Small Business Finance and COVID-19 Outbreaks

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Photo: Trevor Williams – Getty Images

Abstract

Economic conditions for small and medium-sized enterprises (SMEs) improved in the second half of 2020 and early 2021, although measures to contain the recent outbreaks of COVID-19 have affected firms in much of Australia. SMEs are being supported by policy measures, including a number of initiatives that continue to encourage lending to smaller firms. Nonetheless, the volume of SME lending has been little changed for some time, and access to finance continues to be a challenge for small businesses.

Access to finance for small businesses has been a longstanding focus for the Reserve Bank of Australia (RBA). Each year, the RBA convenes a Small Business Finance Advisory Panel to better understand the challenges faced by small businesses; 2021 marked the 29th annual panel. This year's panel convened in early July and focused on the ongoing economic effects of the COVID-19 pandemic. This article summarises recent developments in small business finance, drawing on the panel's discussions, as well as official survey data and the RBA's liaison with businesses and lenders.

Economic conditions for small businesses had improved, but remain challenging

Small businesses have been disproportionately affected by the COVID-19 pandemic because they are more likely to be in industries that have been harder hit by restrictions on movement, such as cafes, restaurants, arts and recreation.

In the second half of 2020 and the first half of 2021, the broader economic recovery had led to an improvement in conditions for many businesses, large and small. As the recovery gained momentum, many small businesses grew more confident about their outlook (Graph 1). However, conditions have been uneven across industries, and demand has been variable since the beginning of 2020 for many small firms. Indeed, sales at smaller retailers declined noticeably in early 2020 before picking up towards the end of the year as conditions improved, while sales at larger retailers have generally been resilient throughout the pandemic (Graph 2).[1]

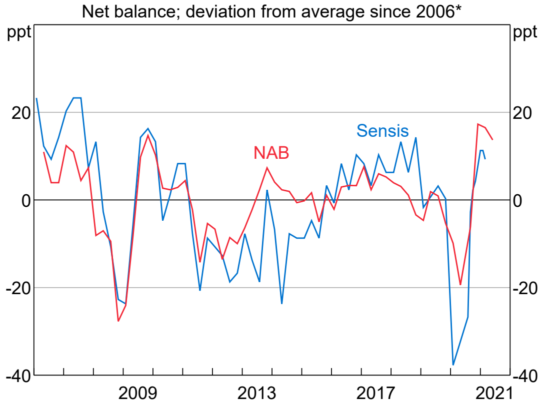
Recent experience has highlighted that, once the virus outbreaks are contained and the restrictions on activity are lifted, activity can bounce back quickly (Ellis 2021). However, recent restrictions on movement in order to contain the spread of the Delta variant of COVID-19 in a number of states have disrupted economic activity and increased uncertainty about the near-term economic outlook (RBA 2021).

The economic disruption from COVID-19, and the associated movement restrictions, affected

Graph 1

Small Business Confidence

Net balance; deviation from average since 2006*



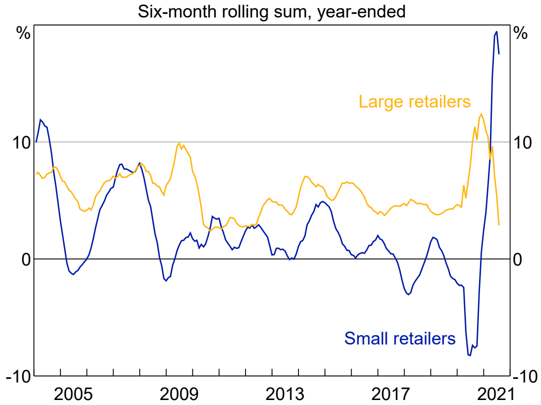
* The net balance is the difference between the percentage of positive responses and the percentage of negative responses

Sources: NAB; RBA; Sensis

Graph 2

Retail Sales Growth by Size

Six-month rolling sum, year-ended



Sources: ABS; RBA

businesses to varying degrees. At this year's meeting, some panellists noted that the ongoing COVID-19 outbreaks and associated containment measures have led to orders being cancelled, revenue declining and staff being laid off and/or stood down. On the other hand, some businesses experienced growth in sales, such as for some goods and services distributed through supermarkets and/or online channels.

