

Ai GROUP SUBMISSION

Productivity Commission: competition
in the Australian Financial System

APRIL 2018



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About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak employer association which together with partner organisations represents the interest of 60,000 businesses employing more than 1 million Australians. Ai Group members are from a broad range of industry sector including manufacturing; engineering; construction; food and beverage processing; transport and logistics; information and technology; telecommunications; labour hire; and defence. Ai Group is a leading advocate for good government policy that is in the best interest of business and the community.

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Australian Industry Group contact for this submission

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1. Summary and recommendations

Ai Group welcomes the opportunity to provide feedback on the Productivity Commission's draft report on *Competition in the Australian financial system* (Jan 2018).

We particularly welcome this timely follow-up on the recommendations of the Murray Review into Australia's financial system (2014). Ai Group participated in the Murray Review in 2014. Our first and second submissions to that review are attached in full. In our first submission to the Murray Review, Ai Group focused on industry's access to finance, for both bank-intermediated lending to small and medium enterprises, as well as early-stage financing. In our second submission, we focussed on superannuation entitlements.

In our first submission to the Murray Review (2014), Ai Group recommended:

- the panel examines any barriers or policy settings that may disadvantage smaller and foreign lenders from competing in the business lending market;
- the panel assesses the risks to competition if there was a weakening in the "four pillars policy", which prevents mergers between Australia's largest four banks;
- the panel investigates the barriers for private investment in public infrastructure, and makes recommendations on how governments could better deliver projects to ensure greater participation by local sources of funding including superannuation funds;
- the panel explores the value of the deposit guarantee to banks, and if an appropriate pricing mechanism exists to recoup some of the benefit provided to banks.

On venture capital, Ai Group recommended:

- that the panel examines ways to simplify and harmonise existing support for venture capital to better address failures in the market providing venture capital and to accelerate the deepening of the domestic venture capital market;
- the panel examines and amend other government policies across portfolios that may unnecessarily discriminate against venture finance, including taxation, migration and corporations law;
- following from the above recommendation, that the panel examines the case for amending the existing "significant investor" visa to be open to venture capitalists;
- the panel examines employee share schemes arrangements, which may be discouraging local innovators from producing locally.

Ai Group would like to see further progress made in implementing these recommendations.

2. The role of financial market development in Australia's business environment: latest evidence

Each year the World Economic Forum (WEF) produces the Global Competitiveness Index (GCI), which tracks over 100 indicators. By establishing a common framework and comparable data on an annual basis, the Report draws attention to the long-term determinants of productivity, growth, income levels, and well-being. Ai Group is the WEF's Partner Institute for the GCI in Australia.¹

One of the 12 'pillars' that comprise the GCI is 'financial market development'. This in turn is built from a set of eight individual indexes, constructed from a range of data and survey-based sources:

1. Availability of financial services
2. Affordability of financial services
3. Financing through local equity market
4. Ease of access to loans
5. Venture capital availability
6. Soundness of banks
7. Regulation of securities exchanges
8. Legal rights index

Collectively, these indicate that as of 2017-18 (latest year available), Australia scored 5.5 points out of a possible 7 points for our financial market development and ranked 6th best globally in this pillar. Within this pillar, Australia scored and ranked very highly for the 'soundness of banks' (6.5 out of 7 points and 4th best), the 'Regulation of securities exchanges' (6.0 out of 7 points and 7th best) and the 'legal rights' index (4th best).

Australia's scores and ranks on the other indexes within the 'financial market development' pillar are less impressive in 2017-18 and over a longer period, acting as a drag on Australia's competitive business environment. The WEF results for 2017-18 suggest Australia must seek improvement in each of these indexes of relevance to this review:

- Availability of financial services (score of 5.1 out of 7 points and ranked 26th best)
- Affordability of financial services (score of 4.3 out of 7 points and ranked 38th best)
- Financing through local equity market (score of 5.2 out of 7 points and ranked 14th best)

¹ Further information about the WEF, the *Global Competitiveness Report 2017-18* and the WEF's global partner institutes is available at: www.weforum.org. Ai Group's summary of Australia's results for 2017-18 and previous years is available at: www.aigroup.com.au/policy-and-research/economics/economicsresearch/

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- Ease of access to loans (score of 5.0 out of 7 points and ranked 15th best)
- Venture capital availability (score of 3.4 out of 7 points and ranked 40th best).

