

**Submission to the  
Senate Inquiry into Access of Small Business  
to Finance**

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## **Executive Summary**

- **There is considerable disparity between the increase in business loan rates compared to increases in both the cash rate and home loan rate.** Since mid 2007, the major banks' average variable indicator rate for business loans has risen approximately 200 basis points relative to the cash rate. This is 90 basis points higher than housing loan indicator rate. This results in a significantly disproportionate investment disincentive to the business sector, stifling expansion decisions relative to the rest of the economy.
- **Access to capital is vital for the farming sector's ability to fund expansion and adopt new technologies.** Capital access is crucial to invest in more efficient capital machinery, adopt new farming processes and maintain financial viability during cashflow downturns. The security provided by Australia's developed financial sector is an important tool for our primary producers' financial security and in turn cost competitiveness in overseas commodity markets.
- **Competition amongst financial providers servicing rural NSW appears healthy and product variety seems to be growing.** While some smaller, non-bank lenders have left the market, the major financial providers are quite active with their agribusiness sections providing a variety of financial services to primary producers in NSW.
- **New entrants, including young farmers, face significant barriers to farm ownership due to the high capital outlay and security required to access credit.** A first-farm grant, similar to first home owner grant, and increased availability and competitiveness of equipment finance in the industry should be explored to overcome these issues.
- **A free service assisting farmers to develop a better understanding of the business lending process and how to enhance the quality of their loan application would overcome some of the obstacles faced by farmers in the capital raising process.** The commercial experience and business acumen required to complete a comprehensive loan application does not fall within most farmers' primary skill set. The adoption of guide-books similar to those used in the European Union would assist the sector's expansion by educating existing and potential farm business owners and decreasing their barriers to access to business credit.

## Introduction

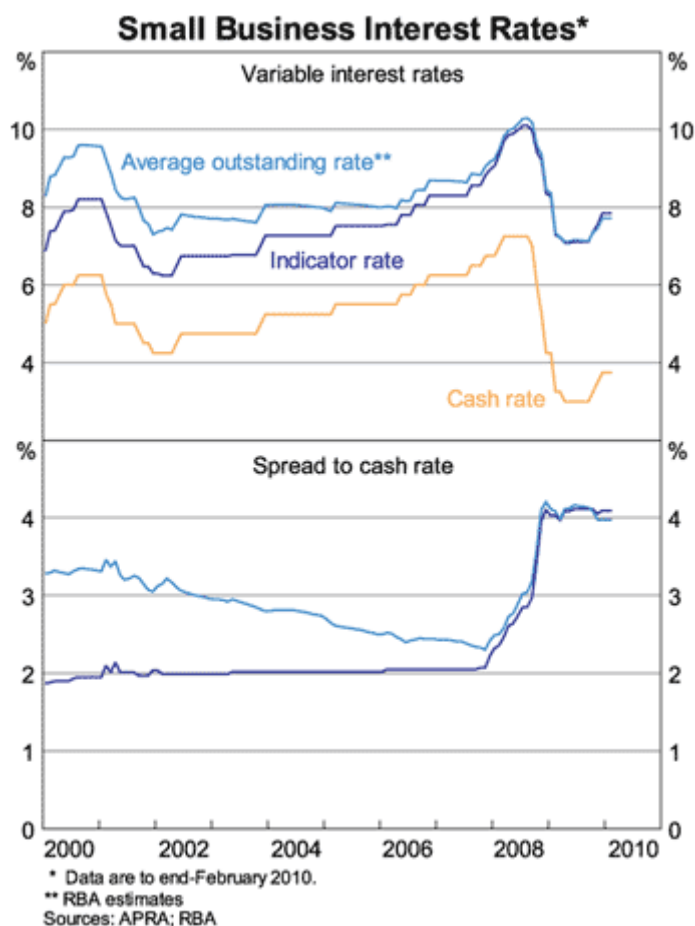
The NSW Farmers' Association (the 'Association') is Australia's largest state farming organisation representing the interests of the majority of commercial farm operations throughout the farming community in NSW. The Association also represents the interests of rural and regional communities and the important issues associated with natural resource management and trade. Through its commercial, policy and apolitical lobbying activities, it provides a powerful and positive link between farmers, the Government and the general public.

## Terms of reference questions

### **The costs, terms and conditions of finance and changes to lending policies and practices affecting small businesses**

Members have raised concerns regarding the increase in business loan rates when compared to both cash rate and home loan rate increases. Such concerns are supported by Graph 4 of the Reserve Bank of Australia's ('RBA') submission<sup>1</sup> to this review (please see Figure 1 below) which shows how the major banks' average variable indicator rate for business term loans have, since mid 2007, risen by about 200 basis points relative to the cash rate. This, the RBA state in the same submission, is larger than the rise of 110 basis points by the housing loan indicator rate.

Figure1: Small Business Interest Rates to end February 2010



This results in a significantly disproportionate investment disincentive to the business sector, stifling expansion decisions relative to the rest of the economy.

<sup>1</sup> <http://www.rba.gov.au/publications/submissions/inquiry-access-small-bus-fin-0310.html>

One of the farming sector's main financial concerns is increasing business cashflow revenues. Industry participants are usually characterised as having considerably more security than needed, with cashflow being the main restriction to loan availability. Members have reported that most banks lend up to 50 and 60 percent of security value. A loan of over 40 percent of mortgage security or equity levels below 60 percent are general guidelines of holding unsustainable debt. This is in the case of no off farm income or contracting income, with all income coming from the assets included in the equity valuation. Hence from this you can see that one who owns their farm can borrow much more than their cashflow can probably sustain.

