Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Financial Services and Small and Medium-Sized Enterprises (SMEs)

Background Paper 12

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1. Purpose of the paper

This background paper provides information about small and medium-sized enterprises (SMEs) in Australia, and describes some ways that SMEs interact with providers of financial products. This paper also highlights that there is no single definition of an SME in Australia, and that data about SMEs is limited.

This paper shows that:

a) Most businesses in Australia are likely to be considered to be SMEs, even though the definition of an SME varies depending upon the context.
b) SMEs account for a large proportion of employment in Australia.
c) Many SMEs are operated by sole traders, and are not legally distinct from their owners.
d) Even when an SME is carried on in a separate legal entity, such as a company, it is common for the owners of the SME to be exposed to some personal financial liability.
e) Banks and other lenders offer a range of unique lending products for businesses, including SMEs.
f) SMEs utilise a range of other, non-lending, financial products.

2. Introduction

SMEs are the most numerous type of business by size in Australia, and are significant employers, despite there being some uncertainty about how to define them.

Some Commonwealth legislation extends protections that were designed to protect consumers to certain small businesses, but these extensions do not encompass all businesses likely to be defined as SMEs.

There are several different legal structures available for SMEs to carry on a business. As the extent of legal separation from the business owners increases, the degree of separation of the business owners' finances from those of the business typically also increases. However, many SMEs rely upon the personal finances of their owners as security to obtain access to finance, regardless of the type of legal entity in which the business is carried on.

Banks are the main source of lending for all businesses, including SMEs, in Australia.

SMEs may also enter into relationships with financial services entities for other financial products, such as cashflow finance management, and for access to payments systems such as credit card systems and EFTPOS terminals.

3. What is an SME?

Micro, small, and medium-sized enterprises – often referred to as simply 'SMEs' – are recognised as being important economic contributors in Australia, and internationally.[1] In Australia, however, there is no agreed or uniform legislative definition of an SME.

Commonwealth legislation does, however, provide for differential treatment or special protections for certain businesses defined as 'small businesses.' Figure 1 shows some of the definitions of a 'small business' used in Commonwealth legislation.

Figure 1: Statutory definitions of small business in Commonwealth legislation

Act and section	Application to small businesses	Test of whether an entity is a small business
Australian Securities and Investments Commission Act 2001, section 12BC	Deems small businesses to be consumers for the purposes of Part 2, Division 2 of the Act, which deals with certain consumer protections in relation to financial services	That the business employs less than 20 employees or, if the business is a manufacturing business, the business employs less than 100 employees
Australian Securities and Investments Commission Act 2001, section 12BF	Provides that a standard form contract in relation to financial products and services where one party is a small business will be void if it meets the test for being 'unfair'	That the business employs less than 20 employees, and the upfront price payable under the contract does not exceed $300,000, or if the contract has a duration of more than 12 months, the upfront price payable under the contract does not exceed $1,000,000

1 The United Nations General Assembly, for example, has designated 27 June each year to be Micro-, Small, and Medium-Sized Enterprises Day; see: Micro-, *Small and Medium-sized Enterprises Day*, GA Res 71/279, 71st sess, 74th plen mtg, Agenda Item 13, UN Doc A/RES/71/279 <http://undocs.org/A/RES/71/279>.

Figure 1: Statutory definitions of small business in Commonwealth legislation (continued)

Act and section	Application to small businesses	Test of whether an entity is a small business
Competition and Consumer Act, Schedule 2, section 23	Provides protections against unfair contracts to small businesses in relation to goods and services, and interests in land	That the business employs less than 20 employees and the upfront price payable under the contract does not exceed $300,000, or if the contract has a duration of more than 12 months, the upfront price payable under the contract does not exceed $1,000,000
Corporations Act 2001, section 761G	Deems small businesses to be retail clients in relation to insurance and 'other' financial products or services for the purpose of Chapter 7 of the Act, which deals with the regulation of financial services and markets	That the business employs less than 20 employees, or, if the business is a manufacturing business, the business employs less than 100 employees
Australian Small Business and Family Enterprise Ombudsman Act 2015, section 5	The Act provides for an Ombudsman with advocacy and assistance function in relation to small and family businesses	That the business employs less than 100 employees or the business has less than $5 million in revenue in a year
Fair Work Act 2009, section 23	Alters the unfair dismissal provisions of the Act	That the business employees less than 15 employees
Income Tax Assessment Act 1997, section 328-110	Provides access to certain concessional treatments in the tax laws	That the business has an annual turnover of less than $10 million

Figure 1 shows that one common legislative approach used in Commonwealth legislation is to define businesses that employ less than a certain number of employees as small businesses. However, this definition is not consistent across all purposes for which small businesses are defined in legislation.

