Australian royal commission reveals predatory bank lending to small businesses

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The ongoing royal commission into financial services has underscored the predatory practices of Australia's banks and financial institutions, and the dire impact they have had on workers and mortgage-holders, farmers, small businesses and franchisees.

Hearings over the past two weeks have shown that some of the country's largest banks hit farmers in financial distress with asset fire-sales, abrupt business and property re-evaluations and foreclosures. In some cases, farmers were forced off their property, despite having never missed a mortgage repayment.

The testimony followed earlier sessions of the commission, in May and June, focusing on relations between the banks and small business owners. Despite having received almost 300 written submissions, that section of the inquest lasted just several weeks and heard from a handful of affected individuals.

This was in line with the perfunctory character of the commission as a whole. It was called by the federal Liberal-National Coalition government in an attempt to assuage widespread public anger over the practices of Australia's banks, which are among the most profitable in the world. The commission will issue a series of toothless recommendations, which the banks will be largely free to ignore.

The hearings nevertheless made clear that providing dubious loans to franchisees and small business owners that threaten to financially cripple them, is integral to the business model of the major banks and financial institutions. They showed that financial advisors and bank representatives are trained to push loans, even when clients have little chance of repaying them.

A number of the submissions to the inquiry were from former franchisees. Media reports over the past year have shown that franchisees, who purchase the rights to operate a business outlet from a parent company, are frequently forced to work grueling hours, without making any profit.

In May, a submission to the federal Senate inquiry into franchises claimed that many of the franchisees of 570 Red Rooster, Oporto and Chicken Treats fast food stores are on the verge of bankruptcy. It claimed that this was the result of an unviable business model and operating restrictions imposed by the parent company, which is owned by private equity firm, Archer Capital. Similar reports have emerged at dozens of other franchise chains.

Marion Messih, who was among the franchisees to testify to the banking royal commission, took out a loan from Westpac to buy a Pie Face food store in Melbourne with a business partner. She stated that the business rarely made more than $500 per week. It was forced to close after a renovation to the shopping centre it was in, and the collapse of the Pie Face franchise.

When the business ended, Messih had intended to sell an investment property to raise the $165,000 outstanding on her portion of the loan and settle personal debts. Her former business partner, however, did not pay her share. Westpac demanded that the proceeds of Messih's property sale go to the entire loan, which was more than double her share. The Financial Ombudsman Service later found that Westpac should not have given the loan in the first place.

Suzanne Riches, an Adelaide school teacher, testified that she took out a loan from the Bank of Queensland to buy two Wendy's ice cream stores. The initial terms that she had agreed to were for a $280,000 loan with monthly repayments of $4,420 over seven years.

Just prior to the finalisation of the agreement the bank demanded that Riches agree to a three-year loan for the same amount, resulting in a doubling of her monthly repayments. She said that she did not feel that she had a choice, stating: “The cooling off period had elapsed ... I had no way to get out of the contract. There were threats of legal implications. I sort of felt I was in a no-win situation.”

Riches was unable to service the debt. She was forced to close the stores, and sell her own block of land.

In another case, Westpac allowed a woman to take out a loan to buy a pool service franchise, using her mother’s home as security, despite the fact that she was a blind disability pensioner suffering cancer and other medical conditions.

Carolyn Flanagan testified that she had not been able to read the documents, tying her loan to the business, when they were presented to her. She said she thought she was only guaranteeing $50,000 of the $165,000 loan. When the business failed, Westpac demanded that Flanagan surrender her home.

During the hearing it emerged that the bank knew little about the pool service business, including its financial plan, proposed staff and position in the market. While examining a Westpac representative, counsel at the commission noted it was unlikely the bank would have given a loan without conducting any due diligence, had Flanagan’s house not been provided as a guarantee.

Other small business owners, not involved in franchises, also testified. In 2008, Suzi Burge and her husband applied for a business loan to expand their Tasmanian crafts business and premises. The Commonwealth Bank gave conditional approval to a 30-year loan with a 7.5 percent interest rate. They altered the terms, before finalisation, making it a 15-year agreement, with a 9.5 percent interest rate.

Burge was drowning in debt, and unable to service the loan. She claims to have offered to sell an investment property to settle it. Instead, the bank sold the commercial property at well under its earlier valuation. In 2012, the Financial Ombudsman Service found the bank was “guilty of maladministration in lending.” Burge’s marriage collapsed and she lost her home.

The banking practices documented at the commission underscore the fragility of the Australian economy, and the deepening social crisis afflicting broad layers of the population. Amid worsening global headwinds, debt has soared, with the national debt-to-income ratio approaching 200 percent, one of the highest figures in the world.

There is widespread speculation among financial analysts that the slowdown in house prices in Sydney and elsewhere, may mark the beginning of the unravelling of the country’s property bubble, which has been fuelled by rampant speculation. Any shocks would inevitably force many more small business people over the financial precipice.