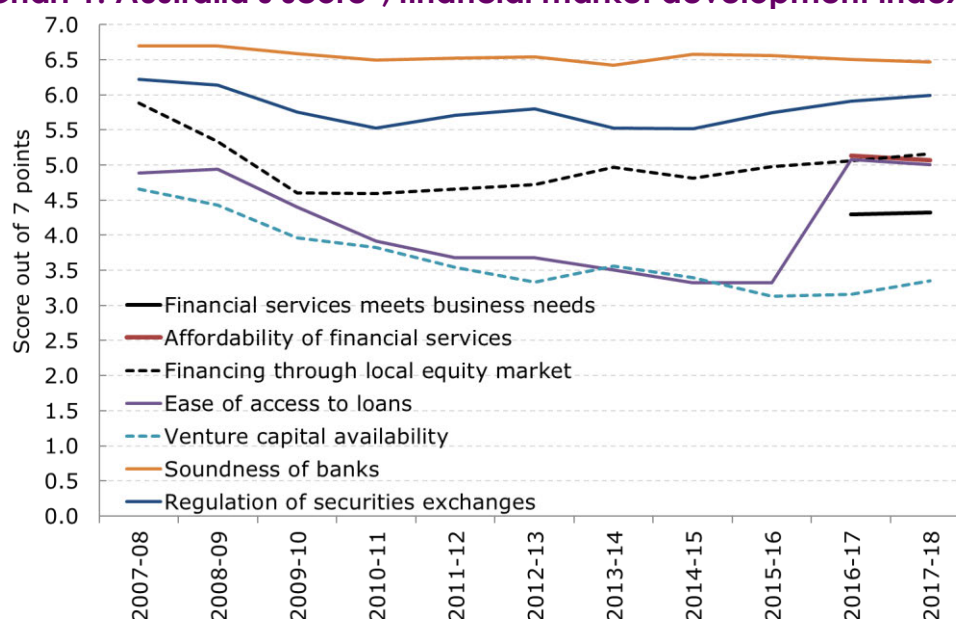
These data are available on a consistent basis since 2007-08. The scores for these indexes indicate changes in Australia's *absolute* performance on each index over time, while the rankings indicate changes in Australia's *relative* performance over time.

Australia's scores confirm that 'venture capital availability' remains a particular area of weakness in Australia's financial market environment for business. This was highlighted by the Murray Review and appears to have remained an area of weakness, with little or no improvement visible over the past decade (chart 1). Australia's ranking for 'venture capital availability' indicate an even bigger deterioration in relative performance, because other countries have improved and grown their venture capital availability over the same time period (chart 2).

Australia's score and ranking for 'ease of access to loans' for businesses deteriorated between 2007-08 and 2015-16 but both the score and the rank improved markedly in 2016-17 and 2017-18. This suggests access to business-related loans has improved in Australia in the past two years.

A new index that seeks to measure the availability of financial services that 'meets business needs' was added to the GCI in 2016-17. This new index indicated a lower score and ranking for Australia than most other financial market development indicators in 2016-17 and 2017-18 (charts 1 and 2).

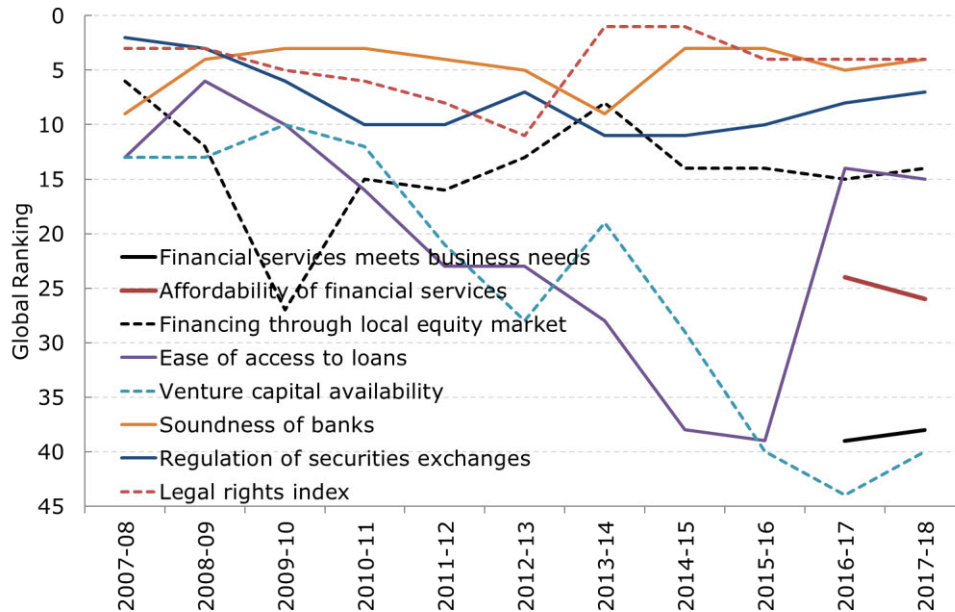
Chart 1: Australia's score*, financial market development indexes