There are almost no legislative references in Commonwealth legislation to 'medium-sized businesses,' which indicates that the Parliament has not granted differential treatment or special protections to medium-sized businesses. The only reference identified is in the *Fair Work Act 2009*, and is an acknowledgement in the Objects of the Act of the 'special circumstances of small and medium-sized businesses.'[2]

For statistical purposes, the Australian Bureau of Statistics (ABS) defines an entity employing less than 20 employees as an SME, and a medium-sized business as a business employing between 20 and 199 employees.[3]

4. Characteristics of SMEs

Some limited data on the size and composition of the SME sector in Australia is available. Additionally, there is some data that shows the economic contribution of SMEs to the Australian economy.

4.1. Number of SMEs in Australia

The ABS provides data on the number of businesses in Australia, regardless of the legal form,[4] by size of employment. When compiling its data on the number of businesses in Australia, the ABS only includes entities that are actively trading in goods and services in a given period.[5] Table 1 shows the number of businesses by number of employees between financial years 2009-10 and 2016-17.

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2 *Fair Work Act 2009 (Cth)* s 3.

3 Australian Bureau of Statistics (ABS), *1321.0 Small Business in Australia*, 2001 (23 October 2002), <http://www.abs.gov.au/ausstats/abs@.nsf/mf/1321.0>

4 Includes sole proprietors, companies, partnerships and trusts.

5 ABS, *8165.0 Counts of Australian Businesses, including Entries and Exits, Jun 2013 to Jun 2017* (20 February 2018), 'Explanatory notes,' <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8165.0Main+Features1Jun%202013%20to%20Jun%202017>

Table 1: Number of businesses in Australia, at June, by number of employees (2009-10 to 2016-17)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
	Number ('000s)							
Nil employees*	1,303.0	1,306.0	1,306.1	1,264.3	1,274.8	1,284.6	1,318.6	1,370.1
1-4 employees	580.1	581.7	582.7	563.4	571.2	584.7	599.4	608.7
5–19 employees	189.0	191.8	198.3	197.4	200.0	197.2	198.7	203.4
20–199 employees	48.9	49.3	50.5	50.9	51.6	51.0	51.0	52.2
200+ employees	3.4	3.5	3.6	3.6	3.6	3.7	3.8	3.9
Total	**2,124.6**	**2,132.4**	**2,141.2**	**2,079.7**	**2,100.2**	**2,121.2**	**2,171.5**	**2,238.3**
	Number of businesses with less than 20 employees ('000s)							
Total	2,072.2	2,079.5	2,087.2	2,025.1	2,044.9	2,066.5	2,116.7	2,182.1
Percentage of Total Businesses	97.5	97.5	97.5	97.4	97.4	97.4	97.5	97.5

Source: ABS, 8165.0 Counts of Australian Businesses, including Entries and Exits, Jun 2009 to Jun 2013; ABS, 8165.0 Counts of Australian Business, including Entries and Exits, Jun 2013 to Jun 2017.

Note: * Defined as non-employing.

As shown in Table 1, the vast majority of businesses employ either no employees, or less than 20 employees. Using the ABS definition of a small business as a business employing less than 20 employees, at the end of 2016-17 there were 2.2 million small businesses in Australia. This represented 97.5 per cent of all businesses operating at the end of 2016-17.

Likewise, using the ABS definition of a medium-sized business as a business employing between 20 and 199 employees, there were 52,200 medium-sized businesses in Australia at the end of 2016-17. This represented only 2 per cent of all businesses operating at the end of 2016-17.

4.2. Employment by SMEs in Australia

Small businesses account for a significant proportion of employment in Australia.

