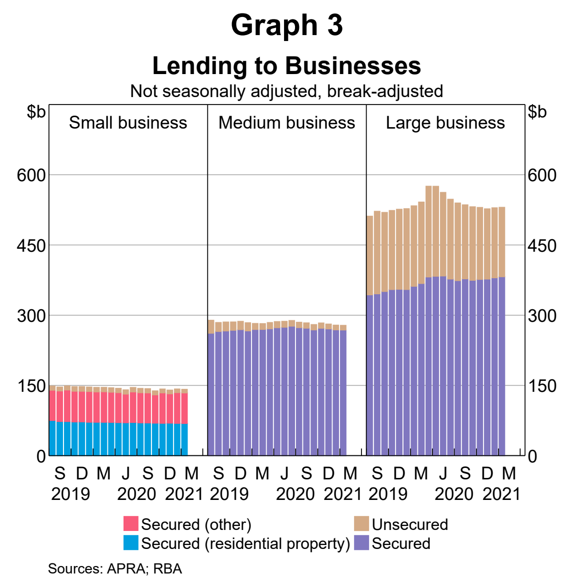
Take-up of the Australian Government's $40 billion SME loan guarantee scheme has been low. By mid February 2021, around $3.4 billion of loans had been made to around 35,000 businesses under the scheme. The scheme was first enhanced in October 2020 by increasing the amounts that can be borrowed, allowing funds to be used for a wider range of purposes, and introducing more flexible collateral arrangements and repayment terms.[2] In March 2021, the scheme was enhanced for SMEs that had received JobKeeper in the March quarter. Those SMEs can borrow up to $5 million for up to 10 years (up from $1 million and 5 years previously), and the funds can now also be used for refinancing of some existing loans. In addition, the Government is guaranteeing 80 per cent of the loan under the targeted scheme (up from 50 per cent). The original scheme will remain open for SMEs until the end of June 2021. Through the scheme, some SMEs can access unsecured loans at interest rates comparable to those charged on secured loans. Some lenders announced further reductions in interest rates on scheme-backed loans after the Reserve Bank provided further policy stimulus in November 2020 (RBA 2021).

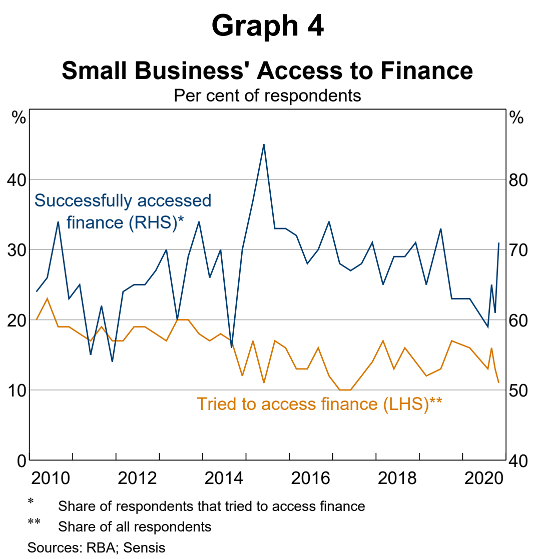
Many businesses have less appetite for taking on additional debt

Survey data and liaison with businesses and banks suggest that many businesses, particularly SMEs, have little appetite for taking out new loans. In part this reflects ongoing uncertainty about the economic outlook. Many businesses have also had a reduced need for external finance because they have made use of support measures to help cover operating costs, and have built up cash buffers over the past year (RBA 2020). Consistent with this, an ABS survey in October 2020 found that three quarters of businesses had not sought any additional funds in the months leading up to the survey; the same share in February 2021 was around 85 per cent. The most commonly cited reason for not seeking additional funds in both surveys was the business having sufficient funds at hand. Other survey data show that fewer businesses tried to access finance in late 2020; a key reason for this was that businesses indicated that they were more likely to draw on savings than take out a bank loan if they needed additional funds (Graph 4). More generally, businesses tended to prefer to use retained earnings to finance investment when possible because it is less costly (Connolly and Jackman 2017).

Although SME lending has been little changed for some time, there have been some pockets of increased activity. Commitments for new loans increased a little over the second half of 2020, to be around the average level observed over the 6 months preceding the pandemic. Most of this increase was driven by new loans for the purchase of property and for purchasing plant and equipment. Lending activity for plant and equipment has been supported by the Australian Government's enhancements to the instant asset tax write-off scheme. Lending to the agriculture sector picked up in 2020, consistent with improved conditions in the sector.

