

Euro debt crisis – impact on Australian SMEs

For many months the mainstream media in Australia has covered the “European debt crisis” in detail on a daily basis, with concerns about the ability of the Greek government (and more recently other European majors including Italy) to meet its obligations.

Alarmists warn that the US may follow suit and the downgrading of its credit rating by Standard & Poors a few months ago was an early signal.

It sounds gloomy, but what does it really mean for SME operators’ businesses in Australia?

How does it affect Australia?

There are two primary issues that Australian businesses using bank funding for working capital and growth purposes could face.

Firstly, that the cost of funds will likely rise, meaning that the recent downward trend in the RBA cash rate cannot be relied upon as an indicator of funding costs for businesses. Secondly, and worse still, that the availability of funding may dry up - the latter has already been an issue for many small businesses since the onset of the Global Financial Crisis, but it may well get worse.

Why such a dire view? Well, our banks don’t borrow funds from the RBA to lend to their customers, so the RBA cash rate doesn’t represent the cost of funding paid by those banks.

At present, deposits into Australian banks are insufficient to satisfy the borrowing requirements of Australian businesses and individuals, so the banks have to borrow the difference from international wholesale markets – somewhere in the order of 33 cents in every dollar they lend.

To put this in context: a recent report indicates that the major Australian banks will need to borrow around \$100 billion dollars over the next 12 months. \$100 billion!





If the banks were to borrow these funds over a short term, the cost might be a bit cheaper, but (especially when dealing with such big numbers and the associated risks) the banks like to lock in their funding requirements over a longer term.

The problem is that when the outlook over that longer term is grim, the rate that the banks have to pay on those borrowings will be higher – regardless of what the RBA may do with cash rates. Frankly, right now the banks are only following the RBA for political and public relations reasons, but this is fast running out of mileage and a delinking of bank lending rates and the RBA cash rate is almost certain.

Funding availability is a much bigger concern, however.

With Australian banks so heavily reliant on international wholesale funding markets, and with those markets currently almost starved of liquidity as a consequence of the debt crisis, access to cash for our banks is not as assured as some may think. Combine with this an apparent preference from a number of the banks to use the available funds for home loans, and the availability of funding for businesses is likely to tighten.

Implications for SME operators

For any industry reliant on debt funding (such as for equipment purchases and/or funding of working capital), any threat to the cost or availability of funding should be taken very seriously.

Business owners and managers simply cannot take for granted that their bank will be there to fund the needs of the business ad infinitum.

Lessons for Australian SME owners and managers:

- Don't expect banks to continue to cut rates in line with RBA cash rates.
 - Whilst these will generally follow a similar trend, there are many more factors at play in determining the interest rates on offer from the banks.
 - Expect that any current margin competitiveness from the banks may be wound back. As the banks become more nervous about the security and cost of their funding, expect them to hold onto any gains, rather than passing them on to borrowers.
- Look to fund your bank debt on a longer term basis to protect as best possible against short term illiquidity in the credit markets, even if there is a price premium involved. There is nothing more valuable in business than certainty.
- Be aware that this will also impact your customers – be cautious with the credit you give and manage your receivables tightly.



SME insights



Issue 13

February 2012

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- Provide advice on debt restructuring.
- Assess risk areas and project management mitigation strategies.
- Conduct customer and supplier due diligence, to identify and manage exposure to those industries.
- Consider and report on restructuring options.
- Act as voluntary administrator.

If you are an advisor or financier to an SME, Ferrier Hodgson can:

- Conduct business reviews to identify potential areas of exposure.
- Provide pre-insolvency consulting advice.
- Consider restructuring options (debt and/or operational).
- Assess exit opportunities.
- Act as receiver/receiver and manager for secured lenders if recovery strategies are required.

Regards

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