In 2015-16, small businesses[6] employed 4.7 million people in Australia, which represented 44 per cent of the total number of people employed in the private, non-financial,[7] sector in Australia.[8] In some industries, small businesses are the predominant employer. For example, in 2015-16:

- 80 per cent of private sector employees in the agriculture, forestry and fishing industry were employed by a small business;
- 77 per cent of private sector employees in the rental, hiring and real estate services industry were employed by a small business; and
- 69 per cent of private sector employees in the construction industry were employed by a small business.[9]

ABS data also shows that medium-sized businesses in the private, non-financial, sector employed 2.5 million people in 2015-16.[10]

4.3. Main legal forms of SMEs

Businesses may be carried on in a range of legal structures. The Productivity Commission's (PC) *Inquiry into Business Set-up, Transfer and Closure* (2015) surveyed the main types of legal entity through which businesses may be conducted: sole trader, partnership, company and trust.[11] The PC noted that:

> *Businesses are often set-up using a combination of different entities and entity types in order to access the taxation or liability benefits of particular structures, and reduce liability risks by isolating elements of a business within a separate entity.*[12]

The ABS has released data on the number of businesses according to the legal structure of the entity. The number of private sector businesses, regardless of size, operating in June 2017 is set out in Table 2.

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6 Defined according to the ABS definition as businesses with less than 20 employees, including no employees: ABS *8155.0 Australian Industry*, 2015–16 (26 May 2017), 'Notes,' <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8155.0Explanatory%20Notes12015-16?OpenDocument>.

7 ABS, *8155.0 Australian Industry*, 2015–16 (26 May 2017), Table 5, <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8155.02015-16>; excludes entities in Australian and New Zealand Standard Industrial Classification (ANZSIC) Division K, Financial and Insurance services.

8 Ibid.

9 Ibid.

10 Ibid.

11 Productivity Commission (PC), *Inquiry Report: Business Set-up, Transfer and Closure* (7 December 2015), 80, <https://www.pc.gov.au/inquiries/completed/business/report>.

12 Ibid 86.

Table 2: Number of businesses (private sector) by legal entity type, June 2017

Companies	Sole Traders	Trusts	Partnerships	Total
		Number		
839,507	586,547	544,410	267,442	2,237,906

Source: ABS, 8165.0 Counts of Australian Businesses, including Entries and Exits, Jun 2013 to Jun 2017, Table 10.

Note: Excludes businesses that have not registered for Goods and Service Tax (GST), such as businesses with a turnover less than $75,000 per annum.

As shown by Table 2, companies are the most common form of business structure. However, companies can be more difficult to operate than other business entities. The PC, for example, found that '[c]ompared to sole traders or partnerships, a company is a relatively complex business structure, with more regulatory and administrative costs due to additional reporting requirements to a separate regulator.'[13]

Proprietary companies, which are limited in size to no more than 50 non-employee members (shareholders),[14] are by far the most numerous form of company in Australia; with about 1.445 million proprietary companies registered in Australia in November 2017, compared with only about 28,900 public companies.[15]. As ABS data on the number of businesses operating in Australia excludes entities not actively trading in goods and services, the number of businesses carried on by companies as measured by the ABS is considerably smaller than the total number of companies registered in Australia.

13 Ibid Appendix B 36.
14 *Corporations Act 2001* (Cth) s 113.
15 Parliamentary Library, Bills Digest No. 82, 2017–18: Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (23 February 2018), 6, <http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/5808296/upload_binary/5808296.pdf>.

4.4. Franchising

Franchising is a popular form of business structure in Australia. According to the Franchising Council of Australia, the most common type of franchising business model is the 'business format franchise.' The Council defines a 'business format franchise' as:

> *a comprehensive system for the conduct of the business, including such elements as business planning, management system, location, appearance and image, and quality of goods.*[16]

The ABS's *Selected Characteristics of Australian Business* measure the proportion of businesses that are currently franchisees. The ABS data also disaggregates that data according to the number of employees of the franchisee.

Table 3: Per cent of businesses that are franchisees, 2015-16

	Per cent
Franchisees as a percentage of businesses with:	
0–4 employees	2.4
5–19 employees	7.7
20–199 employees	9.7
200 + employees	6.2
Franchisees as a percentage of all businesses	4.5

Source: ABS, 8167.0 Selected Characteristics of Australian Business, various years.

Note: The ABS survey measures the proportion of businesses that are in a 'franchisee relationship'.