In addition, refinancing activity has been higher so far in the financial year 2020/21 compared to the





year prior, consistent with businesses looking to obtain lower interest rates on existing facilities (Graph 5). Moreover, large businesses and SMEs have increased the size of credit facilities available to them over 2020, suggesting that they are continuing their cautious approach to managing access to liquidity (Graph 6).

Policy measures have cushioned a tightening in the supply of credit

Access to finance tightened for businesses in response to the pandemic, mostly for those that have been more affected by the economic conditions and for businesses approaching a given bank for the first time. Banks have reported in liaison that much of the tightening has reflected applying existing lending standards in a weaker economic environment. As the economic recovery has taken hold, some banks have indicated that they are starting to seek out more opportunities to lend to SMEs. However, access to finance remains a little tighter than before the pandemic.

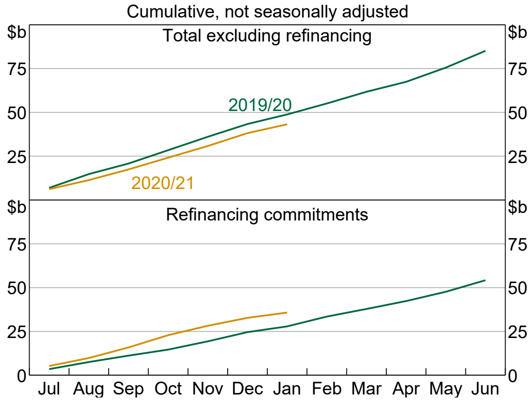
Policy measures introduced to support the flow of low-cost funds to the economy have helped to mitigate the tightening in access to finance for SMEs. In particular, over the year or so since the Reserve Bank implemented the package of measures announced in March 2020, the cash rate declined by around 75 basis points. Funding costs for banks have declined by a similar amount and lower funding costs flowed through to lower borrowing costs for households and businesses (Garner and Suthakar 2021). By early 2021, interest rates on variable-rate loans to SMEs had declined by around 85 basis points and rates for large businesses had declined by around 90 basis points since the end of February 2020.

The difference between interest rates on loans for smaller businesses and those for larger businesses has been little changed since the onset of the pandemic, which is in stark contrast to the significant widening seen during the global financial crisis (Graph 7). Indeed, the difference between small and large business interest rates has been broadly stable since the global financial crisis. Small businesses have generally noted in liaison that pricing has not been a significant barrier for obtaining bank loans during the pandemic or in recent years.

Graph 5

SME New Loan Commitments

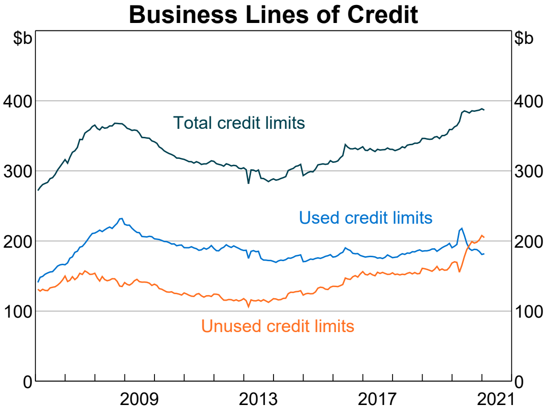
Cumulative, not seasonally adjusted



Sources: APRA; RBA

Graph 6

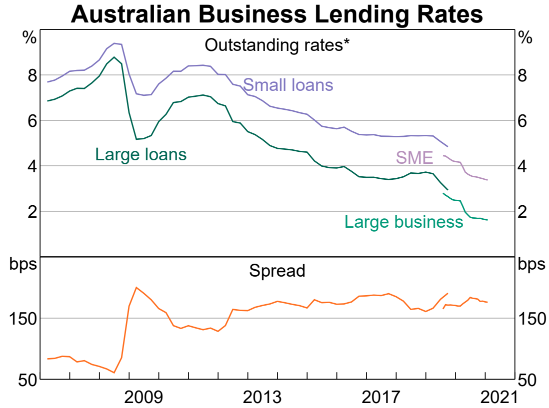
Business Lines of Credit



Sources: ABS; APRA; RBA

Graph 7

Australian Business Lending Rates



* Small loans data up to June 2019 reflect loans valued less than $2 million; large loans data up to June 2019 reflect loans valued $2 million or more; from July 2019 new data are used from the Economics and Financial Statistics (EFS) collection (See Statistical Table F7)

