How are Small Businesses Accessing Finance During COVID?

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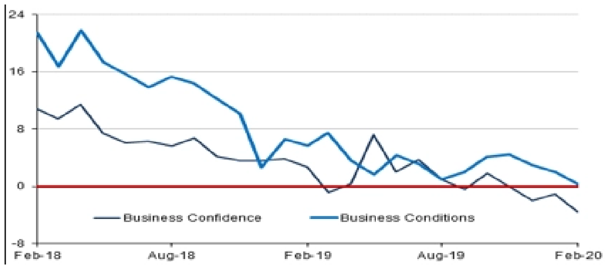
Small and medium-sized businesses (SMBs) make up most of all Australian businesses and drive growth, provide employment opportunities and create new markets. SMBs employ around seven million Australians (which is some 70% of total employment) and they make a significant contribution to the creation of new jobs. At the end of 2019, there were an estimated 2.2 million Small Businesses in Australia, providing personal income and employment to over 5 million Australians.

The owners of small businesses are facing very difficult times during the current pandemic. Lockdowns and restrictions on economic activities have led to a lack of confidence among the business community. Currently, small businesses are focusing on their recovery by understanding the risks to their businesses caused by this unprecedented event.

These small businesses today need help and support. Without access to the right funding, small businesses will not grow, and some will not survive which can lead to higher unemployment and a possible recession. It is critical that small businesses have easy and affordable access to the required finance and need to know what sort of financing is available to them. They are worse affected because of their heavy reliance on steady cash flows.

The current economic situation, panic, uncertainty and negativity seem to dominate business sentiments. This is reflected in the diagram below.

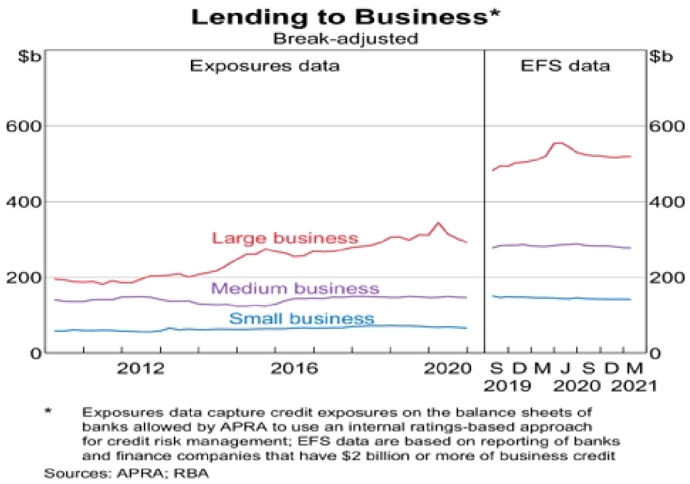
Australia Business Confidence Chart

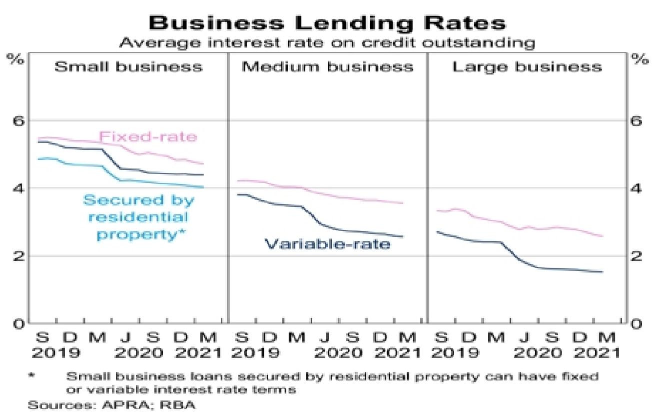


Source: National Australia Bank's Monthly Business Survey.

Demand for new loans by small business declined recently, probably because they are reluctant to take on debt given sharp uncertainty about the economic outlook as shown in the diagram below. Because of this, many businesses have postponed or cancelled their future investment plans. On the other hand, getting loans from banks is not easy for a small business as banks have tightened their exposure to stay compliant with regulatory requirements regarding capital. Also, the finance requirement of small businesses is often not large enough for most of the big banks to give them priority, which at times leads to a higher rate of lending.

The various short-term initiatives taken by Federal and State governments to support businesses' cash flows are also likely to have dampened the immediate demand for credit. This includes the JobKeeper program, offering tax credits, and the SMB loan guarantee scheme. Commercial banks and landlords have also provided support, through deferred payments and rent reductions. Interest rates on loans to SMEs have also declined to historically low levels by recent easing in monetary policy. While the government's rescue package has provided some relief for many small businesses, they still rely heavily on borrowing to fund their operations. Small businesses are finding it hard to access credit as the outbreak restricts economic activity.





Although the demand for new loans is less in the current environment because of the reasons mentioned above, the access to finance continues to be a challenge for small businesses. Lack of alternative finance options is also likely to be a contributing factor to SMEs paying higher interest rates than large businesses, which have access to a broader range of funding sources.

What is the option – Alternative finance

Alternative forms of lending and investment are becoming more commonplace. Digital tools open significant new opportunities for SMBs within the Australian economy to grow and innovate. These alternative financing platforms usually use an innovative way to assess the borrower's credit worthiness, allowing businesses to acquire funding they did not have access to previously. It usually utilises technology to facilitate the end-to-end processes from on-boarding to funding and settlement. Flexibility in security requirements and simplified application process and quicker access to funds than traditional bank loans are some of the reasons for change in small businesses behaviour regarding lending. Alternative lending provides full range of loan options like short term working capital loans to long term commercial real estate loans to consumers and business owners outside of a traditional bank loan.

Alternative finance options that small businesses can consider include 'Crowdfunding' (balance sheet lending) and 'Peer to peer (P2P) investment' (marketplace lending) among others. Crowdfunding occurs when lots of people on the online platform offering small amounts for which they may receive rewards or share in return. P2P investment is possible for both businesses and individuals and is carried out through platforms that help investors to find people to lend to. These types of approaches cut out banks completely. This approach has been driven by low-interest rates and an inability to gain access to more traditional forms of financing such as banks. The increasing level of comfort with doing business online has also been a driver of this sort of financing. 'Invoice trading' is another alternative financing method that has been gaining popularity due to its low fees and speed of funding. It is a form of accounts receivable financing. In this method, small businesses can receive funding by selling outstanding invoices to a network of investors.

What we need to consider for the future?

Despite the number of non-bank lenders available in the Australian market, this alternative is still faced with apprehension by many small business owners. The available data suggests that non-traditional sources of finance accounted for less than 2 per cent of overall SME lending in 2018 (RBA 2021). Awareness and understanding are significant barriers to growth in the use of non-bank lenders. This is simply because Australia's finance industry has been dominated by the big four banks, leaving little room for smaller independent lenders to build the same comfort and trust levels that the banks hold. This suggests that there is a need for further education within the sector about alternative finance to remove any pre-conceptions.

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