Table 3 shows that franchisees are most likely to have between 20 and 199 employees, and be defined as medium-sized businesses by the ABS.[17]

16 Franchise Council of Australia, 'What is franchising?,' website, <https://www.franchise.org.au/what-is-franchising-.html>; other types of franchise arrangement identified by the Council are Manufacturer-Retailer, Manufacturer-Wholesaler, Wholesaler-Retailer, Retailer-Retailer.

17 ABS, above n 3.

Accreditation of franchise systems by banks or other lenders appears to be relatively common in the franchising sector in Australia. According to Westpac:

> *A bank accreditation enables a potential franchisee looking to buy a franchise to borrow 40 to 70 per cent of the total set up costs of a new franchise, or purchase costs of an existing franchise business.*[18]

The Westpac and ANZ websites provide a list of currently accredited franchises systems by each of those entities.[19]

4.5. Other business organisation considerations

4.5.1. Real estate as security

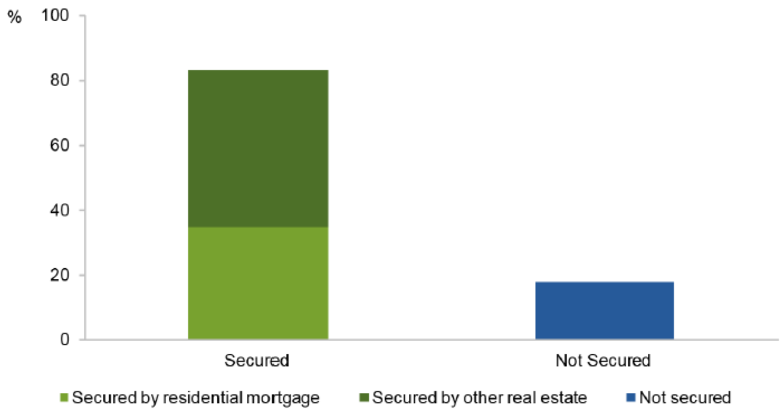
Small business lending is often intermingled with the personal finances of the business owner; particularly the residential property of the business owner. Where this occurs, the legal separation of the business owner from the business activity, which might exist from the use of a company or trust structure, is partially removed.

The PC's *Draft Report into Competition in the Australian Financial System* (2018)*,* considered the proportion of SME lending by major banks that was secured, including the proportion that was secured by a mortgage over residential property. The PC's findings are reproduced in Chart 1. Chart 1 below shows that around one third of lending to SMEs is secured by residential real estate, and around 80 per cent of SME lending is secured by some form of real estate (including residential real estate).

18 Labrina Tsekouras (Westpac), 'Benefits of Bank Accreditation,' *Business Franchise Australia and New Zealand*, (May/June 2014), 82, <https://www.businessfranchiseaustralia.com.au/sites/default/files/Labrina%20Tsekouras%2C%20Westpac.pdf>.

19 Westpac, *Westpac Accredited Franchise List Current as at February 2017* (February 2017), <https://introducers.westpac.com.au/wp-content/uploads/Westpac-Accredited-Franchise-List-WORD-2017.pdf>; ANZ, Franchisors who have special lending arrangements with ANZ (September 2009), <http://www.anz.com/aus/promo/commercial/Choose-Blue-News/PDF/Franchising-franchisor-list.pdf>.

Chart 1: Per cent of small business lending by the major banks on term loans secured by real estate, June 2017



Source: *PC, Draft Report into Competition in the Australian Financial System, (7 February 2018), Figure 9.5, 256, <http://www.pc.gov.au/inquiries/current/financial-system/draft/>.*

Under the Australian Prudential Regulation Authority's (APRA) current standardised approach to capital adequacy requirements of Authorised Deposit-taking Institutions (ADIs), lending to SMEs that is secured by residential real estate is given the same risk weighting as the weighting currently given to owner-occupier housing with lenders mortgage insurance (LMI).[20] Those risk weights vary between 35 per cent and 75 per cent, depending on the loan-to-valuation ratio (LVR). Lending secured by commercial property, however, is currently treated in the same way as unsecured lending.[21]

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20 Australian Prudential Regulation Authority (APRA), *Background Paper 9: The regulatory capital framework for authorised deposit-taking institutions (ADIs)* (27 April 2018), Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 6 and 10, <https://financialservices.royalcommission.gov.au/publications/Documents/apra-the-regulatory-capital-framework-for-authorised-deposit-taking-institutions-adis-paper-9.pdf>; APRA currently also permits, subject to approval, ADIs to use their own financial models and experience data to develop their own internal ratings-based (IRB) approaches to risk weighting: see page 5.

