

SMALL BUSINESS NOT BANKING ON MERGERS

An address to

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by

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Thank you very much for the invitation to address such a distinguished audience on a controversial and important public policy issue -- the proposed mergers involving four of Canada's largest banks. As I'm sure everyone here is very much aware, if approved, the Royal Bank of Canada would become one with the Bank of Montreal, while the Canadian Imperial Bank of Commerce would join forces with the Toronto-Dominion Bank. The fact that this is a vital issue for the Canadian financial sector and the business community as a whole may be the only thing I say here today that the bankers and small businesses can agree upon.

To provide some context for the small business perspective on bank mergers, it is important to examine the entire small business-banking relationship over the years. It has often been stormy, and is always complex. If there are any bankers in the audience today, and I suspect that there are, I'm glad you are sitting down as what I am about to say may surprise some of you. The independent business sector and the organization I am proud to represent is not anti-bank. To the contrary, we want the banks to be better. Throughout the 27-year history of the Canadian Federation of Independent Business, this has always been our objective. I admit that the reasons for this are self-serving, since a better banking system greatly helps small business owners in a number of ways, from obtaining start-up loans to get going, to credit lines to keep going, to term loans and other bank services to help along the way. A weak and vulnerable banking system is not in the best interests of small business owners, or Canadians as a whole.

The truth is that we want banks to keep getting better and better. We want their shareholders to do well and their thousands of employees not to worry about their job security. So what we are dealing with here is not a personality clash as much as a culture clash between two business forces which in so many ways couldn't be more different if they tried.

Bankers work in large bureaucratic institutions, and have to date enjoyed a very protected position in the Canadian marketplace. On the other hand, small business owners operate in extremely competitive markets, usually have personal assets on the line as well as business assets, and do not easily conform or relate to the operation of a large bureaucracy. In addition, entrepreneurs are by their very nature risk takers. If they weren't, chances are they would never

have started a business in the first place. Small business owners tend to be optimistic, individualistic and impatient. Bankers, conversely, tend to be risk averse. Their cultures encourages them to be nervous and discourages them from going out on a limb by making independent decisions, especially when it concerns such matters as credit lines and loans. Another difference is that small business owners are not uncomfortable with a certain amount of business chaos or uncertainty. By comparison, small business often views banks as massive bureaucratic structures which move at the pace of a receding glacier from the ice age. And as their decision-making slowly melts through the layers of bureaucracy, the outcome all too frequently has been demands for unreasonable amounts of collateral and high service charges.

That being said, there is no doubt that some of this built-in tension is constructive in that it serves to keep both sides on their toes. We appreciate that bankers are not in the business of charity, and small businesses certainly relate to the concept of a fair and reasonable rate of return for financial services. It is, however, the degree of fairness and the level of expertise, or the lack thereof, which become the sticking point in this sometimes contentious relationship.

These issues have come to a head recently since the Canadian financial services industry is currently under the microscope from a number of vantage points, and appropriately so. Pressure for change in this industry, as with virtually all industries, is being driven by technology and global competition. Something everyone can likely agree on is that the status quo is not an option. What is at issue is how to manage the inevitable and significant change in the best interests of all stakeholders -- the financial institutions themselves, shareholders, depositors and other consumers of financial services. It is also important to realize that, despite this climate of change, and especially that which is technology-driven, there remains within the banking sector a culture which is strongly change-resistant.

For example, the issue of small business financing has always been, and will likely continue to be, a matter of some controversy. Financial institutions -- notably the Big Five which dominate small business financing in Canada -- continue to claim they are doing all they can to help small

firms obtain appropriate financing, while many small business owners claim exactly the opposite is true. Which side has the best chance of winning this argument which takes place many times every day all over the country? The facts clearly show it is not small business, as a difference of opinion between the two sides is much more likely to be resolved in the banks' favour, regardless of who is really in the right. The power imbalance between a big bank and a small business is enormous, and that is unlikely to ever change.

Despite this reality, I would suggest both bankers and small businesses work together in the days ahead to improve this situation, as it is in both our interests to do so. But it won't be easy, and to appreciate why I say that, it is necessary to understand how history has contributed to the distrust and scepticism within the small business community with regard to the banks.

Data collected by CFIB over the last 20 years clearly illustrate that the availability of financing has always been a concern for small firms, and that concern has become greater over the past decade. The proportion of small businesses reporting problems with obtaining financing hovered around 20 per cent throughout the 1980s, and jumped to almost 40 per cent during the recession of the early 1990s. It has only fallen back to about 30 per cent in recent years although we have enjoyed a more robust economy. And the news doesn't get any better when we take a look at what has gone on in the critical areas of loans. Despite bank protestations to the contrary, the absolute dollar amount of loans outstanding to small business -- based on loan limits under \$200,000. -- has remained roughly flat over the last decade at about \$17 billion, dipping somewhat during the last recession. In fact, loans to small firms have just recently achieved their pre-recession peak even after several years of decent economy growth. During this same period, amounts outstanding to larger businesses -- defined as loans greater than \$200,000. -- have grown from about \$60 billion to about \$84 billion. These trends would suggest that the increasing concerns of small businesses are well-founded, as loans to smaller firms have simply not grown with the economy in this decade. That is an indisputable fact.

