Australian Government

Australian
Small Business and
Family Enterprise
Ombudsman

Supply Chain Finance Review

POSITION PAPER

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Supply Chain Finance Review

Background

As part of the ASBFEO's Review of payment terms, times and practices, directed by the then Minister for Employment, Skills, Small and Family Business, consultations with large businesses revealed that a suite of products generically referred to as 'supply chain finance' (SCF) were being offered to facilitate early payment to suppliers. One of the Ombudsman's recommendations was to conduct a further review of the impact of supply chain financing options on small and family businesses.

More recently, the issue has come to the attention of the Office through:

- Large businesses extending payment terms to certain cohorts of suppliers, with SCF offerings proposed to offset extended terms;
- Small businesses contacting our office about their concerns over these SCF arrangements;
- Increased media attention on the adoption of SCF in the market; and
- International instances of large businesses extending payment terms to small suppliers while providing SCF arrangements.

About this Position Paper

This position paper provides an interim snapshot of the SCF sector based on our initial research and consultations the Office has conducted. A list of consulted organisations is at Attachment D.

How to provide feedback

You are invited to respond to the questions posed in this position paper by emailing inquiries@asbfeo.gov.au

Submissions will close on 28 February 2020

For small and family businesses, you can also share your own experience with supply chain finance through our survey or contribute to the discussion on our Mindhive challenge.

Foreword

Long payment terms and late payments are a major issue for small business across all industry sectors. Cash flow pressure is consistently raised by small and family businesses that are constantly affected by late payments. Late payments by large business to small business account for 53% of invoices[1]. This means that $115 billion worth of payments to small business are late and stops $7 billion of working capital being available to small businesses every year.

Small business and family enterprise need smooth and predictable cash flows to operate effectively, and reinvest to grow. It is critical for the Australian business community that small businesses are treated fairly by their big business customers. Following our 2017 inquiry and 2019 review of Payment Terms, Times and Practices, the issue of Supply Chain Financing (SCF) has been front and centre in the Australian business landscape and why in October 2019 we launched this review.

It is important to clearly differentiate between the SCF product and the behaviour of large businesses that choose to use the product. SCF is a legitimate and effective tool to free-up cash flow for small and family business. We have spoken to small businesses that have used SCF to great effect to reinvest in their business and scale rapidly. My Office has always held the view that where large businesses offer reasonable payment terms (30 days or less) to their small business suppliers (businesses with less than $10 million annual turnover) and pay on time, offering optional SCF products can provide significant benefits to their suppliers.

However, our Review has found that too many big businesses have extended payment times and then offered SCF. This practice severely impacts small business suppliers and is clearly unacceptable. The Business Council of Australia's Supplier Payment Code is supposed to protect small business and promote acceptable payment terms. However, it is voluntary, has no monitoring mechanism and is unenforceable. The definition of 'small business' under that Code is wide open to manipulation, and yet again, small business then bears the burden of large businesses' poor payment practices.

Where large businesses refuse to engage fairly with small business, Government is left little choice but to regulate. However, it is clear that some large businesses are ready to step up. Since announcing our review, two large businesses have taken the lead by reducing their payment terms for small business while simplifying eligibility criteria. Telstra has moved to 20 day terms for suppliers with invoices up to $2m annually. Rio Tinto has moved to 20 day terms for suppliers with annual turnovers up to $10m. I applaud both Telstra and Rio Tinto for moving so quickly, and strongly encourage others to follow their lead.

The draft recommendations in this report outline ways to support small business to achieve fair payment terms and times, and change large business behaviours.

Kate Carnell
Australian Small Business ad Family Enterprise Ombudsman

[1] Xero Small Business Insights, 'Paying the price, the economic impact of big businesses paying Australian small businesses late', June 2019

Executive Summary

Findings

1. ***Manipulation of definition of small business*** Large businesses are using various definitions of small business. Most use the restrictive "fewer than 20 employees" definition, whilst some require satisfaction of both an employee number (eg. less than 20 employees) and a turnover threshold (eg. less than $10m turnover). This has the effect of excluding many businesses that would otherwise satisfy the common definitions of small business and those recommended by the Supplier Payment Code. This means that they are not considered to be small business and are then paid far more slowly than would otherwise be the case. The Supplier Payment Code framework permits these types of definition manipulation.
2. ***Unenforceability of Supplier Payment Code*** Putting aside the manipulation of the small business definition permitted by the Supplier Payment Code, the Code is also voluntary, there is no monitoring of compliance, and there is no mechanism to enforce its terms. It is in unenforceable.
3. ***Exposure to prolonged payment times*** Businesses that do not satisfy the definition of small business set by large business are exposed to payment terms and actual (late) payment times that significantly exceed 30 days (eg. 45, 60, 90 following end of month).
4. ***SCF is able to be appropriately used*** SCF can be of advantage to small business when a small business chooses to use it to bring forward good payment terms (ie. less than 30 days from supply of goods or services).
5. ***SCF is inappropriately used to reduce prolonged payment times*** Many large businesses extend payment terms and times and then offer SCF which has a severe impact on small business where these longer payment terms and times apply and SCF must then be used to bring payment terms back within 30 days.
6. ***SCF is using AI to target small business*** The data collected by SCF providers is extremely detailed and provides insight into individual small business profit margins and cash flow fluctuations. We are aware that some SCF providers are using artificial intelligence (AI) and algorithms to target small businesses by dynamically setting SCF fees to extract the greatest possible return from small businesses, including those that are already in distress.
7. ***SCF produces artificial benefits to big business*** SCF provides significant advantages to large business since it allows them to artificially improve their accounts and also receive a discount on their invoices (funded by small businesses and shared with the SCF providers). The ability to artificially manipulate accounts means that when large businesses themselves experience cash flow or insolvency issues, SCF may be used to mask this to the market.

Draft recommendations

1. ***Consistent small business definition*** The small business definition adopted across Government should be either to simply define small business as not including, say, the top 100 companies or "(a) a small business has fewer than 100 employees or (b) less than 100 employees, with satisfaction of either (a) or (b) being sufficient to qualify as a small business".
2. ***Enforceable payment times*** The Supplier Payment Code should be replaced by the Commonwealth Government's Payment Times Reporting Framework with that Framework being administered and enforced by an appropriately funded, empowered and proactive entity.
3. ***30 day payment standard*** The minimum standard for all supplier payments (regardless of supplier size) should be 30 days.
4. ***SCF as a real choice*** SCF should be available to small business to reduce payment times from 30 days to better.
5. ***Appropriate coverage by accounting standards*** The accounting standards need to provide greater clarity and properly cover SCF to ensure that accounts cannot be manipulated, particularly to mask cash flow issues and insolvency.
6. ***Further review from competition perspective*** The ACCC should review SCF provider activity from an Australian Competition Law viewpoint, including how data is applied through using artificial intelligence and algorithms.
7. ***Further review from regulated financial product perspective*** Treasury and ASIC should review whether SCF should be a regulated financial product with coverage of rate setting.