The closure of Australia's international borders has prevented firms from hiring foreign workers, exacerbating labour shortages in specific fields (Lowe 2021). This message was echoed by some panellists, who reported a large decline in the number of applicants for each vacant job, making it difficult to hire new staff, particularly those with specific skills such as those working in IT. Similarly, in the most recent NAB Quarterly Business survey, the availability of suitable labour was reported to be increasingly constraining output. Some panellists also noted that they were affected by supply shortages due to bottlenecks and delays throughout global supply chains, with global manufacturing delivery times and shipping prices increasing throughout most of the first half of 2021.[2]

The appetite for taking on new loans had picked up for some businesses, though demand for finance continues to be soft

Following a period of relatively soft demand for finance last year, liaison with banks suggested there had been a growing appetite for business borrowing in the period prior to the recent lockdowns. Consistent with this, non-mining business' investment expectations for the 2021/22 financial year have picked up from late last year. More recently, banks have indicated that demand for new debt is likely to be soft in the coming months, as firms adopt a cautious approach while restrictions remain in place.

The volume of lending to SMEs increased in the June quarter, after having been little changed for an extended period (Graph 3; Graph 4). The pick-up in business lending was consistent with improvements in economic conditions over the first half of 2021 and an increase in business confidence.

However, this increase in the stock of outstanding business credit largely predates recent lockdowns due to COVID-19 outbreaks. These restrictions to contain the spread of the virus will adversely affect a range of businesses and may reduce demand for debt for some time.

During 2020 and the first part of 2021, many businesses also had a reduced need for external finance because they made use of government support measures and temporary changes to stand down rules to help manage operating costs (discussed further below), and built up and maintained cash buffers – in part, reflecting ongoing uncertainty about the economic outlook. These messages were reinforced by panellists, with some noting that many small businesses are unwilling to take on new debt and are withholding investment until conditions improve further.

The Australian Government's $40 billion SME Guarantee Scheme, which started in late March 2020 and was enhanced in October 2020, closed to new applications at the end of June 2021. Overall, take-up of the scheme was low, with around $6.5 billion of loan commitments made to around 66,000 businesses. In April 2021, the government introduced the SME Recovery Scheme, which is an enhanced and extended loan guarantee scheme for SMEs. The SME Recovery Scheme was initially open only to firms that had received JobKeeper payments in the March quarter of 2021 or were affected by the floods in NSW in March 2021, although in late August the government announced this requirement would be removed. Advertised interest rates on loans under the Recovery Scheme are generally below those under the original scheme. Liaison suggests that take-up of the Recovery Scheme has been low to date – in part because those businesses that received JobKeeper earlier this year have been reluctant to take on more debt.

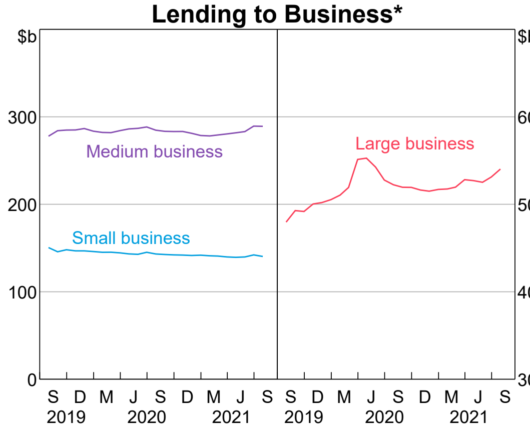
Small businesses have reported for many years that access to finance is difficult

Notwithstanding limited demand for debt in the current environment, for many years small businesses have reported that they find it difficult to access finance on terms that suit their needs. Small businesses tend to face a number of difficulties accessing finance associated with their smaller scale, less diversified nature and lack of collateral. Businesses are often required to provide collateral or personal guarantees to receive finance from banks. Small businesses have previously commented that they find it difficult to borrow more than around $100,000 on an unsecured basis and are often required to provide residential property as collateral for a business loan, with many reluctant to do so (Connolly and Bank 2018). Data provided by banks show that over 95 per cent of SME lending is secured, whereas only 70 per cent of lending to large business is secured.