Sources: APRA; RBA

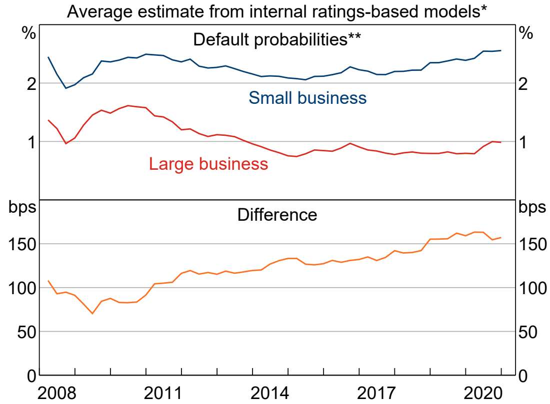
The estimated risk profiles for small and large businesses have increased a little since the onset of the pandemic (Graph 8). These estimates are constructed by the major banks, drawing on historical experience prior to the pandemic. It suggests that small businesses are around twice as likely to default on loans as large businesses. This is consistent with interest rates on loans to smaller businesses being notably higher than those to larger businesses. Although business failures were much lower in 2020 than in recent years because of the various support measures, failures are expected to rise as the temporary support measures end (Bullock 2020). This is not expected to affect bank balance sheets much, but it could further raise the assessed riskiness of some business loans. Even so, it is worth highlighting that the vast majority of SME borrowers that deferred loan repayments in 2020 have resumed payments. In early 2021, only around 1 per cent of all SME borrowers still had a deferral arrangement, down from a peak of 13 per cent in June 2020. Also, the share of business loans that are non-performing remained low over 2020.

For a number of years, small businesses have reported that they have found it difficult to access finance with terms that suit their needs.[3] Surveys of small businesses indicate that access to finance remains difficult but improved towards the end of 2020 (Graph 9). This is consistent with the increase in the share of businesses that successfully applied for finance; however, this also comes at a time where fewer businesses are seeking funding from banks (Graph 4). Nevertheless, the recent improvement is consistent with both the economic recovery more broadly and the various initiatives aimed at supporting small businesses. These initiatives will help to support the provision of finance as the demand for new loans pick up. ✈

Graph 8

Business Lending Default Probabilities

Average estimate from internal ratings-based models*



* On-balance sheet exposures of major banks

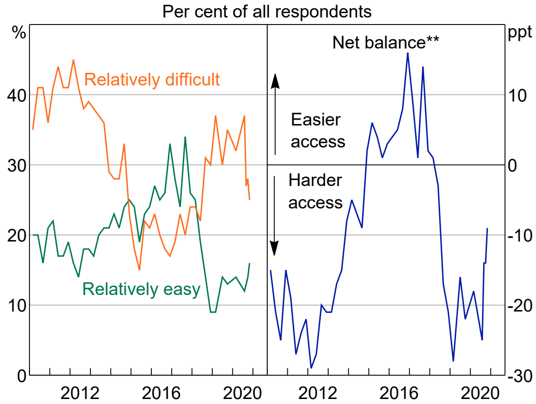
** Small business is the SME retail and SME corporate categories in APRA's capital framework; Large business is the corporate category

Sources: APRA; RBA

Graph 9

Small Business Perception of Access to Finance*

Per cent of all respondents



* Survey has asked about perceptions of changes in access to finance relative to a previous period since July 2019; before that the survey asked for point-in-time assessments

** 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

Sources: RBA; Sensis

Footnotes

[*] The authors are from Domestic Markets Department

[1] Total business failures in Australia are concentrated among small businesses. According to the Australian Securities and Investments Commission (ASIC), over 75 per cent of the businesses that entered insolvency proceedings in 2018/19 would have been eligible to make use of the new insolvency framework.

[2] For further details on the Australian Government's SME loan guarantee scheme, please see <https://treasury.gov.au/coronavirus/sme-guarantee-scheme>.

[3] Panellists at the Reserve Bank's annual Small Business Finance Advisory Panel have previously noted, for example, that access to finance for start-ups is very limited, banks are often reluctant to extend finance without real estate as collateral, and the process to obtain finance is lengthy and onerous. For summaries of key themes from Panels over recent years, see Connolly and Bank 2018 and Lewis and Liu 2020.

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