Next steps

We are seeking specific and general comments on the draft recommendations and have also set out a number of relevant questions for comment. As part of our consultation, we continue to be interested in hearing of your experiences with SCF.

Given the significant impact that the extension of payment times and increasingly widespread use that SCF is having on small businesses, we seek comments by **Friday, 28 February 2020** and we anticipate finalising the recommendations shortly after closure of the consultation.

Introduction

Long payment terms and late payments are the biggest risk to cash flow for small businesses. Nearly 40% of small businesses report significant cash flow pressures due to late payments. Approximately half of all invoices issued by small business to large businesses are paid late, totalling $115 billion delayed earnings per year.[2] This leads to increased pressure on small business and a stall on money circulating in the economy.

Small businesses have very little bargaining power compared to large entities who have a number of potential suppliers in any marketplace. This impacts their ability to demand fair payment terms for goods supplied and services rendered. It is critically important that good payment terms and times are passed down the supply chain to support the cash flow and growth of small businesses and recirculate funds in the economy.

Due to extremely poor payment practices in Australia, this Office has undertaken comprehensive research on how to improve payment times to small businesses. Our 2017 inquiry and 2019 review of Payment Terms, Times and Practices recommended the introduction of an annual reporting framework, and clearer expectations and government policies on payment practices within Australia.

The Development of Supply Chain Financing

A recent development in payment times and practices in Australia is the introduction, and enthusiastic adoption by large businesses, of Supply Chain Financing (SCF). SCF allows a large business to offer discounts to their suppliers in return for early payment of an invoice. Discounts for early payment have been an historic feature of trade negotiations, but the new platforms offering SCF, often backed by powerful artificial intelligence, have brought an insidious new front to the war small businesses are waging to get paid within a reasonable time frame.

The utilisation of artificial intelligence in forms of SCF also removes the human element of business interaction and allows further squeezing of any discounts agreed to for prompt payment. The impacts of this sort of behaviour have already been examined through the Banking Royal Commission in Financial Misconduct. As small businesses already operate from a weakened position with their large business counterparts, the adoption of these technologies in unscrupulous ways has the capacity to flip the entire business operating system on its head. This is being facilitated by external online platforms to strip value from other people's businesses and concentrate information in the hands of those with the greatest bargaining power.

Having called out the rising abuse of SCF, it should be noted that it is not generally the product that is the issue but the way that the product is used. A small business with a contract to a large business that includes, say, 30 day payment terms may choose to utilise SCF to speed up their payments to as little as four days from the approval of the invoice. They may do this for a range of reasons, including to fund rapid growth, to access capital at a rate they would be unable to secure from a financial institution, or simply to plug an unexpected hole in their cash flow to enable them to make payroll for the month. All of these are valid reasons for small businesses to choose to take a small discount on their invoice for prompt payment, and in less than 30 days.

A more pernicious practice has developed, however, with large businesses choosing to extend their payment times (often from 30 days to 60, from 45 days to 60, or in the most alarming circumstances from 30 days to 90 from the end of month of invoicing). Alongside these extensions, those large businesses then offer a SCF solution allowing the smaller supplier to be paid within the original payment terms, at a cost to that supplier. This has the potential to save the large businesses many millions of dollars over a year, again at a cost to their smaller suppliers and after the larger business

[2] SME Growth Index, Scottish Pacific Business Finance, September 2019

has received products or services from the small business. To add insult to the smaller suppliers, it is often these large businesses offering SCF alongside extended payment terms that claim to have 'small business friendly' procurement and payment policies.

Government action

The Federal Government is moving to ensure shorter payment terms, and on-time payments, are a priority in the Australian business landscape. In the last 18 months the Government has announced:

- 20 day payment terms for government contracts under $1m, announced in November 2018 and implemented from 1 July 2019;
- 5 day payment terms where both government and business are using the e-invoice PEPPOL framework; and
- Continued consultation on a payment times reporting framework.

It is critical is to ensure that smaller subcontracts flowing down government supply chains are being paid efficiently. The Government's announcement on 21 November 2018 that it 'will require those same large businesses seeking to tender for government contracts to match our 20 day payment policy'[3] was welcome, and smaller businesses are keen to see this implemented. It is not a simple solution, however, as a mechanism is needed to ensure the same terms are delivered right to the end of the supply chain.

Industry behaviour

While Government can regulate, the primary issue leading to poor payment practices is the attitudes and behaviours of large businesses. Many large corporate entities publicly promote their commitment to reasonable payment times for small businesses. The Business Council of Australia's Supplier Payment Code (the Code) was launched in May 2017, allowing large businesses to signal their commitment to paying small businesses within 30 days. But the Code is fundamentally flawed.

- It is voluntary, and able to be signed by any business operating in Australia. Only those businesses with payment times in line with the 30 day requirement will sign it;
- There are no audit or compliance mechanisms in place, and as such, it is impossible to confirm whether a Code signatory is actually compliant; and
- The definition of 'small business' is often unclear, and subject to manipulation by Code signatories.

When the Code was established, a 'small business' was one that had fewer than 20 Full Time Equivalent (FTE) employees, or had less than AUD$10 million annual turnover. Following the 2019 Independent Review of the Code[4] the 20 FTE definition was removed.[5] The change was grandfathered for earlier Code signatories and as such, many large businesses still use the earlier, more restrictive definition of a small business. This is clearly not in the spirit of paying small businesses within 30 days. In some more extreme cases, large businesses choose to apply both the head count and turnover requirements, further limiting the number of their suppliers they are required to pay on time to be Code compliant.

[3] https://www.pm.gov.au/media/paying-small-business-time

[4]https://assets.nationbuilder.com/bca/pages/4328/attachments/original/1552017251/ASPCReview080319Final.pdf?1552017251

[5] Above n3, p13.

The Code has recently been called "useless because there were too many loopholes"[6] and is often anecdotally referred to as a cynical marketing exercise by the 'big end of town'. There have been recent calls for investigative action on payment times for small business, including suggestions that "tough legislation giving the government wide powers to investigate payment times and practices [should be] passed in the next few months."[7]

The Government's proposed Payment Times Reporting Framework should provide compelling evidence of payment terms performance across the economy. Transparency and certainty are absolutely critical in this endeavour. These are hallmarks of a well-functioning economy and provide confidence to those doing business. The key issue in ensuring the Framework operates as it should will be the agency that administers the framework. This Office already has wide ranging powers to directly investigate and require production of information and documents on a company-by-company basis. This Office also holds powers to demand answers from companies and publicise where they fail to respond. These powers do not require any additional legislation. Should another agency be appointed to administer the framework, it is critical that it be given powers to investigate that are of a level at least equivalent to those already held by the Ombudsman and it also has power to provide transparency and assurance of practices across the Australian economy.

Improvements in the landscape

While the behaviours of large business clearly needs to change, not all businesses do the wrong thing. Some larger businesses are genuinely committed to implementing positive small business policies around payment terms. It is also heartening that some SCF providers are aware of how these types of products can be (and have been) used to undermine the viability of small business. Following our consultation and media coverage, several large Australian corporate businesses (such as Telstra and Rio Tinto) have announced that they will improve their payment terms and times for small business and are reviewing their use of SCF programs.