Survey measures of small business' perceptions of their access to finance deteriorated sharply a few years ago (Graph 5).[3] More recently, surveys of

Graph 3

Lending to Business*



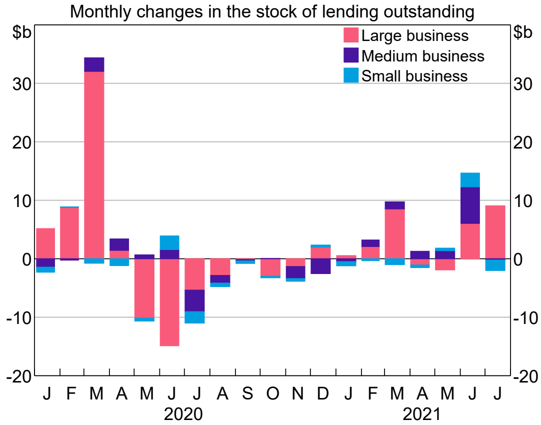
* Data cover financial institutions with $2 billion or more of business credit; not seasonally adjusted

Sources: APRA; RBA

Graph 4

Lending to Business*

Monthly changes in the stock of lending outstanding



* Data cover financial institutions with $2 billion or more of business credit; not seasonally adjusted

Sources: APRA; RBA

small businesses indicate that access to finance has become less difficult since mid 2020, in part reflecting the improved economic outlook. Consistent with this, banks reported in liaison that they had been seeking more opportunities to lend to businesses, including smaller businesses. This followed a tightening in access to finance in early 2020 and longer-than-usual loan approval times, as banks became more cautious about lending to new customers and to affected sectors. At the same time, banks were managing operational constraints due to a higher volume of customer enquiries.

Smaller businesses tend to face higher borrowing costs than large businesses. One reason for this is that smaller businesses typically have a higher risk profile (Graph 6). The major banks' estimates of default probabilities, which are based on historical experience prior to the pandemic, suggest that small businesses are more than twice as likely to default on loans as standard mortgage customers and large corporations.

Many small businesses have benefited from support measures introduced in response to the virus outbreaks

Initiatives introduced by the federal, state and territory governments as well as lenders and landlords have supported cash flows and balance sheets of SMEs during the pandemic. Australian Government measures initiated in 2020 – such as JobKeeper, Boosting Cash Flow for Employers and the accelerated depreciation schemes – reduced labour costs and provided direct tax subsidies. State governments provided relief and support to SMEs through a number of targeted support measures, with some state governments introducing industry support packages, payroll tax cuts and waivers, advisory and support programs, and rental assistance to landlords and tenants. Similarly, lenders and landlords provided relief from loan and rental payments.

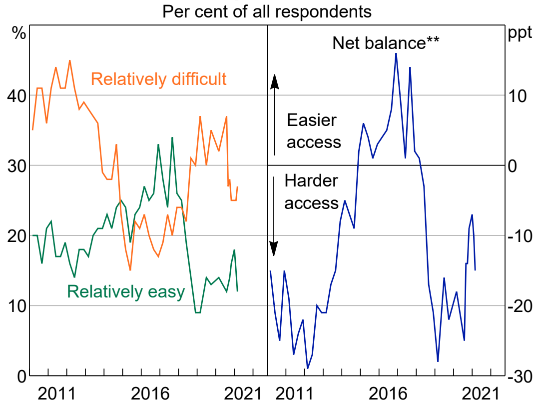
Most of the broader cashflow support measures and relief measures that were introduced in 2020 were phased out or were due to be phased out in time, alongside the initial economic recovery. More recently, new support measures have been introduced, including payments to businesses that have been negatively affected by the recent lockdowns (Appendix – Table A1). Many banks have also reintroduced support measures, in particular deferrals for loan payments, and the Australian Prudential Regulation Authority reinstated the regulatory support for loans affected by the lockdowns, as was the case in mid 2020.

Small businesses reported that the various measures adopted in 2020 were important in underpinning employment levels and sustaining operations; in a survey conducted in October 2020, over 40 per cent of small businesses that were accessing JobKeeper reported that their business had survived because of the scheme. There is some

Graph 5

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

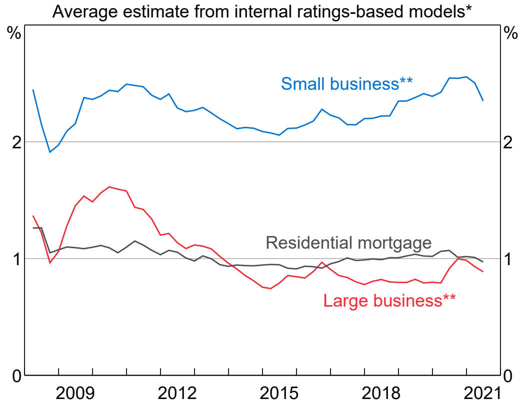
** Net balance is the difference between the percentage of firms indicating access is relatively easy and the percentage of firms indicating access is relatively difficult

Sources: RBA; Sensis

Graph 6

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

evidence that these measures have been more important for SMEs than large businesses, including because SMEs have been disproportionally affected by containment measures and because large businesses were not eligible for some support measures (such as the Boosting Cash Flow for Employers scheme).