I want to get deeper into some of the recent history which helps to further explain why there are

valid reasons for a less than smooth working relationship with the banks much of the time, and how large a gap there is to bridge before progress can be made.

Increased automation and the adoption of new technology by financial institutions has contributed to more centralization of decision-making. This has meant less authority in the hands of the local banker, who has always been in the best position to know whether the business owner is a good credit risk. Individual account managers frequently express frustration to our members about their being overruled by central decision makers. Automation has also led to branch closings and other cutbacks in service when a full service branch is replaced by ATMs. It is certainly true that some services can be provided very well electronically, but small firms still need the physical presence of a bank for other essential services. To compound the situation, the closing of branches has also meant that the number of banking options available for small businesses in many communities has been reduced. Our own research shows that 9 per cent of our members currently have access to only one bank, and another 13 per cent have the option of dealing with one additional institution. The nasty kicker to all this is that research has also shown that having little if any choice in banks clearly translates into higher costs of financial services for small businesses, and more difficulty in accessing credit. When the data are broken down by province or industry sector, the extent of concentration in the hands of one or two institutions gets even worse. If these numbers are bad now, they would certainly not get better in a post-merger world that has three major banks instead of five.

More technology in banking is not only important, but necessary and inevitable, so there is no resistance from small firms on this front. Indeed, small firms have generally been keen to embrace technology when it better their business prospects in some way. We have done considerable research on this topic, which can be found on the CFIB website at www.cfib.ca. And just for the record, for those of you who have been enjoying my remarks today so much you can hardly wait to read them again, or if you may have dozed off and want to see what you missed, this speech will be up on our site when you return to work this afternoon.

But technology, as I'm sure we can all agree, is here to stay. This being said, one of the major oversights of the banks over the past three decades has been the steady reduction of authority at the local branch level. There was a time when the local branch manager remained in the branch long enough to really know the customers, both business and otherwise. The manager was an integral part of the community, and he or she alone had considerable authority to make critical life or death decisions for a business.

This has changed drastically in recent years. For a small business customer, the rapid turnover of account managers is one of the greatest flaws in the banking system today. It is a major source of irritation among small businesses, as owners are repeatedly having to bring yet another new banker up the learning curve of their business. CFIB research has shown that this is not just a great time-consuming nuisance for the business owner, but that a manager unfamiliar with the business will charge higher service charges, make higher collateral demands and be quicker to pull or reduce a line of credit than an account manager who knows the business and the owner. Research done by the Canadian Bankers' Association as long ago as 1982 identified the problem of account manager turnover for small businesses, and detailed the commitments of the banks at that time to do something about it. Today, I regret to say that nothing has changed for the better. Past promises that were never fulfilled have served to make small businesses deeply suspicious of bankers bearing gifts, and especially so in the current environment of rapid change.

The message from the senior bankers and their policies over the years seems to beg the question: "So, small businesses don't have the easiest time getting financing -- why should we care?" Here are some of the reasons why they, and all of us, should care. First, small businesses now more than ever are the most dynamic job creators in our economy, and this trend will likely accelerate in future. Second, recent CFIB research shows Canada's youth overwhelmingly see small business as the best route to get into the workforce, and have been turning away from the corporate and public sectors out of choice and necessity. Another factor is that currently financing problems are the worst among the small and newer firms -- the very ones we are counting on to survive, expand, and provide jobs and wealth creation as we move into the new

millennium. A further discouraging factor is the large number of businesses who have had such negative experiences with banks that they have vowed never to “get into bed” with a bank again. What this means is growth and job creation forfeited because these business owners turn down opportunities to expand if outside financing is needed, and our entire economy under performs as a result. So that is some of the history and reality from the small business standpoint in terms of how and why they regard the banks with no small degree of scepticism, and the foundation for how small business views the prospect of big bank mergers.