A prominent player in the SCF market and CEO of London-based Greensill Capital, Lex Greensill, has stated 'The focus of people like Kate Carnell has caused us to pause and say we actually need to think about the way that our capital is being delivered ... We're in the process of formulating a position on eligibility for our products moving forward that is consistent with the view that Kate … has espoused.'[8]

We consider it unacceptable for corporate entities to extend payment times to their suppliers and then offer a product to suppliers to enable them to get paid on their original terms (with a discount). The insult is compounded where those same entities claim to offer favourable terms to 'small' suppliers but impose a restrictive definition of what constitutes a 'small' supplier. However, we stress that where a large entity does indeed offer good payment terms (30 days or less), and applies an expansive definition of 'small business' – or better yet, pays all suppliers within 30 days – the use of SCF to provide greater choice and transparency to their suppliers is an acceptable business practice. It is not the product that is inherently flawed but the way it is used.

[6] https://www.theaustralian.com.au/business/companies/ending-supplier-payment-rorts/news-story/60e3c65f7e6b663ebc982300dc015874

[7] The Australian Business Review, 'Ending supplier payment rorts', 29 January 2020

[8] https://www.afr.com/companies/financial-services/greensill-won-t-be-used-to-bully-small-business-20200123-p53tz3

Questions for comment

We welcome your feedback on any or all of our draft recommendations and the following questions that relate to the recommendations:

1. ***Consistent small business definition***
    a. For consistency, should there be a single definition of small business for payment terms?
    b. If so, what should that definition be? (For example, $10m turnover?)
2. ***Enforceable payment times***
    a. Is there a need for a mandatory Supplier Payment Code?
    b. What role does the proposed Commonwealth Government's Payment Times Reporting Framework have in:
        i. Assessing payment terms performance when SCF is utilised; and
        ii. Auditing and issuing fines or other sanctions for non-compliance?
3. ***30 day payment term standard***
    a. For consistency, should there be an economy wide 30 day payment term mandated?
    b. For government contracts, how could 30 day payment terms be made to flow down supply chains to small business suppliers?
4. ***SCF as a real choice***
    a. Should SCF be available to small business to reduce payment times from 30 days to better?
    b. What forms of SCF are of the greatest benefit to small business?
5. ***Appropriate coverage by accounting standards***
    a. Should the Australian Accounting Standards Board (AASB) be consulting with its international counterparts to provide clarity as to how to capture and treat SCF in financial reporting?
    b. Should auditors be given formal guidance to ensure consistency in the financial reporting (by note or otherwise) of entities using any form of SCF?
    c. How do small and family business accountants become educated as to what SCF is and what its implications are for reporting?
6. ***Further questions from competition & regulated financial product perspectives***
    a. What protections are required for small business that have their business performance data captured and stored by big business that may be shared with third parties?
    b. Should a small business receive a copy of the contract between the finance provider or platform provider and the other party to the supply chain transaction (buyer)? With the goal of transparency, what data should be shared between the provider and the buyer?
    c. Is there a role that the ACCC needs to play in regards to unconscionable conduct or third line forcing? Are there any other areas that the ACCC should consider?
    d. Should a contract providing SCF in any form be regulated as to how it is implemented/utilised by a big business?

e. What mechanisms could protect small business users of SCF from the costs and administrative burden of having to engage with several buyer-led SCF providers?

f. Should the SCF provider report the effective annualised rate of interest charge/discount?

g. Should the effective annualised interest rate/discount be reported publicly as a "comparative rate"?

h. Is there a role that the Australian Securities and Investments Commission (ASIC) needs to play?

i. Is there a role that the Australian Financial Complaints Authority (AFCA) needs to play?

Supply Chain Finance

What is Supply Chain Finance?

Supply Chain Finance (SCF) "is the use of financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions."[9]

As a category of business finance there is no one form of SCF. Nor is SCF a static concept but rather an evolving set of practices using or combining a variety of techniques; some of these are mature and others are new or "leading edge" variants of established techniques. The techniques are often used in combination with each other and with other financial and physical supply chain services.[10]

Our consultations have revealed that across the spectrum of businesses, there is confusion as to exactly what SCF is and how it works. There is also confusion about what use of SCF means for both suppliers and customers. Large entities often hesitate to categorise the transactions or explain how the industry operates and what their role is. This is compounded by the extensive use of technology platforms and systems.

What does it look like?

The Supply Chain Finance Forum categorises SCF as falling into either the "Receivable Purchase" category or the "Loan or Advance-based" category. The individual types of SCF within these categories are detailed in the Glossary at Appendix A.

Our focus is on SCF provided through a buyer-led programme, including "Reverse factoring" and "Dynamic Discounting" whereby suppliers in a bigger business' supply chain are invited or directed to participate in a structured model of accessing early payment of their sales invoices, at a trade discount or interest cost. We have identified important issues to address when small business suppliers lose control over their normal payment terms with big business customers.

Fees, terms and conditions vary considerably and non-bank finance providers may not be subject to the same regulations that apply to mainstream banks. Transparency in any contractual arrangement is critical. A business needs to clearly understand what fees, terms, penalties and restrictions apply.

Below is a synopsis of supply chain finance options for accessing capital through the buyer supplier relationship:

[9] Standard Definitions for techniques of Supply Chain Finance published by the Global Supply Chain Finance Forum in 2016 p 8.
[10] Standard Definitions for techniques of Sup 9

Name of Product	
Purchase Order Financing	Lender (usually a bank) loans money to a supplier for the sourcing, manufacture or conversion of raw materials or semi-finished goods into finished goods which are shipped to a buyer, having as guarantee purchase orders
Pre-approved Invoice Financing	Factors purchase accounts receivables from suppliers upon buyer receiving invoice and based on data driven likelihood of buyer ultimately meeting payment obligation
Inventory Financing	Lender (usually a bank) loans money to a firm with the maximum amount of the loan linked to the firm's assets in the form of cash, inventory, and accounts receivable
Dynamic Discounting	Dynamic settlement of invoices where for every day of advanced payment with respect to a pre-defined baseline, the supplier grants to the buyer a discount on the invoice nominal value
Reverse Factoring	Provides a supplier with the option of receiving the discounted value of either (a) an invoice prior to its actual due date, or (b) an account payable due to be paid by a buyer to the supplier at a future date

DOMINANT MARKET PLAYERS IN SUPPLY CHAIN FINANCE ARRANGEMENTS

Reverse Factoring

Establishing the Program: A Buyer company will enter into an early payment program for its suppliers with a third-party SCF provider and an 'application programming interface' (API) is installed on the buyer company's internal systems.

Joining the Program: The buyer company approaches suppliers about their interest in opting into the program.

Invoice Approval and Advice: When the buyer approves the supplier's invoice, it is visible to the SCF third party finance provider who contacts the supplier and notifies them of their commitment to pay the invoice immediately.