In mid 2020, a peak of around 13 per cent of all SME borrowers had a loan deferral arrangement in place and more than 225,000 business loans were deferred, although this share had declined to around 1 per cent by early 2021. Data published by the Australian Banking Association in early August indicate that, since 8 July 2021, more than 600 business loans have been deferred. Of these deferred loans, around 80 per cent are for businesses from New South Wales. Bank liaison suggests there has been an uptick in customer enquiries since loan deferral arrangements were reintroduced, but this increase was less than expected and well below the peak number of calls received last year.

Policy measures by the RBA have supported the supply of credit to SMEs. As a result of the RBA's package of monetary policy measures, interest rates on SME loans have declined to historically low levels (Graph 7). Since February 2020, interest rates on variable-rate loans and fixed-rate loans to SMEs have declined by around 95 basis points and 80 basis points, respectively. There has been elevated refinancing activity among businesses to access the lower interest rates on offer. Moreover, the Term Funding Facility (TFF) – which provided low-cost funding to banks for terms of three years – included an incentive for banks to increase their lending to businesses, especially SMEs.[4]

The Australian Government also introduced measures to encourage lending to SMEs, including the establishment of the $15 billion Structured Finance Support Fund (SFSF), which supplements investments in securitisations that are issued by smaller banks and non-bank lenders. As at 30 June 2021, the SFSF has made $3.8 billion in investment commitments (Australian Office of Financial Management 2021). As discussed above, the Australian Government also introduced the $40 billion SME Loan Guarantee Scheme and SME Loan Recovery Scheme to enable participating lenders to issue cheaper loans to SMEs (Treasury Department 2021).

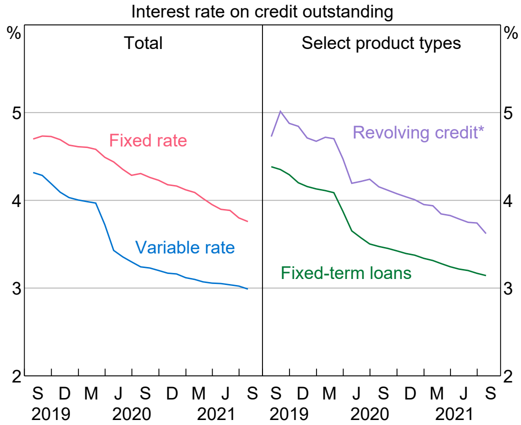
There are a number of ongoing measures that continue to provide support to small businesses

Other initiatives introduced by the Australian Government will provide ongoing support to small businesses, some of which were introduced or announced prior to the pandemic. Recent initiatives include 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. As discussed below, the $540 million Australian Business Growth Fund was formally launched in October 2020; the fund will provide longer-term equity funding to established small businesses looking to expand. In January 2021, the government launched a new framework for insolvency laws, which has been designed to help more small businesses survive insolvency proceedings. At the same time, the compulsory Payment Times Reporting Scheme commenced, requiring larger corporations to publicise how quickly they pay invoices issued by small businesses.

Graph 7

SME Lending Rates

Interest rate on credit outstanding



* Excluding credit cards and margin loans

Sources: APRA; RBA

Small businesses' use of non-bank finance is expanding, but from a low base

Equity

Small businesses typically have access to a narrower pool of equity funding than larger companies. Australian private companies can only raise equity from professional and sophisticated investors (such as angel investors or venture capitalists), small-scale personal offers or crowd-sourced equity funding.

As in previous years, some panellists reported being approached by private equity investors in the past year. This aligns with reports from industry surveys that venture capital and private equity deals have been resilient throughout the pandemic, and that Australia-focused capital fundraising increased in 2020 (Preqin and Australian Investment Council 2021). Some small businesses have noted that private equity is attractive due to the flexibility it can offer, low collateral requirements, and the ability to make use of expertise and support from entities involved in providing the equity. However, for some years, small businesses have raised concerns with selling equity as this can involve relinquishing significant control over their business (Connolly and Jackman 2017).

The $540 million Australian Business Growth Fund (ABGF), which was formally launched in October 2020, will provide an alternative source of longer-term equity funding to established SMEs (Treasury Department 2020). The ABGF will provide businesses with equity capital of between $5 million and $15 million, up to a 49 per cent minority equity stake in the business. Additionally, the business will be required to appoint a member of the ABGF and an independent, non-executive chair to the business' board of directors.