* score of 1 to 7 points out of a possible maximum of 7 points.

Source: World Economic Forum and Ai Group.

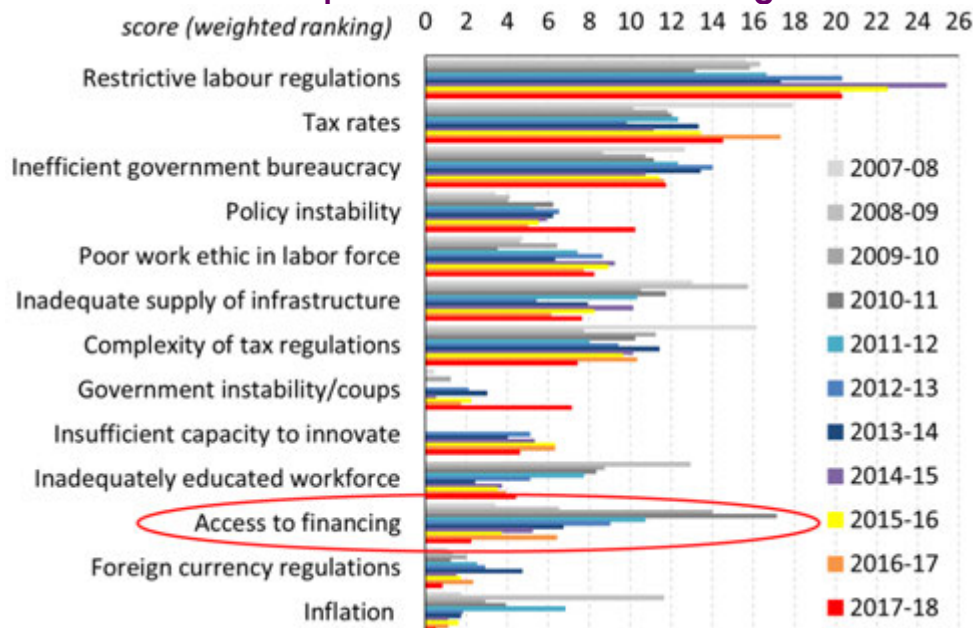
Chart 2: Australia's global ranking, financial market development indexes



Source: World Economic Forum and Ai Group.

In a separate section of the GCI data series, business leaders in all countries are asked to identify the 'most problematic factors for doing business in your country'. In Australia, factors relating to labour flexibilities and taxation arrangements have generally scored the highest as problematic factors over the past decade (chart 3). 'Access to finance' is one of the many other options available as an answer. It scored highly as a problematic factor in 2009-10 and 2010-11 in the aftermath of the GFC, but even then, it was not the first or even the second highest ranked problem. Since then, access to finance has receded as a problem for Australian business, relative to other issues.