Supplier action: The supplier effectively "sells" the receivable / sales invoice to the SCF third party finance provider and accepts a discount on the face value of the sales invoice.

SCF Third Party Provider: The supplier is paid the lesser value and the buyer reimburses the SCF provider at the end of the standard payment term. The financing of the early remittance is through the aggregation of receivables into financial products, such as bonds.

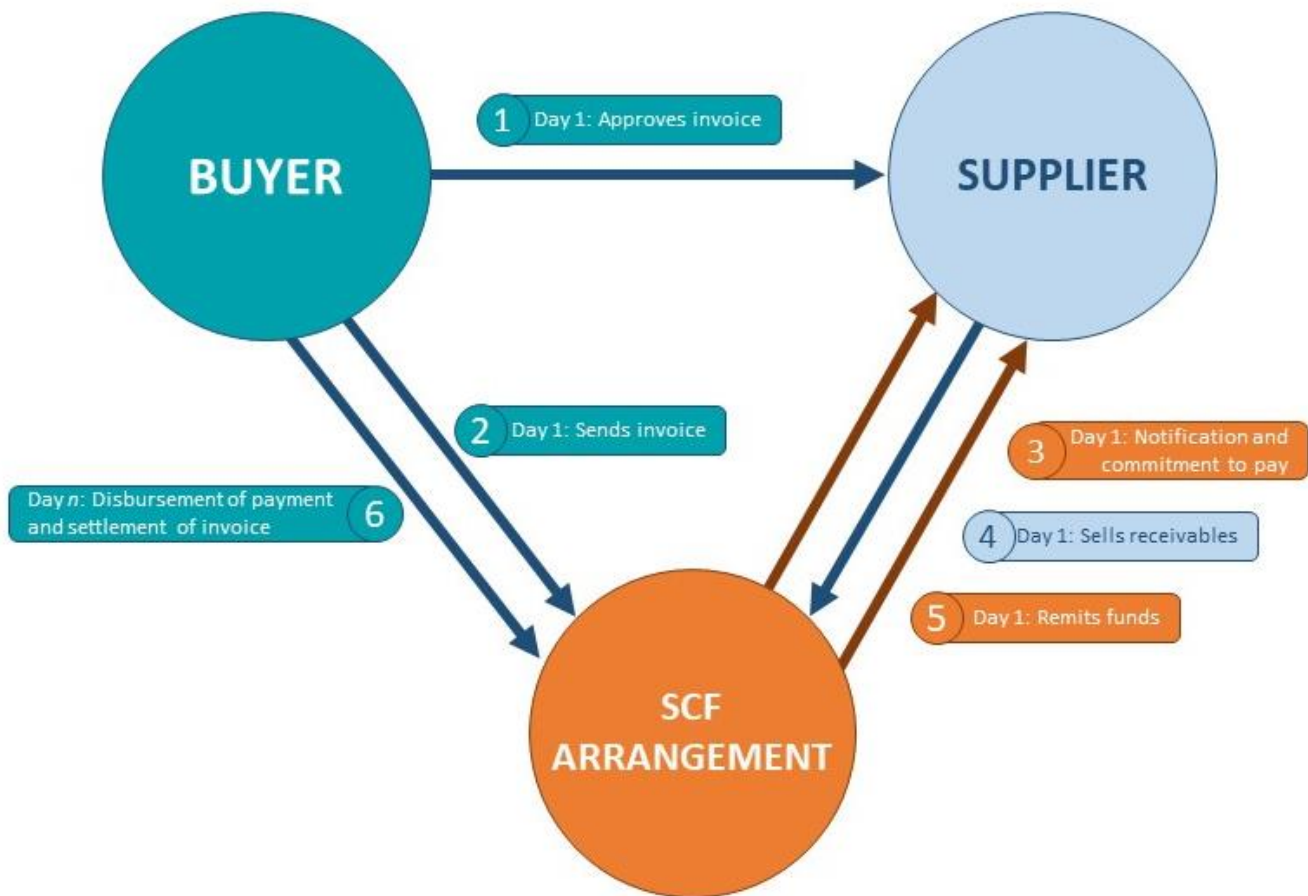
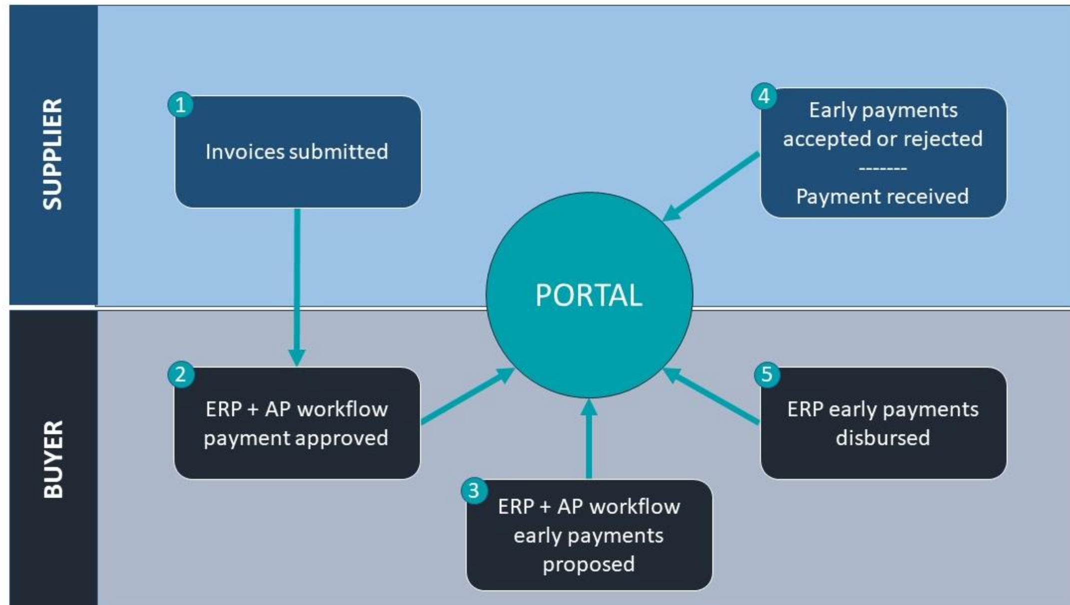


*Diagram based upon original image *Reverse Factoring* by Greensill Capital, 2020.

Example

Bob is a carpenter who sub-contracts to ABC Construction. This is the biggest contract that he has ever had. Bob signed up to 30 day payment terms for the work he completes for ABC. After being on these terms for 6 months, ABC advised Bob that they were changing all payment terms to 65 days. ABC tells Bob that it offers a reverse factoring scheme, which means that Bob can still get paid in 30 days, provided he agrees to take a discount from anywhere between 2% and 8% on his invoices depending on how soon he wishes to be paid on each invoice. This impacts Bob's ability to pay his own suppliers, properly assess the cost of jobs, and manage his cash flow projections. Unfortunately for Bob, as he needs to make payroll, he has no choice but to accept a discount on his invoices.