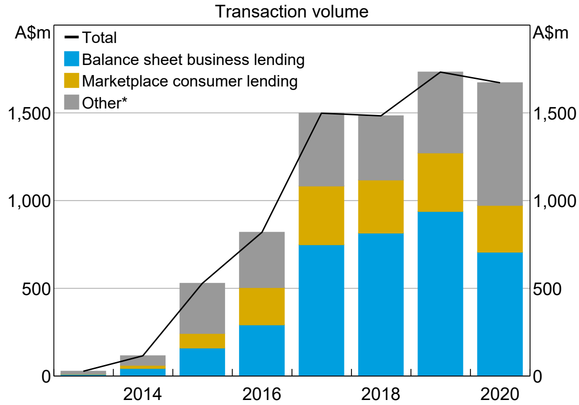
Non-traditional finance

Australian small businesses have increased their use of non-traditional finance sources over recent years – although it remains small as a share of overall business funding, at less than 2 per cent of loan commitments (Graph 8). Based on the most recent survey from 2020, the largest source of non-traditional finance remains business balance-sheet lending, which is where an online platform provider uses the customer information (such as transactional data) from its platform to identify credit-worthy borrowers and provide loans and trade credit from its own balance sheet. Credit limits are typically generated based on previous sales data, thereby speeding up processing times, and repayments are often automatically deducted from the proceeds of the borrower's sales. However, interest rates on this type of (unsecured) borrowing tend to be much higher than on (secured) bank loans, depending on the assessment of the risk of the business. As such, this is generally used for short-term liquidity needs.

Other forms of non-traditional finance have grown in recent years. Marketplace lending, the second largest source of non-traditional finance, is a type of alternative finance platform that connects 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. Donation and rewards-based crowdfunding – which allows individuals and businesses to raise funds as a donation – or in exchange for non-monetary rewards or products, saw significant growth globally in 2020. This was largely due to COVID-19-related charitable, community and health-related online fundraising activities around the world. In Australia, donation-based crowdfunding grew by over 140 per cent between 2019 and 2020.

Graph 8

Non-Traditional Finance



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

Sources: Cambridge Centre for Alternative Finance; RBA

Appendix A

Table A1: Selected 2021 Policy Responses to the COVID-19 Pandemic Targeted at SMEs[(a)]

State	Agency	Measure	Timeframe
NSW	Australian and NSW Govts	Payments of between $1,500 and $100,000 per week (up to 40 per cent of a businesses' payroll) made to NSW businesses that experienced a decline in turnover of more than 30 per cent, available to businesses with turnover between $75,000 and $250 million, contingent on the business maintaining its mid-July 2021 staffing levels.	18 July to present
	NSW Govt	Payments of up to $300,000 (up to 40 per cent of a businesses' payroll) to businesses with turnover between $250 million and $500 million, available to tourism, hospitality or recreation businesses that experienced a decline in turnover of more than 50 per cent, contingent on the business maintaining its staffing levels prior to the decline in revenue.	26 June to present
	NSW Govt	Payments of up to $500,000 (up to 40 per cent of a businesses' payroll) to businesses with turnover between $500 million and $1 billion, available to tourism, hospitality or recreation businesses that experienced a decline in turnover of more than 70 per cent, contingent on the business maintaining its staffing levels prior to the decline in revenue.	26 June to present
	NSW Govt	2021 COVID-19 business grants offering one-off payments to businesses of between $7,500 and $15,000 based on their decline in turnover, available to businesses with turnover between $75,000 and $50 million, contingent on the business maintaining its employee headcount.	26 June to 17 July
	NSW Govt	COVID-19 micro-business support grants providing payments of $1,500 a fortnight to businesses with turnover between $30,000 and $75,000 that experienced a decline in turnover of more than 30 per cent.	1 June to present
	NSW Govt	Payroll tax waivers of 50 per cent for businesses with wage liabilities between $1.2 and $10 million that experienced a 30 per cent or more decline in turnover. Additionally, businesses will have the option to defer payroll tax payment.	2020/21 Financial Year
	Australian Govt	NSW small business grants and small business support payments will be tax exempt.	2020/21 Financial Year
WA	WA Govt	Once-off payments of $2,000 to businesses affected by the ANZAC Day long weekend restrictions, available to businesses with payroll less than $4 million and turnover greater than $75,000.	23 April to 26 April
	WA Govt	Once-off payments of $3,000 to businesses affected by the four-day lockdown, available to businesses with payroll less than $4 million and turnover greater than $75,000.	29 June to 3 July
SA	SA Govt	Once-off payments of $3,000 to businesses that experienced a decline of 30 per cent or more in turnover, available to businesses with payroll less than $10 million and turnover greater than $75,000.	20 July to 27 July
	Australian and SA Govts	Once-off payments of $3,000 to businesses and $1,000 to sole traders in eligible industry sectors, available to businesses that experienced a decline in turnover of 30 per cent or more. Businesses based in the Adelaide CBD may be eligible for an additional $1,000.	28 July to 10 August
VIC	VIC Govt	Once-off payments of $2,500, $5,000 or $7,000 to businesses impacted by movement restrictions under phase two of the Business Costs Assistance Program, available to businesses with payroll less than $10 million.	28 May to 10 June
	VIC Govt	Once-off payments of $3,500 or $7,000 per premise to licensed hospitality businesses.	28 May to 10 June
	VIC Govt	Once-off payments of $4,800 to businesses that were eligible for but did not previously apply for phase two of the Business Costs Assistance Program.	15 July to 27 July
	VIC Govt	Four top-up payments of $2,500, $2,000 and $2,800 to businesses that were recipients of phase two of the Business Costs Assistance Program and that were impacted by restrictions at the time of the top-up.	4 June to 28 July
	Australian and VIC Govts	Once-off payments of up to $20,000 to businesses that experienced a drop in revenue of 70 per cent or more and that have not previously received funding under any of the Victorian Government COVID-19 support packages launched on or after 27 May 2021, available to businesses with payroll less than $10 million.	15 July to present