### **The importance of reasonable access to funding to support small business expansion and the sector's contribution to employment growth and economic recovery**

Agriculture is a significant contributor to the NSW economy. The gross value of NSW agricultural commodities production in 2008 was \$8.59 billion, representing about 20 percent of total Australian agricultural production.<sup>2</sup> However this figure increases to \$27 billion when factoring in the multiplier effect of businesses and industries further down the supply chain.

Agriculture is a large employer in rural NSW. In August 2009, 87,800 people were directly employed either full time or part time in agriculture in NSW.<sup>3</sup> In addition, agriculture indirectly supports employment in a range of services located in rural and regional areas.

Agriculture is also the biggest land user in NSW and a significant contributor to the State's balance of payments. Agriculture covers an estimated 58.6 million hectares or 73 percent of the land mass of NSW with approximately 40,077 farming establishments.<sup>4</sup> The value of exports of agricultural commodities from NSW amounted to \$1.5 billion in 2004-05, representing approximately 6.5 percent of merchandise exports from NSW.<sup>5</sup>

Access to capital is vital to primary producers as it enables the sector to expand and adopt new technologies. This supports the sector both by allowing farmers to invest in more efficient capital machinery, adopt new farming processes and maintain financial viability during droughts and cashflow downturns.

Operating in international commodity markets, Australian farmers compete directly with foreign primary producers, some with considerably cheaper cost bases. These savings stem from cheaper labour and more relaxed regulatory requirements. As such, Australian farmers' access to capital and variety of financial products, both results of an advanced financial sector, are an important tool to maintaining financial viability and in turn cost competitiveness.

### **The state of competition in small business lending and the impact of the Government's banking guarantees;**

Members have indicated that competition amongst the major financial providers appears healthy and product variety seems to be growing. Most banks now offer a variety of financial products such as short and long term options, cap rates, and in and out facilities. While some smaller, non-bank lenders have left the market, the major financial providers are quite active with their respective agribusiness sections, including NAB, Westpac and Rabobank, while ANZ and CBA are present but less aggressive.

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<sup>2</sup> ABS (2009), *Value of Selected Agricultural Commodities Produced, 2007-08*, cat number 7503.0

<sup>3</sup> ABS (2009) *Labour Force, Australia, Detailed, Quarterly August 2009*, cat number 6291.0.55.003

<sup>4</sup> ABS (2008) *Agricultural State Profile, New South Wales, 2006-07*, cat number 7123.1.55.001

<sup>5</sup> ABS (2006) *Agricultural State Profile, New South Wales, 2004-05*, cat number 7123.1.55.001

## **Opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion;**

A major obstacle to new entrants into the farming sector is the size of the security required to get access to the credit required to purchase a farm. This affects both young farmers and those entering from other business sectors.

To maintain rural and regional communities it is imperative to entice young farmers into the industry, yet it is extremely hard for young people to enter into farm ownership due to the high capital outlay. The farming population in Australia is ageing indicating that there has been a diminution of the attractiveness of the sector as a lifestyle and business decision.

Proportion of farmers 65+		Proportion of farmers <35	
2001	15%	2001	12%
2006	18%	2006	10%

If this trend continues there will be very few family farms left which has been the hallmark of rural Australia. This has repercussions both in regards to the contributions small family owned farm businesses provide to a competitive farming sector as well as their use and contribution to social services in the area. This includes local schools and volunteering in fire fighting organisations.

The Association calls for an extension to the first home owners grant to include farms. The Association advocates that the Federal Government should extend its current first home grant to first farm buyers, providing up to 10 percent of the land purchase price, to a limit of \$100,000.

Other new entrants to the sector historically leverage off existing business assets to expand into farming. Often these business owners are farm contractors who rely on equipment loans to purchase new capital machinery. While they may be able to afford the farm-debt, they still face significant hurdles accessing finance given their lack of security or capital to meet the bank's loan requirements.

Accordingly the Association would like to highlight the need to consider the availability and competitiveness of equipment finance in the industry, which may be potential entrants' only source of funds. Aligned with this is the accelerated depreciation schedule which would be a major help for these cash rich, security poor businesses. The Association also calls for an extension to the Small Business and General Business Tax Break for a further twelve months to support those farmers who have been unable to take advantage of the capital investment incentive due to ongoing financial constraints caused by the drought.

## **Policies, practices and strategies to enhance access to small business finance that exist in other countries**

A free service assisting farmers develop a better understanding of the business lending process and how to enhance the quality of their loan application would overcome some of the obstacles faced by farmers in the capital raising process. The commercial experience and business acumen required to complete a comprehensive loan application does not fall within most farmers' primary skill set. Farm business loan applications can include a combination of business plans, risk analysis, succession plans, security appraisals and financial assessments. The collation of such details go beyond the skills of many potential farmer owners resulting in sub-par quality loan applications which in-turn leads to fewer loan approvals.

To overcome this issue, Governments such as the European Union ('EU') have developed guide-books to assist small and medium-sized enterprises apply for loan financing. The EU Enterprise and Industry's

*How to deal with the new rating culture* guide book<sup>6</sup> assists loan applicants by detailing how a bank rates loan applicants, including:

- the quantitative information banks require including financial statements, business plans and tax returns;
- reviewing the applicant's market situation and legal form;
- determining the interest rate of a loan; and
- monitoring changes in a borrower's credit quality.

Making this information freely available to small business in Australia, including primary producers, would go a long way to enhancing both their understanding of the business lending process and the credibility and quality of their loan application. This would in-turn assist the sector's expansion by educating existing and potential farm business owners and decreasing their barriers to business credit.

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<sup>6</sup> [http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc\\_id=1219&userservice\\_id=1&request.id=0](http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc_id=1219&userservice_id=1&request.id=0)