Chart 3: Most problematic factors for doing business in Australia*



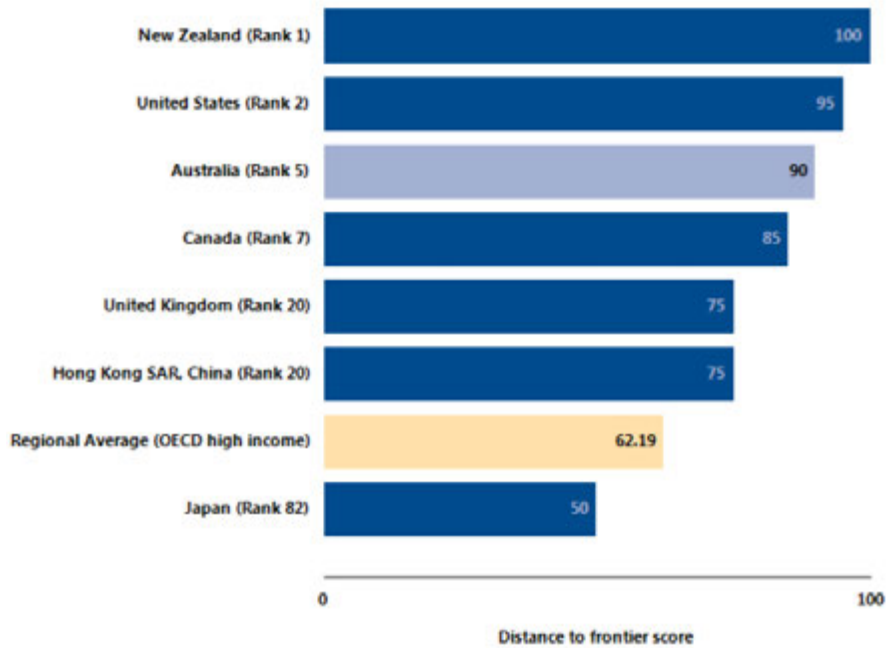
* From this list of factors, respondents were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5 (least problematic). The score corresponds to the responses weighted according to their rankings. Source: World Economic Forum and Ai Group.

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The World Bank's 'Doing Business' data series indicates similar results to the WEF for Australia. In 2017, the World Bank ranked Australia as the 5th best country (of 190 countries) with regard to the 'ease of getting credit' for business. The World Bank found that New Zealand was the world leader on this measure in 2017, with the US coming a close second (chart 4).

Within this measure, the World Bank gave Australia a score of 7 out of 8 points on the depth of credit information index and a score of 11 out of 12 points on the strength of legal rights index. Higher scores indicated more credit information and stronger legal rights for borrowers and lenders.

Chart 3: Ease of getting credit by business, global rankings



Source: World Bank, *Doing Business 2017, Equal opportunity for all, Economy profile: Australia*.

3. Ai Group responses to draft report recommendations

Draft recommendations 9.1, 10.4 and 10.5 (listed below) have potential to materially improve credit services and financial transaction services for Australian businesses. Ai Group supports these three recommendations.

DRAFT RECOMMENDATION 9.1 STANDARDISED RISK WEIGHTINGS FOR SME LENDING

Instead of applying a single risk weight to all small and medium business lending not secured by a residence, the Australian Prudential Regulation Authority (APRA) should provide a broader schedule of risk weights in its Prudential Standard APS 112.

It should take into account the different risk profile and the type of lending (such as the value of the loans made to an individual business and alternative forms of loan security including commercial property and differing loan to value ratios on this security) to better reflect the Basel Committee's standardised risk weightings. International best practice should be closely considered.

In light of apparent major improvements in the use of Artificial Intelligence algorithms and data collection via the new payments platform, APRA should consider proposals by ADIs for variations to the standardised risk assessment for business lending, based on their data and risk management systems.

DRAFT RECOMMENDATION 10.4 MERCHANT CHOICE OF DEFAULT NETWORK ROUTING

Merchants should be given the ability to choose the default network to route contactless transactions for dual-network cards. As the technology is readily available, this option should be offered from 1 January 2019 at the latest.

The Payments System Board should require that neither a scheme, nor any of its participants (including issuers and/or acquirers), can prevent merchants from setting (or asking their acquirers to set) the default route.

DRAFT RECOMMENDATION 10.5 ACCESS REGIME FOR THE NEW PAYMENTS PLATFORM

The New Payments Platform (NPP) is a significant piece of national infrastructure that can benefit competition in retail banking and payments. But more transparency is needed to facilitate third-party access. The NPP should be subject to an access regime imposed by the Payments System Board.

As part of an access regime, the Payments System Board should:

- review the fees set by participant entities of the NPP and transaction fees set by New Payments Platform Australia
- require all transacting participant entities that use an overlay service to share de-identified transaction-level data with the overlay service provider
- consult the Australian Competition and Consumer Commission on the final design of the data sharing obligations.