# Has Business Credit Turned – The SME Markets ???

## Bank GFC Behaviour Drives Credit Demand

### The Big Chill

Self-evidently the GFC delivered Australian domestic business lenders the ability to aggressively re-price their lending books using both price and security and significantly enhance margins using a common mantra of properly valuing the risk of that lending. The second argument used by providers has been the rise in their own cost of funding, especially significant given the dependence on offshore and wholesale markets for banks to fund their lending. Nearly catastrophic consequences flowed from this:

- Borrower perceptions of these arguments quickly took the view that credit was either unavailable or seriously constrained and they were fighting for a limited pool of debt

- As the banks worked their margin enhancement, demand for business credit plummeted

Although parallel patterns emerged market wide, they have been most dramatic in the SME segment [(1)]:

| Exhibit 1 | Apr 08 | Oct 09 | Apr 09 |
|---|---|---|---|
| Increased Interest Rate on Bank Borrowings (last 6 months) (% of SMEs) | 33.1 | 59.3 | 68.8 |
| Upward Re-Pricing Rate (% Change) | 2.4 | 2.2 | 2.8 |
| And led directly to depressed demand for credit: Planned New Borrowings (% of SMEs) | 77.1 | 65.0 | 51.1 |

### The Big Change

As the major domestic business lenders have started emphasising they are open for business and the Australian economy pulls away from its very shallow "recession", these trends are quickly reversing:

| Exhibit 2 | Oct 09 |
|---|---|
| Increased Interest Rate (last 6 months) - (% of SMEs) | 31.2 |
| Upward Re-Pricing Rate - (% Change) | 3.1 |
| Planned New Borrowings - (% of SMEs) | 58.3 |

Power appears to be again swinging back to the quality business borrower, with frightened lenders now openly competing amongst themselves for cynical business customers. Highlighted in recent Research Notes, this competitive resurgence (a) remains pretty much confined to a game between the Big 4 domestic providers, (b) is occurring within an environment of manic competition for deposits and (c) a real and immanent customer churn build up waiting on a disruptive market event for the floodgates to open.

East's NPS and customer satisfaction measures continue to show zero advocacy taking place (plenty of detraction) amongst business customers, although we do expect to see these improve providing lenders can deal with the fall out caused by their margin enhancement behaviour over the past year and a half. With a modest average Debt Ratio of 31.2% [(2)] for SME and Middle Market companies, these customers are well poised to take advantage of re-opening credit markets and bank debt.

Business credit demand has clearly turned a corner and is re-challenging lenders to deliver constructive value to their businesses and needs, left fallow over the past 18 months.

(1) East & Partners, SME Banking Markets program, 2008 and 2009
(2) PricewaterhouseCoopers, Private Business Barometer, October 2009

BANKING • RESEARCH • ADVISORY • STRATEGY

March 2010