*Based upon original image *Dynamic Discounting* by ICG Consulting, 2020.

Dynamic Discounting

Establishing the Program: Dynamic discounting is a program set up by the buying company that establishes a process by which buyers and suppliers can alter the standard terms of payment "on the fly" in a highly dynamic, flexible, real-time environment.

Joining the Program: It is a voluntary system where the buyer offers the vendor an early payment discount**.** Both parties can view the invoices on a web-based platform to select the approved invoices for early payment to be made.

Supplier Action: Supplier submits an invoice for payment and the payment status appears in the portal, where the buyer offers a discount for early payment on selected invoices. The supplier views and accepts early payment offers through the portal.

Example

Sophie contracts to a large tech company, Whizz Bang, which has made great fanfare spruiking their movement to 30 day payment terms for their small business suppliers. Sophie contacts Whizz Bang to move onto the 30 day terms within their system. However, Whizz Bang defines a small business as having fewer than 20 employees. As Sophie has 21 employees, she doesn't fit this category and goes onto the standard terms which have recently been extended from 45 days to 62 days from the end of the month. As Sophie's business has a turnover of about $2 million per year, she still considers herself a small business. However, in acknowledging the impact of extending payment terms, Whizz Bang offers Sophie access to earlier payment at a discount through a third party supply chain financier.

Sophie would prefer not to take a cut on her invoices to get paid, and tries to wait it out, but there are a couple of months where she needs to get paid in 30 days to manage cash flow. Sophie notices that after taking a discount to get paid, the following month her 'discount offer' is higher on about the 30th day of the month, leading her to believe that Whizz Bang know she will be looking to get paid close to that date. Sophie contacts her procurement manager and is assured that Whizz Bang don't target offers at specific times, but she remains unsure about how transparent they are being.

Example

Gabe owns a business that contracts with XYZ which is a large agricultural firm. XYZ regularly publicises its work in supporting the local communities that they operate in, and claims to support small business by being a signatory to the Supplier Payment Code. Under the Code, XYZ chooses to define small business as having less than 20 employees and sets out a range of postcodes where this arrangement applies.

Gabe has chosen to work with XYZ as he believes it will look after him, given he is a small, local supplier. Gabe's friend who lives in the next postcode also supplies to XYZ and Gabe knows that his friend gets good payment times as part of their 'local supplier' commitment. Gabe, who has 12 staff, has worked hard to employ as many local people as possible, knowing that XYZ is also a big supporter of the local community.

One day, Gabe is contacted by his procurement manager at XYZ to be told that it is implementing a dynamic discounting policy for its suppliers who fall outside their 'small business' definition, and at the same time they are extending those business' terms from 30 to 90 days. XYZ explains to Gabe that although it uses a definition of fewer than 20 employees to define small business, those businesses also need to be within a set range of postcodes and he is based outside that range. Gabe is moved by XYZ to the longer payment terms with dynamic discounting.

Gabe contacts XYZ and asks why the discounts that he needs to accept to be paid within 30 days are constantly varying. He notes that whenever he really needs to bring payments forward to within 30 days that the discounts on his invoices seem even greater than they normally are. He is told that the discounts vary because they are set against a variety of indicators and that the algorithm takes his own circumstances into account. This impacts Gabe's ability to minimise project overruns and therefore accurately predict timeframes to quote projects.

Gabe is left with a choice: To try to manage the longer payment terms, to take a constantly varying discount on invoices and have his profit squeezed even further, or to move premises to within the postcodes set by XYZ.

Market Place

Invoice receipt and Invoice approval: The Buyer (usually a large business) receives and approves the supplier's invoice.

Supplier names a rate: The supplier logs into the technology driven marketplace platform and submits their request for early payment (earlier than contract payment terms) by nominating an acceptable rate of discount they will accept. In many instances, several different suppliers will nominate their individual rate. A business that has a debt payable immediately may nominate a much higher rate than a business which does not really need the money, but it would be beneficial for their cash flow to have it.

Buyer names a rate: The buyer logs into the same marketplace platform and nominates the rate of discount they require before they would pay a supplier's invoice earlier than the contract payment terms dictate.

Matching: Marketplace algorithms align the objectives of the buyer and their various suppliers. If the aggregated discount rate of all the suppliers' offers align with the discount the buyer wants to see before they will pay the invoices, all of the nominated invoices get paid, with the discounts split according to the supplier's 'bids'. If the aggregated discount rate is not sufficient for the buyer, no suppliers receive early payment.

Payment Rescheduled: The marketplace platform interacts with buyer's systems to confirm the discount amount and rescheduled supplier payment date.

Market Place Version II

Establish Program: The Buyer requests a facility to operate on the platform and adds their suppliers to the 'buyer portal'. Only those suppliers added to the buyer portal can access the facility.

Joining the Program: Suppliers are invited to join the platform. Suppliers can access this when they need to but do not have to use it if they choose not to.

Supplier Action: a Supplier provides their invoice to the Buyer who checks it, makes sure it is right, and updates the information in the platform. The supplier can then see which of their invoices have been approved, and accept a discount for earlier payment, or extend the time they will wait to be paid and receive a small bonus.

SCF Third Party Provider: Pays cash to the Supplier once the agreed date is reached.

Further Buyer Action: If the Buyer wants to extend the time in which they pay the SCF Provider, they can do so on the platform and pay a fee to access the extended time.

Example

Patricia is a franchisee who was having difficulty meeting her supplier invoice payment dates. A couple of Patricia's commercial clients pay slowly, and she is finding it hard to start new work due to a lack of funds. One of Patricia's large clients, Supersales, adopts a SCF solution called MarketBid which allows her to 'bid' for early payment by logging on to a platform that shows her which of her invoices are approved and ready for payment, and she then needs to bid the discount amount she is willing to take on those invoices to get paid in a shorter time. Patricia is having cash flow issues because another one of her customers has recently extended their payment terms, and it has left Patricia struggling to make payroll this month. She logs on to the platform to see that two of her invoices with Supersales have been approved, and as she needs the money for one quickly, she offers to take a 10% discount on it if she can get paid in three days.

The MarketBid platform looks at all of the 'bids' placed on Supersales invoices that day, and provides Supersales with a total, aggregated amount that they will save if they pay the invoices on the bid terms. Unfortunately for Patricia, other suppliers have not bid as high, so the total bids are rejected along with Patricia's request since the overall aggregated discount is unacceptable to Supersales. Patricia will have to try again tomorrow, and will probably increase her bid to a higher discount as she really needs the invoice to be paid and she hopes that this will sufficiently lift the aggregated discount. Patricia is worried that if she keeps bidding for invoices to be paid early, Supersales will realise that it can take a cut on her margin and will negotiate harder the next time they sign a contract, but she is in a bind since she also is committed to making sure her staff are paid on time.

Technology Platform

Establishing the Program: A Buyer company extends its standard payment terms with suppliers, without consultation or negotiation. "In consideration" of suppliers accepting the extended payment terms, the Buyer company makes available a financing facility. The financing facility is provided by a third party.