It is worth noting that since small business is traditionally very free-market oriented, and has not typically railed against mergers in general, the bank merger issue is a difficult one as it appears we are recommending government intervention in the marketplace. I have heard from some more philosophical small firm owners that have said “Let them merge -- it will just mean one or two fewer banks to get turned down by.” But small business owners know that financial services has never been a truly competitive marketplace, and that the major banks have enjoyed substantial protection of their position to the extent that they have become by far the most dominant players. When the securities and trust industries were opened up to competition some years ago, the banks wasted no time in swooping down and effectively taking them over. Small businesses observed this, weren't crazy about it, but shrugged their shoulders as they believed they could deal with it. On the merger issue, small business have not shrugged their shoulders, and new information I am releasing today shows the same to be true with respect to the general public. Small business has taken the position that since a competitive market does not exist in this area, some policy intervention is absolutely necessary to ensure that the best interests of all Canadian be taken into account.

What is definitely not needed is more concentration of power in the hands of bankers via mergers and permitting banks to get into areas such as the retailing of insurance and small vehicle leasing through their branch network. After all, having pointed out the serious and fundamental problems the banks have had in servicing small businesses for decades, it seems to make infinite sense to us that the banks clean up their existing acts before taking on insurance, car leasing or

any other target which tempts their appetite for more power and profit. Opposition of small business to the banks moving into these areas has been consistent and overwhelming over the years.

There is no doubt that the ultimate answer for small businesses and other financial services consumers is more competition in the marketplace. At the CFIB, we have been saying this for years, and this was also the underlying conclusion of the MacKay Task Force Report on financial institutions reform. Unfortunately, achieving a more competitive environment for small business financing is easier said than done. The Big Five are very well ensconced in the Canadian marketplace. The fact that we are now contemplating a new regulatory structure for financial institutions that will encourage foreign and domestic competitors such as credit unions is certainly positive, but it is unrealistic to expect any such competition to be able to spring up and take on the big Canadian banks anytime soon. Lending to small business takes specialized expertise, and cannot be developed overnight. Consequently, some sort of transition period will be necessary to prevent the existing banks from squelching any new competitors before they get off the ground. We believe that hard evidence of the existence of viable, long term competition must be present before mergers are even contemplated.

Ever since the merger proposals were thrust on the country -- and the unsuspecting Finance Minister -- small business opposition has been growing. Among our members, we found just over a year ago that 64 per cent were opposed to big bank mergers when they were just a theoretical concept. Following the merger announcements, opposition increased to 68 per cent in the summer, and all indications are that it has continued to grow throughout the past few months. Disaggregating these results is also interesting. Not surprisingly, the smallest and youngest businesses were the most opposed to mergers, as this is the group that has the most difficult time getting reasonable financing under current conditions, let alone post-merger. Another group very strongly opposed was women business owners, of which over three-quarters voted thumbs down to the mergers. I should note that we have provided our raw data from various CFIB surveys to the Bureau of Competition Policy as they were interested in some of the competition and market

share implications contained in the survey results.

Among the general public, it has been difficult to gauge what was happening to public opinion since most of the major polling companies were on contract to one side or the other in the debate and results were not being made public. At CFIB, we recently commissioned the Environics Research Group, a prestigious and independent research firm, to conduct a standard public opinion poll on the merger issue. Run between October 29 and November 10 of this year, it found the general public currently opposes mergers by a margin of two to one -- 60 per cent opposing the mergers versus 31 per cent in favour and 9 percent who didn't know or had no opinion. These findings are consistent across the country, with the Atlantic region most opposed at 67 per cent and Québec least opposed but still with a strong majority of 57 per cent. These are staggering numbers. They tell the decision makers in the federal government and politicians throughout the country that to approve these mergers would be going against the majority of not only small business owners, but Canadians overall.

The same poll also asked which groups the public believed would be the major beneficiaries if the mergers were to take place (multiple responses were permitted). 57 per cent responded that they thought it would be bank shareholders, followed by 48 per cent saying bank executives, and 44 per cent voicing the opinion it would be the banks' big business customers. After that, the numbers dropped off significantly, with 16 per cent believing the Canadian economy would benefit most from the mergers and only 13 per cent mentioning that consumers would benefit most. 10 per cent said small business customers would benefit, while 7 per cent believed no one would be helped by the mergers. A further 7 per cent mentioned bank employees would benefit from the mergers.

In Ontario, we also asked whether there should be public hearings in this province to assess the impact of potential bank mergers on communities. We asked this question in Ontario only for several reasons -- Ontario is the industrial heartland of the country and also the headquarters of the major banks, and would likely see most branch closures and job losses as a result of mergers.

And unlike some other provinces, Ontario has a very weak “second tier” of financial institutions, leading to fewer alternatives for small firms.

The response to this question was overwhelming. Fully 82 per cent of respondents said they support Ontario hearings on this issue. Even many of those supporting mergers apparently are in favour of holding hearings. This speaks volumes about the unease that exists, even among merger supporters. As Ontario has the largest concentration of head offices and branches of the merging banks, we believe the time has come for the Ontario government to announce public hearings on the bank mergers. If, as we contend, the mergers would be detrimental to small business, the general public and the economy overall, this is as much a matter of provincial concern as a federal one, although of course the ultimate decision rests in Ottawa’s hands.