21 Ibid 9.

In relation to the current capital adequacy requirements, the PC *Draft Inquiry Report into Competition in the Australian Financial System* (2018) found:

> *The APRA capital requirements …create an incentive for lenders to seek a residence as collateral (where available) and for SME borrowers to offer a residence as collateral to access the lowest price finance.*[22] (footnote omitted)

APRA is considering altering the risk weightings for SME lending[23] in prudential standards to provide that '[l]oans to SMEs secured by residential property … attract the same risk weights as for interest-only loans and loans to purchase investment property.'[24] In addition to increasing the capital adequacy requirements of lending to SMEs secured by residential property, APRA is also proposing to reduce the capital adequacy requirements for lending to SMEs secured by commercial property, and lending to SMEs that is not secured by any property.[25] Under APRA's proposed changes, the risk weighting for SME lending secured by a mortgage over residential property would still be lower than for other SME lending. If implemented, the changes would be likely to apply from 1 January 2021.[26] Section 11AF of the *Banking Act 1959* gives APRA the power to make prudential standards for ADIs. Section 11AG of that Act requires ADIs to comply with any prudential standard issued under that Act.

4.5.2. Crowd-source funding and FinTech

'Disruptive' technologies may have the capacity to provide alternate sources of finance to business; however, those technologies are still emerging.

A relatively new phenomenon in business funding is crowd-sourced funding; where businesses gain funding directly from the public: known as the crowd. The Australian Tax Office (ATO) has identified four types of crowd-sourced funding, and some of the features of each.[27] Those four types are as summarised in Figure 2.

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[22] PC, *Draft Report into Competition in the Australian Financial System*, (7 February 2018), 255, <http://www.pc.gov.au/inquiries/current/financial-system/draft/>.

[23] APRA proposes to define an SME as a business that has annual group sales of less than $50 million: see APRA, above n 20, 10.

[24] APRA, above n 20, 10.

[25] Ibid.

[26] APRA, *Discussion Paper: Revisions to the capital framework for authorised deposit-taking institutions* (14 February 2018), 8, <http://www.apra.gov.au/adi/PrudentialFramework/Documents/Revisions%20to%20the%20capital%20framework%20for%20ADIs.pdf>.

[27] Australian Tax Office (ATO), 'Crowdfunding', <https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding/#Typesofcrowdfunding1>; see also PC, above n 11, 129.

Figure 2: Types of crowd-source funding

Donation based crowd-source funding	A contributor makes a payment to the project or venture, without receiving anything in return.
Reward based crowd-source funding	A promoter provides a reward (goods, services or rights) to contributors in return for their payment.
Equity based crowd-source funding	The contributor makes a payment in return for a share (or equity interest) in the company undertaking the project or venture.
Debt based crowd-source funding	The contributor lends money to the promoter (or pool of promoters) who, in return, agrees to pay interest and repay principal on the loan.

In 2017, Federal Parliament legislated to allow public companies to undertake equity crowd-sourced funding.[28] The Parliament is considering a Bill that proposes to allow for crowd-sourced equity funding for proprietary companies.[29]

[28] *Corporations Amendment (Crowd-sourced Funding) Act 2017* (Cth).

[29] Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr5984%22>

FinTech is a term that captures the use of emerging technologies to bypass incumbent financial service providers. The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) has recognised that FinTechs have the capacity to disrupt traditional financing models by:

> [using] *technology and innovative business models to originate, assess credit risk and fund loans – with easy application processes and quicker turnaround times.*[30]

The ASBFEO commissioned a survey in 2017 that measured the status of the FinTech sector in Australia. The report in response to that survey noted that, in 2014, there were fewer than 100 FinTech companies in Australia, but by 2018 there were 579.[31] That Report also found that, in 2016, there was $656 million invested in FinTech companies in Australia.[32]

5. Types of financial services utilised by SMEs

There is limited information available about the range of financial services used by SMEs, and how those financial services differ from financial services typically used by consumers. On the basis of available information and data, however, some of the unique ways SMEs interact with financial service providers is outlined below.