The Financing Facility: is sometimes referred to as a "hosted service" or a data exchange and allows the host to access data of the supplier company and enable the SCF.

Joining the Program: The third party financing facility requires a standard form contract to be executed by the supplier company, the terms of which refer to provisions in the contract between the financier and the Buyer company, but which are not visible to the supplier company – who may be affected by those provisions.

Supplier action: Once registered with the third party finance provider, the supplier can request early payment of an invoice issued to the buyer company. The discount to be allowed by the supplier is calculated based on the daily bank bill rate increased by a margin and the number of days the payment is advanced.

SCF Third Party Provider: The terms and conditions of the agreement suggest that some or all of the discount allowed by the supplier business may be shared with the finance provider or the buyer company.

Who are the players?

Historically, SCF hasn't been an option for smaller businesses because programs offered by mainstream banks are engineered to serve businesses with strong credit ratings and extensive supplier lists. Some estimates are that it costs as much as five thousand dollars to simply set up a business in a bank-operated SCF platform. Today, non-investment grade and smaller suppliers have access to the benefits of SCF through an ever-increasing range of finance providers.

Westpac Bank has contributed to our review and other non-bank finance providers, including Apricity Finance, FIFO Capital, and Greensill, have either made submissions or participated in consultations with us.

A financier may also provide the technology platform for the enabling software and systems. Alternatively, the technology may stand alone and be employed by both parties to the buy/sell transaction. C2FO, Taulia and PrimeRevenue, are examples of this.

As part of our review, we have reached out to a large number of big businesses that had indicated in our 2019 Review of Payment Terms, Times and Practices that they had alternative finance options. A list of those businesses is included in Appendix D.

How it is used?

Benefits

Working capital

Working capital optimisation is critical in the financial management of a business. The ability of small businesses to effectively manage their working capital and cash flows is crucial. The different supply chain finance options can provide certainty of payments allowing businesses to better plan as well as allowing money to be reinvested in the business. Thus, a non-traditional option to reduce the cost of accessing capital can allow small businesses to effectively manage the true cost of capital.

Example

Kelly runs a small business manufacturing 'bliss balls', and she is scaling the business quickly. Her major customer, BigShop, has always paid her within 30 days of receipt of an invoice, and their relationship is good. Kelly manages to secure a second large customer, and needs to ramp up her production capabilities. She goes to her bank to see if they will give her a short term loan to scale, but the interest rate they offer is much higher than she is willing to pay. Kelly contacts BigShop to see if they would be willing to pay her earlier than the 30 days. BigShop say that they have an SCF platform that they usually reserve for their largest suppliers, but are happy to offer it to her too. Kelly is able to access payments in 5 days using the SCF platform at a rate she is happy with (and much better than the short term loan from the bank). Kelly successfully scales her business, and continues her excellent working relationship with her customers.

Access to cheaper funding

The development of electronic invoicing platforms and involvement of non-bank service and finance providers (fintechs) has allowed the costs of establishing loan facilities for small businesses to be significantly cut. Suppliers who agree to join a supply chain finance arrangement also typically benefit from a shortened payment cycle. The cost to the supplier for these early payments is calculated not on the credit standing of the small business supplier but more on the higher credit rating of the big business buyer.

The credit facilities available to suppliers under a supply chain financing arrangement also allows them to circumvent the access barrier for small business through traditional banking loans which rely on bricks and mortar as collateral.

Example

Stefan is a builder who has customers that require him to pay them on 30 day terms. Stefan is unable to broker better terms because the customers only get paid by the bank after 'stage completion'. Stefan has a bank overdraft that cannot be increased from $350,000 and requires top ups provided by unsecured debt from fintech lenders as well as leveraging his supplier relationships. Stefan has tried to get finance from traditional lenders but has not had much luck with them. Stefan arranges an SCF facility that provides a $2 million limit with credit insurance as security. Stefan uses it to pay suppliers on the due date as well as extending the terms on which he pays the SCF provider to 90 days. His suppliers have access to the platform to be paid earlier than normal due date at a discount, or receive 100% of expected amount on the due date. This arrangement has provided funding certainty and assisted projected growth; and allows Stefan to consistently pay his sub-contractors on time or early which positions his business as a preferred employer while also allowing all new projects to be confidently costed through improved cash flow management.

More reliable and efficient invoicing systems

One of the advantages that modern SCF platform providers have is that they install software packages that link the invoicing systems of buyers and suppliers, whether directly or indirectly, which facilitates less administrative work and reduced invoice disputes[11]. Suppliers who agree to participate in a supply chain financing arrangement can also expect greater certainty regarding the timing of the payment and that the payment will actually be made.

Supplier-buyer relationship

SCF arrangements can also be designed to build confidence and trust in the buyer – supplier relationship, and allow small businesses to work with big businesses in meeting shared goals. A recent example is Walmart, the world's largest retailer, working with HSBC, a leading international bank, to offer Walmart's suppliers improved financing from HSBC based on the supplier's sustainability ratings. [12]

Unlocking capital and releasing into the economy

In a broader context, the adoption of SCF arrangements helps capital that is locked up in supply chains to be released into the economy; something in the order of $42 trillion is tied up in payments in the approval state globally.

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[11] https://blog.apruve.com/how-can-your-business-benefit-from-reverse-factoring

[12] https://www.marketwatch.com/press-release/hsbc-and-walmart-join-forces-on-sustainable-supply-chain-finance-programme-2019-04-17

Concerns

Extended payment terms

It is a common refrain that supply chain financing is a “win-win-win” for suppliers, buyers, and platform and finance providers. In fact, many buyers are motivated to develop supply chain finance solutions by the promise of extended payment terms[13], even though unfavourable payment terms are especially costly for financially constrained suppliers. This can result in those firms taking on increased liquidity risk whilst cutting investments[14]. It may be the case that SCF arrangements are more likely to offer benefits to all participants where the buyer has a strategic orientation that attempts to mitigate, in the longer term, supply chain risks rather than attempts to secure short term financial benefits through practices such as extending payment terms[15].

Examples of buyers using SCF arrangements to secure their supply chains can be found in the wake of the global financial crisis where both Walmart[16] and Philips[17] introduced programs to financially buttress their suppliers. By way of contrast, there are more recent local examples of major companies attempting to link the extension of payment times with the introduction of supply chain financing arrangements[18].

The use of artificial intelligence and big data

As far back as June 2017, the International Finance Corporation (IFC) revealed there was support for the view that a “big innovation” in the SCF market was the use of transactional data for risk assessment and mitigation and that “the data collected through technology providers can be used to enhance the knowledge of the credit-worthiness of a particular enterprise, industry or region”[19]. This type of mindset is problematic for small business suppliers when they believe they are negotiating in good faith with their customers with regards to pricing and supply.