State	Agency	Measure	Timeframe
	Australian and VIC Govts	Once-off payments of $5,000 to businesses that remain affected by capacity limits and other restrictions, available to businesses in 24 eligible sectors that were eligible for Victoria's previous assistance programs.(b)	15 July to 27 July
	Australian and VIC Govts	Once-off payments of up to $20,000 to licensed hospitality businesses that are still operating under capacity limits.	15 July to 27 July
	Australian and VIC Govts	Four top-up payments of $5,000, $10,000 or $20,000 based on the capacity of the premises to licensed hospitality businesses that have previously received or been approved grants under the Licensed Hospitality Venue Fund program.	28 July to 2 September
	Australian and VIC Govts	Once-off payments up to $14,000 to businesses that were eligible for payments under phases one and two of the Business Costs Assistance Program.	5 August to 2 September
	Australian and VIC Govts	Payments of $5,000, $10,000 or $20,000 per week based on the capacity of the premises to licensed hospitality businesses that have previously received or been approved grants under the Licensed Hospitality Venue Fund program.	4 September to present
	Australian and VIC Govts	Payments of $2,800, $5,600 or $8,400 per week to businesses that were eligible for payments under phases one, two and three of the Business Costs Assistance Program.	4 September to present
QLD	Australian and QLD Govts	Once-off payments between $10,000 and $30,000 to businesses and $1,000 to sole traders that were impacted by the South East Queensland lockdown or the Cairns and Yarrabah lockdown, available to businesses with turnover greater than $75,000 and payroll less than $10 million.	31 July to 11 August
ACT	ACT Govt	Once-off payments of up to $20,000 for employing businesses and up to $7,500 for non-employing businesses that experienced a decline in turnover of 30 per cent or more, available to businesses with turnover greater than $75,000 and payroll less than $10 million.	13 August to 17 September
NT	NT Govt	Once-off payments of $1,000 to businesses impacted by the Greater Darwin and Katherine lockdown, available to businesses with turnover between $75,000 and $10 million and with fewer than 20 full-time employees.	16 August to 20 August
Federal	Banks	Loan deferrals of up to three months for small businesses.	8 July – present

(a) As at 6 September 2021

(b) Twenty-four sectors are eligible for the grant including gyms, cafes, restaurants, catering services and hairdressers

Sources: Media reports; RBA

Footnotes

[*] The authors are from Domestic Markets Department.

[1] Kent (2021) provides a discussion of conditions facing small businesses as the economy recovered in late 2020 and early 2021.

[2] See Ellis (2021) for further discussion on the impact of the pandemic on global supply chains.

[3] For more information, see Lewis and Liu (2020).

[4] See Black, Jackman and Schwartz (2021) for further discussion of the TFF.

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