5.1. SME finance

No data specifically relating to the provision of finance to SMEs has been identified. However, the Reserve Bank of Australia ('RBA') holds some statistical information on lending by size of commitment, and interest rate charged to smaller businesses relative to larger businesses. If an inference is made that smaller businesses are more likely to have smaller loan facilities, this information may provide an indication of the size and typical terms of SME lending in Australia.

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30 Australian Small Business and Family Enterprise Ombudsman (ASBFEO), Fintech lending to small and medium sized enterprises: Improving transparency and disclosure (28 February 2018), 15 <http://www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-fintech-report.pdf>.

31 Ibid 8.

32 Ibid.

Table 4 shows average interest rates charged to businesses by banks for types of loan facilities under $2 million, and loan facilities for $2 million or more as at December 2017.

Table 4: Business loan facility interest rates by facility size, December 2017

	Variable-rate	Fixed-rate	Bills	Average
		Per cent		
Facility below $2 million	5.70	5.25	4.05	5.30
Facility $2 million or more	3.55	3.55	3.30	3.45

Source: RBA, Table D8: Bank Lending to Business – Selected Statistics (December 2017)

Table 4 shows that smaller loan facilities typically face higher interest rates than larger loan facilities. If an inference were drawn that SMEs are more likely to utilise smaller loan facilities, then it would follow that SMEs generally face higher interest rates.

The RBA also provides data on the amount of business lending outstanding by facility size. That data is set out in Table 5.

Table 5: Bank lending to business outstanding by facility size, December 2017

	Under $100,000	$100,000 to less than $500,000	$500,000 to less than $2 million	$2 million and over	Total
Value of lending ($'m)	11,297	99,637	149,040	750,179	1,031,571
Per cent of all business lending	1.1%	9.7%	14.4%	72.7%	100.0%

Source: RBA, Table D7.3: Bank Lending to Business – Total Credit Outstanding by Size and by Sector (December 2017).

Table 5 shows that the vast majority of business lending by banks is provided via facilities in excess of $2 million. Again, if an inference was made that smaller businesses were more likely to have small loan facilities, the data in Table 5 indicates that the majority of bank lending to businesses is made to non-SMEs.

Lending to businesses, including SMEs, may also be structured differently to consumer lending, particularly because of taxation considerations. For example, finance for vehicles used in business may be structured as a chattel mortgage, not as a finance lease, as this may achieve a more desirable taxation outcome (particularly in relation to GST) than a leasing arrangement.[33]

Banks are the main source of lending for businesses in Australia, with 90.5 per cent of commercial finance commitments in January 2018 being made via banks.[34] However, in relation to commercial leasing, general financiers are the dominant source of funds; comprising 35.3 per cent of commercial leasing finance commitments in January 2018.[35]

5.2. Trade credit

Trade credit is a form of revolving lending over inventory or other supplies held by a business. Trade credit may arise from deferred settlement terms extended by suppliers of inventory (business-to-business lending), but may also be financed by a revolving line of credit from a bank or other lender.[36]

The terminology used to describe such facilities varies between industries. For example, in the automotive industry the term ‘floorplan finance’ is common,[37] while in other industries such facilities may be referred to as a ‘floating charge,’[38] or simply a trade finance facility.

The RBA has found that ‘[r]evolving credit lines are particularly suited to financing short-term production and inventory investment given their flexibility and convenience.’[39] Revolving lines of credit typically allow the borrower to repeatedly drawdown, repay and re-borrow funds on an indefinite basis.[40]

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[33] ATO, ‘GST Issues Register: Hire purchase agreements and chattel mortgage,’ (2 May 2013), website, <https://www.ato.gov.au/Business/GST/In-detail/GST-issues-registers/Financial-services---questions-and-answers/?anchor=Hirepurchaseagreementsandchattelmortgage#Hirepurchaseagreementsandchattelmortgage>.

[34] ABS, *5671.0 Lending Finance, Australia*, (14 April 2018), <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5671.0January%202018>.

[35] Ibid.

[36] G La Cava, *Research Discussion Paper: Inventory Investment in Australia and the Global Financial Crisis*, (November 2013) Reserve Bank of Australia, 5 <https://www.rba.gov.au/publications/rdp/2013/pdf/rdp2013-13.pdf>.

