



**Ai GROUP SUBMISSION**

26 AUGUST 2014

Financial System Inquiry - Second Submission

## About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing; engineering; construction; automotive; food; transport; information technology; telecommunications; call centres; labour hire; printing; defence; mining equipment and supplies; airlines; and other industries. The businesses which we represent employ more than 1 million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations.

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## Overview

The Australian Industry Group would like to thank the Panel for considering our first submission. We also welcome the chance to respond to the interim report released on 14 July. Our initial submission focused on industry's access to finance, for both bank-intermediated lending to small and medium enterprises, as well as early-stage financing. In this submission, we would like to briefly address these issues again, as well issues raised in the interim report on superannuation entitlements.

## SMEs' access to Bank Finance

The ability of Australian industry to access finance at a competitive cost so it can expand and invest in new ideas is key to Australia's future. We must meet the challenges posed by the economy's current transition away from the resources sector by innovating into new products and investing in productivity-enhancing technologies and processes. Businesses can only make these vital investments if we have a stable and competitive financial system.

Ai Group agrees with the interim finding that there are structural impediments for small and medium enterprises to access finance, which include information asymmetries, regulation and taxation. In this regard, Ai Group welcomes the policy ideas canvassed in the interim report addressing SMEs' access to finance. In particular, introducing a database of businesses' past loan performance and taxation information is a worthy idea. We will consult with our members on the policy design once the final report is handed down.

However, we strongly caution against generalising from the Panel's view that "*accessing external finance is not a major issue for most SMEs*" at the moment.

Ai Group members, and particularly SME members, frequently cite difficulties getting finance from their bank at a competitive rate as a major challenge facing their business. Over the past decade this had been particularly evident among members in the manufacturing sector. In the current environment of tepid business investment intentions across non-mining industries, it is not surprising that accessing external finance does not rate highly. This period is, however atypical, with non-mining investment levels still at low levels in an historical sense.

Interestingly, since the interim report was released, another interesting data release has confirmed the more typical anecdotes Ai Group often hears from our members. The Export Finance and Insurance Corporation conducted a survey of SMEs involved in trade in its [Export Index](#), which was conducted in May 2014. They reported that SME exporters reported higher levels of confidence along with higher sales and profits, they predicted access to finance to become more difficult in the next 12 months.

Over the next three months, 23.1 percent of respondents expected tighter access to finance, an increase of 4.2 percentage points since the previous survey in February. Over the next year, 26.5 percent expected finance would be more difficult to access. This was most notable for the smallest businesses, with 62% of respondents with less than \$1m believing access to finance will become more difficult in the next 12 months. This falls to 10% for those with turnover between \$10-\$20m, and then to 6% for those with turnover of more than \$20m.

It is also worth noting businesses' expectations for tighter credit owed to their recent experience with banks rather than the expectation of higher interest rates, which is outlined in Table 1.

Ai Group encourages the panel to look beyond the current period of relatively low demand for finance and examine measures that could encourage greater competition in the business lending market.

**Table 1 – SMEs and accessing bank finance**

**Key Reason for Access to Finance in Offshore Business Support to Become More Difficult**  
% of SME Exporters

(N: 227)	
Recent experience with financial institution:	
<i>Credit curtailed (lines withdrawn/reduced)</i>	17.2
<i>Credit refused</i>	21.1
<i>Change in type of credit offered / available</i>	8.8
Financial performance has weakened:	
<i>Cash flow weakened</i>	9.7
<i>Profitability declined</i>	8.8
Lack of collateral required by bank	7.5
Expect cost of credit to increase	4.8
Bank increasing collateral / information requirements	9.3
Bank lacks understanding of potential foreign markets	8.4
Future business plans involved increased business risk	2.2
Other	0.9
No view / unsure	1.3
<b>TOTAL</b>	<b>100.0</b>

Source: EFIC Export Index June 2014

## Venture Capital

Australian entrepreneurs face significant challenges accessing early-stage financing, either through debt or equity channels, an issue raised in several initial submissions including by the Australian Industry Group. No doubt this contributes, in part, to the low levels of innovation identified in a recent ABS release, *Innovation in Australian Businesses*, which reported only 37 per cent of Australian businesses introduced some sort of innovation in 2012-13, a lower proportion than a year earlier (41.3% in 2011-12). The most-cited reason for the majority of businesses that failed to innovate was a lack of access to funds, reported by one in five of the respondents.

There are several low-hanging fruit policy changes that could go some way to boost the level of early-stage financing to Australian entrepreneurs. Ai Group agrees with the Panel's suggestion that the Government's yet-to-be-announced tax white paper process be tasked with examining if changes to research and development (R&D) tax credit system would encourage more start-up ventures. In particular, shifting payments to a quarterly basis for new ventures would help alleviate cash flow constraints given new ventures tend to make significant cash outlays in the early stages of the product lifecycle. We also welcome changes to the tax laws mooted by the Government around equity shares for start-ups, and would ask the panel to examine the other policy solutions put forward including changes to the Significant Investor visa category.

However, more broadly, we would encourage the Panel to take a broader look at the successful policy settings in place in economies such as New Zealand and Israel, which are both smaller economies than Australia but have developed vibrant early-stage finance markets.

### Default superannuation funds

In its Interim Report, the Panel rightly states that it is too early to assess the effectiveness of the MySuper reforms in stimulating competition and improving after-fee returns for default fund members.

Over the past few years, Ai Group has made detailed submissions regarding the default superannuation system to the Productivity Commission's inquiry into *Default Superannuation Funds in Modern Award* and in response to the Australian Government's Discussion Paper on *Better Regulation and Governance, Enhanced Transparency and Improved Competition in Superannuation*.

A large proportion of employers and employees use one of the default superannuation funds which are listed in relevant awards and, in Ai Group's experience, most employers support the simplicity of this system. Employees also appear to support the default superannuation system given that most do not exercise their right to choose another fund.

Ai Group supports the concept of 2-15 default superannuation funds being listed in each modern award consistent with s.156H of the *Fair Work Act 2009* (Cth). However, we support a fair and transparent process applying when the default funds are selected for each award, and a regular review of the funds in each award.

Such a fair and transparent process is provided for in Division 4A (4 Yearly Review of Default Fund Terms of Modern Awards) of the *Fair Work Act*. The Act requires that an Expert Panel of the Fair Work Commission (FWC) conduct a review every four years of default funds in awards. The FWC is responsible for maintaining awards and therefore it is sensible for the FWC to be responsible for maintaining the superannuation terms in awards. The first Review commenced in early 2014 but has stalled pending the appointment of another Member of the Expert Panel by the Australian Government. The Government has advertised for the vacant position and we anticipate that another Member will be appointed in the near future.

The process in the *Fair Work Act* is new and it should be allowed to take its course. At the conclusion of the Review, all parties will be able to express their views on the Review, including expressing views on whether any legislative or other changes are warranted.