Taulia, a SCF platform provider, states that the use of machine learning and AI big business has the capacity to “identify the most suitable payment terms for individual suppliers … buyers can take advantage of prediction and network insights to find the APR that best balances supplier adoption levels against their required rate of return.”[20]

Additionally, in the same article it was stated that: “vendors with strong networks may also be able to draw upon insights from those networks about how suppliers react to offers at varying payment terms, sizes, rates and tenors.”

It is unreasonable for large businesses to use complicated and expensive AI systems to manipulate small businesses into reducing their margins. When small business data is aggregated from the top down it creates value and control for big business and the platform and financial providers. In contrast, where small businesses retain bottom up control of their data they can determine when

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[13] https://pdfs.semanticscholar.org/53cb/8909028c8afa5f889846cb1b79d38ffa0757.pdf

[14]https://www.researchgate.net/publication/327713701_A_Supply_Chain_Theory_of_Factoring_and_Reverse_Factoring

[15] https://pure.tue.nl/ws/files/3620999/387399093290135.pdf

[16] The Wall St Journal, “Wal-Mart looks to bolster suppliers”, 14 November 2019

[17] https://treasurytoday.com/asa-2010-winners/philips-highly-commended-working-capital-management-financial-supply-chain

[18] For example, see The Australian, “Telstra drops supply chain scheme, reconsiders payment plans”, 31 January 2020 ,The Australian Financial Review, “Rio Tinto caves over reverse factoring controversy”, 29 January 2020 and The Australian Financial Review, “Reverse factoring proliferation in CIMIC”, 8 October 2019

[19] https://www.ifc.org/wps/wcm/connect/fdc6f3a9-c6d1-4c49-9b5d-e5b0d5d3a7a7/EMCompass+Note+39+Supply+Chain+Financing+FINAL2.pdf?MOD=AJPERES&CVID=lPgy6Tr

[20] https://taulia.com/wp-content/uploads/2019/01/Taulia-Harnessing-the-power-of-AI.pdf

and how that data is used. When big business utilise third party platforms, small business data privacy needs to be ensured.

Supply chain "bullying"

This is a term used to describe how many large companies delay payments to their suppliers so as to improve their own cash flows[21]. Suppliers that are much weaker financially than their buyers/customers and that are co-dependent on their customers are more likely to acquiesce, even though a significant proportion of suppliers are not interested in taking up any early payment option[22] [23]. Possible reasons why large companies may put pressure on the suppliers to accept delayed payments are:

- To improve their own cash flows. This is not dependent on what portion of their suppliers take up the early payment option, as either way the buyer gets to retain the cash required to pay the invoices for a longer period.
- To give plausible reason for their auditors to accept that the funds owed to their financial providers remain a form of payables, and not debt. The reasoning used is that if only those suppliers who take up the early payment option have their terms extended then those trade payables begin to take on the appearance of debt. But, if all or most suppliers are required to accept extended payment terms, even when they decline using the early payment facility, then the buyer's auditors may be more inclined to accept that the reverse factored invoices remain a form of payable[24].

Additionally, there is the issue of small business suppliers being forced to use the big business buyer's finance provider that they have partnered with. This indicates a loss of choice for a small business to select their own SCF option if they wish to do so. This compounds the fact that small businesses will have difficulty in navigating the market if they supply to multiple big businesses who each have different SCF arrangements. This imposes extra administration burden and time required to understand how they all work and what it means financially for their small business.

Accounting disclosures by buyers

The Financial Reporting Council (FRC), the UK's regulator of auditors, accountants and actuaries, issued a report on the accounting treatment of reverse factoring to a British parliamentary investigation into the collapse of Carillion, a major UK construction company, addressing the accounting treatment of reverse factoring[25]. The key issues identified was whether the arrangement between the buyer and the financial provider should be recognised as a trade payable or as a form of debt, and whether any cash flow from the buyer under such an arrangement is operational or financial in essence.

Moody's has raised concerns that any lack of disclosure in financial statements of debt-like liabilities created by a SCF program is a risk for investors in those companies. The risk as they see it is that if the financial providers that have been financing the arrangement decide to withdraw, this would

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[21] https://www.cips.org/en-AU/supply-management/news/2018/may/ftse-100-asked-to-tackle-supply-chain-bullying/

[22] https://www.supplychaindive.com/news/uk-small-business-federation-decries-supply-chain-bullying/524582/

[23] https://taulia.com/resources/taulia-supplier-survey-2019/

[24] https://www.scfbriefing.com/why-the-long-debate-about-the-accounting-treatment-of-supplier-finance-may-be-closer-to-a-resolution/

[25] https://www.parliament.uk/documents/commons-committees/work-and-pensions/Carillion%20report/Letter-from-FRC-to-Chairs-21-March-2018.pdf

trigger a liquidity hole for the buyer[26]. The systemic risk that flows on from this point is that sub-contractors and suppliers down the supply chain will also face liquidity stress. The masking of debt-like liabilities was one of a number of issues identified in the collapse of Carillion[27]. As a counterpoint, Moody's identify Deutsche Telekom AG, Telefonica S.A. and Telenet Group Holdings NV as companies that willingly reclassify trade payables into debt.

Supplier beware

It is common for promotors of these SCF arrangements to refer to how the discount rate, or interest rate, or the transaction fee required to be paid by the supplier to access the early payment of invoices is more favourable than other funding options. However, to make any such comparisons there are several complications. For example:

- There is no standard time gap between the discounted early payment and the full priced invoice payment. Some buyers will make the fully priced invoice payment to suppliers in 30 days after the issuance of an invoice, some in 45 days and some in 120 days. A 2% discount over 30 days is quite different to a 2% discount over 120 days.
- As early payment under reverse factoring is typically from the date of invoice approval, not from the date of invoice issuance, this can result in a 5 to 15 day delay in early payments under a SCF scheme compared to traditional factoring (which is triggered by the invoice issuance). This delay in early payment under reverse factoring not only may affect the supplier's liquidity but should also be recognised in calculating their actual financing costs.
- It may not be clear whether the interest rate quoted is inclusive of all transaction fees.
- It may not be clear whether the interest rate quoted is for the payment term or is an annual rate.

To assist suppliers in assessing the various funding options being offered to them, the discount rate required by a SCF option needs to be annualised, whether that be as an annual percentage rate or as a comparison rate.

Suppliers also should remain aware that their commitment to a SCF arrangement with major customers will impact on their financing structures. The interest rate offered in any current funding arrangements typically would assume the inclusion of transactions with their major customers. Were those transactions with those major customers to be no longer part of the mix, the risk profile of, and hence the interest rate charged for, the remaining structure would likely be weakened.[28]

We are advocating that users are informed and receive fair treatment. These SCF options should not be seen as the solution for late payments or a replacement for paying business on time. They should be a supplementary option to be paid quicker than standard 30 day terms offered.

Winning on the swings and on the roundabouts

A key attribute of SCF is reputed to be that the small business supplier gets access to funds at a lower rate than they usually have available to them based on the big business buyer's superior credit rating. In return, the buyer gets to better manage its working capital. However, it seems that in some circumstances the buyer not only gets extended credit but it gets to keep a portion of that reduced rate instead of passing it all to the supplier.