[37] Ibid 11, citation omitted.

[38] G Udell, ‘SME Access to Intermediated Credit: What Do We Know and What Don’t We Know?,’ Small Businesses Conditions and Finance Conference, Sydney, 19–20 March 2015, ‘note 21.’ 75 <https://www.rba.gov.au/publications/confs/2015/pdf/udell.pdf>.

[39] La Cava, above n 37, 6.

[40] Ibid 5–6.

5.3. Cashflow finance

Factoring and invoice discounting are ways that a business may quickly realise the value of outstanding customer debts by entering into an arrangement with a third party for that third party to finance part of the outstanding debt immediately. In effect, both methods are a form of lending against the expected cashflow of a business. The RBA noted the distinction between factoring and invoice discounting as follows:

> *Invoice discounting is where a financial institution (the factor) lends to a business against the security of its trade receivables (typically up to 80 per cent of the value of the receivables) at rates similar to an overdraft facility. When the receivable is paid, the loan is repaid. Factoring is the same, except that the factor takes an active role in collecting trade payments.*[41]

Information on the level of use and costs associated with factoring and discounting in Australia is scarce. A survey conducted by the ASBFEO in 2017 found that, of the businesses surveyed, only 10 per cent utilised invoice external finance, invoice factoring and debtors insurance to combat late payments.[42]

Currently, the ASIC Corporations (Factoring Arrangements) Instrument 2017/794[43] exempts factoring arrangements from some of the requirements that would otherwise apply under the *Corporations Act 2001*.

5.4. Payment systems and merchant fees

Businesses are charged fees, known as ‘merchant fees’, to access payments systems. A payment system is a system of concluding transactions that is approved by the Payments System Board of the RBA. There are various payments systems that have been approved by the Payments System Board, such as EFTPOS, MasterCard and Visa.[44]

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41 RBA, ‘Recent Developments in Small Business Finance,’ *Reserve Bank of Australia Bulletin*, (February 2002), 58 <https://www.rba.gov.au/publications/bulletin/2002/feb/pdf/bu-0202-2.pdf>

42 ASBFEO, *Payment Times and Practices Inquiry Working Paper 3: Analysis of Survey responses* (April 2017), 27 <http://www.asbfeo.gov.au/sites/default/files/ASBFEO_WP3.pdf>.

43 ASIC Corporations (Factoring Arrangements) Instrument 2017/794 <https://www.legislation.gov.au/Series/F2017L01198>.

44 See, for example: RBA, ‘Designation of Credit Card Schemes in Australia’ (12 April 2001), media release <https://www.rba.gov.au/media-releases/2001/mr-01-09.html>.

The PC's *Draft Report into Competition in the Australian Financial System* found that:

> *Card payment systems are dominated by the major banks (as the issuers of over 70% of Australia's debit and credit cards), and the global card schemes, MasterCard and Visa (which enable over 80% of credit card payments).*[45]

Some businesses and representative bodies have noted the cost pressures imposed by payment systems, which may disproportionately impact SMEs that lack economies of scale.[46]

In 2016, the Parliament enacted the *Competition and Consumer Amendment (Payment Surcharges) Act 2016*.[47] That amending Act made changes to the *Competition and Consumer Act 2010* to limit credit card payment surcharges. As a result of the amendments, section 55B of Part IVC of the *Competition and Consumer Act 2010* prescribes that payment surcharges must not be 'excessive,' as defined by the regulations or RBA standard.[48]

Following these reforms, merchants retain the right to impose a cost-based surcharge on card payments, but any surcharge is limited to the amount it costs the merchant to accept that type of card for that transaction.[49]

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45 PC, above n 22, 25.

46 See, for example: Australian Retailers Association, *Submission to the Productivity Commissions Inquiry into Competition in the Australian Financial System* (March 2018), 3 <http://www.pc.gov.au/__data/assets/pdf_file/0003/226668/subdr113-financial-system.pdf>.

47 *Competition and Consumer Amendment (Payment Surcharges) Act 2016* (Cth).

48 *Competition and Consumer Act 2010* (Cth), Part IVC, s 55B.

49 RBA, '*Questions &Answers: Card Payments Regulation: Surcharging – General*,' <http://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/q-and-a/card-payments-regulation-qa-conclusions-paper.html>.