Speaking of Ottawa, I want to acknowledge our respect for the manner in which federal Finance Minister Paul Martin has handled this issue so far. We have had a number of meetings with the Minister regarding small business concerns, and the fact that he has stuck to his guns in seeing the process through despite pressure to speed things along is commendable, as this important issue demands adequate consideration. It is important to take the time to get this right. The decision to permit mergers, if made, will be irreversible.

One side benefit of this policy exercise has been that more light has been shed on the Canadian financial sector than ever before. Canadians generally have come up the learning curve on what happens in the financial industry, and we do not think it a coincidence that opposition to the mergers has increased with such knowledge. In the wake of the recent release of the Ianno Task Force report, which came out strongly negatively on the mergers, the “Big Four” banks stated that the real problem was that they were not communicating well enough with Canadians, and if people really understood what was proposed they would feel differently.

We believe the reverse is true, and that the banks have communicated all too well, and opposition to the mergers has grown accordingly. The banks have communicated very well their own

confusion about why they are merging -- first it was a necessity driven by global forces, then it was a means of providing better service to Canadians, and more recently as a means of helping along succession within the individual institutions. The banks have also communicated very well the disagreements among institutions with respect to the real outcomes in terms of job losses and bank closings. Lately, we have heard threats -- that not proceeding with mergers will mean even more bank closings, and that opponents of the mergers are undemocratic and even unCanadian. Do you think they had anyone in this room in mind? I certainly hope not.

The banks have also communicated very well the fact that they have not done their homework on the mergers. On the proposal for the new small business bank supposed to be created by the Royal Bank and the Bank of Montreal, the announcement came with vague promises and no details. The banks themselves conceded they had no business plan for this new institution. With the resources they are throwing at this campaign, it is quite remarkable they could not get their act together before letting the merger monster out of the vault. Perhaps they underestimated the Canadian public and the small business community. If so, it would not be the first time.

On a more personal note, I wrote some three months ago to the heads of the four merger banks, outlining a number of questions we at CFIB believed to be relevant from the small business perspective. In fairness, some of the questions may not be answerable due to the confidentiality provisions of the Competition Policy proceedings. But, even if this is the case, to date I have only received two rather perfunctory responses from the TD and the CIBC, and no answer at all from the Royal and the Bank of Montreal. Yet we hear every week how important the merger banks believe small business to be, and how they want to serve them better and communicate with them better. Perhaps they could start by responding to letters.

As for the promises made with respect to this proposed small business bank -- reducing the turnover of account managers, reduced service charges, increased funding for small business loans -- all of these promises have been made before and never delivered upon. We also wonder why these promises have to be tied to the merger, since all of them were achievable in the past

but never seriously pursued.

Regarding the arguments in favour of the mergers, the most compelling for any business person is that economies will be achieved that will permit cost savings. As illustrated in the MacKay report and elsewhere, the evidence is mixed whether big bank mergers actually ever do achieve these economies. But assuming there are some savings to be had, the question for small business owners is what will happen to these savings? Many economies have been realized by the banks over the past couple of decades with the adoption of new technology and closing of branches. But small firms have found their credit conditions worsened as a result. Who can say that any future costs savings will be passed on to small business customers when they never have been in the past, especially if the merged banks end up with more market power and less incentive to offer competitive prices?

I conclude where I began -- that we at CFIB want a better banking system. But better banks does not have to mean bigger banks and fewer competitive choices. I call on the banks today to recognize that despite the many differences which exist between the independent business sector and their own institutions, there is much more to be gained than lost by building a better working relationship. Banks have a huge role to play in job creation, because their decisions impact every day on the small businesses which account for the majority of net new employment.

We realize very well that small firms will always have a challenge obtaining financing, and that it is not an easy market to serve. It will always be true that loaning out five million dollars once to a corporate customer is much easier than loaning out \$100,000 to fifty small business customers. Also, profit margins for the banks are slim on small business loans. At the same time, banks have found that when they take into account the entire business relationship with the small firm owner -- including personal business such as RRSPs and home mortgages -- the overall picture is very profitable indeed.

Here is the bottom line for the nation, including the banks.

A healthy small business sector is a prerequisite for a healthy economy. Any policy or action that weakens this sector, or makes it more difficult for it to grow, weakens the economy and society as a whole. Ensuring that small businesses have a wider choice of financial service providers and decent access to credit at reasonable cost has such significant spin-off benefits for job creation and economic growth that it should be a priority objective for all policy-makers and every financial institution. Put simply, it is a win-win proposition all round. And that is something we can all bank on.