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[26] https://www.moodys.com/research/Moodys-Reverse-factorings-rising-popularity-comes-with-high-but-hidden--PBC_1195322

[27] https://www.theguardian.com/business/2018/jul/09/carillion-collapse-exposed-government-outsourcing-flaws-report

[28] https://pdfs.semanticscholar.org/53cb/8909028c8afa5f889846cb1b79d38ffa0757.pdf

One version of this is associated with a product a number of SCF providers offer called dynamic discounting. With this product, the big business buyer itself provides the funding for early payment but at a discount, supposedly based on the buyer's own credit rating. However, Taulia claims on its website that buyers who use Taulia's dynamic discounting scheme can "earn a risk-free high return … by investing [their] cash to capture discounts, [they] can earn risk-free returns that are much higher than traditional investments. Our customers achieve double-digit returns and there is no risk as [they're] committed to pay at invoice maturity anyway." It would seem logical that if the buyer is earning returns that are much higher than traditional investments then some of this efficiency should be reflected in lower supplier's costs.[29]

Another way that buyers can seek to profit from arranging for their suppliers to take discounts in return for early payment is shown by the decision of Vodafone, a major international telecommunications retailer, to use its own money to invest in a SCF financial provider that was "full of invoices" from many of Vodafone's own suppliers.[30]

Who should be playing a role?

Our research and consultations so far have indicated that there is a role to be played by a broad range of regulators, including the Auditing and Accounting Standards Boards.

The issues arise primarily from how supply chain finance models and programs are used. The question as to whether supply chain finance is a financial product, operating within a financial market, needs to be answered. Utilising technology platforms to facilitate working capital between suppliers and buyers effectively creates a market. According to Australia's corporate regulator, a financial product is:

> '*generally a facility through which, or through the acquisition of which, a person … manages financial risk*'.[31]
>
> Further, you *'manage the financial consequences of particular circumstances happening; or avoid or limit the financial consequences of fluctuations in, or in the value of, receipts or costs (including prices and interest rates), for example hedging a liability by acquiring a futures contract'.*[32]

Thus, it is reasonable to consider the practice of supply chain finance is a financial product in this context as the big business buyer is managing the risk of their trade payables. Additionally, this practice is a component of advice from consulting firms as a way to optimise cash flows within the cash conversion cycle.

This raises the question as to whether there is a financial market in operation and whether the players involved are currently unregulated. A financial market imposes regulatory obligations for operators in these financial markets[33]. As referenced in ASIC's Regulatory Guide 172.30, a financial market applies to any form of technology or physical infrastructure that would enable persons to make or accept offers or invitations by means of the facility. As supply chain finance is driven by technology as the vehicle for the flow of capital, this emerging market in Australia requires the relevant regulatory bodies to have appropriate oversight of its operation in various forms.

It is important for regulators to be dynamic and ahead of the game when it comes to the development of new business practices. We learned from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that regulators were not up to date and

[29] https://taulia.com/solutions/dynamic-discounting/

[30] https://www.bloomberg.com/news/articles/2019-03-18/vodafone-finds-a-novel-investment-to-make-money-off-its-suppliers

[31] Corporations Act 2001, Chapter 7, Part 7.1, Division 3 S763A

[32] Corporations Act 2001, Chapter 7, Part 7.1, Division 3, S763C

[33] ASIC, 'Regulatory Guide 172: Financial markets: Domestic and overseas operators', May 2018

we subsequently saw the consequences of unchecked financial misconduct. Legislation and regulation is traditionally slow to catch up with trends in corporate practices and the introduction of new financial products. This is particularly exacerbated by digitisation and the rapid pace of change within and across the global economy.

ACCC

The ACCC are 'examining allegations about certain payment terms, and whether they raise concerns under Australia's competition and consumer laws'[34]. These will be reviewed under the prism of unfair contract terms legislation as well as the misleading and deceptive conduct protections of the Competition and Consumer Act 2010.

ASIC

A number of questions have been raised through consultations as to whether ASIC should consider SCF as a regulated financial product and introduce appropriate regulation.

Auditing and accounting standards

As has been evidenced internationally and referred to above, where supply chain finance operates in more mature markets, there are real concerns as to the current financial reporting by entities employing supply chain finance as a business practice. This is revealed in the 'current lack of alignment of accounting standards and practices across jurisdictions, including the main accounting disciplines'.[35]

Some analysts and ratings agencies are inclined to see the purchaser's liability to the intermediary as a form of borrowing. However, it is not standard accounting practice to account for it as such. Because there are currently no specific disclosure requirements in US GAAP concerning these types of programs, there is limited financial reporting disclosure about their existence and auditors are left to determine their own position in respect of the financial report.

On 2 October 2019, the Big Four accounting firms submitted a joint letter to the Financial Accounting Standards Board to request formal guidance regarding financial statement disclosures and presentation of cash flows that an entity entering into SCF program should provide. The authors suggested that the FASB's Emerging Issues Task Force address the issue so that "users of the financial statements will have a better basis for making informed decisions with respect to the entity's financial position, liquidity and cash flows".[36]

This is not only an issue for international audit firms who report on the accounts of big business, but also the small suburban accountants who need to understand the different products and what they mean for reporting, disclosures and assessment of business performance. We consider there may be an emerging issue of correct accounting of supply chain finance transactions within a small business; is the discount a finance charge? Or the part reversal of a sale? Or a credit note? Such options may affect the correct GST treatment and adjustment and flow through to tax compliance obligations.

[34] https://www.afr.com/companies/mining/rio-tinto-caves-over-reverse-factoring-controversy-20200129-p53vum

[35] Standard Definitions for techniques of Supply Chain Finance published by the Global Supply Chain Finance Forum 2016 p 15

[36] Ibid citing Letter from Big Four Accounting Firms to Shayne Kuhaneck, Acting Technical Director, FASB 2 October, 2019 p 4

Appendix A: Glossary

Supply Chain Finance terminology:

Receivable Purchase Category

Receivables Discounting:

Sellers of goods and services sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount.

Recourse:

The risk remains with the business. If the customer does not pay the invoice, the business will have to buy back the receivable from the finance company and chase up the bad debt themselves.

Factoring:

Factoring is a form of Receivables Purchase, by which the small business supplier sells their receivables (represented by outstanding sales invoices) at a discount to a finance provider (the factor). Factoring, as a financial product, can take many forms. The differentiation between Factoring and Receivables Discounting is that Factoring involves the finance provider taking responsibility for managing the debtor portfolio and collecting the ultimate payment of the underlying receivable. That is, **Factoring** involves selling the debt *and* the risk to the factor; once the transaction is agreed, the factor is responsible for pursuing and ultimately collecting the debt.

Whole-of-ledger factoring requires a business to sell *all* invoices to the factor – including those for customers who pay on time. This means the business will be paying a fee to the factor for financing a receivable that will most likely be paid on time anyway. Alternatively, **spot factoring** or **single invoice discounting** allows the business to pick and choose which invoices to sell to the factor, giving the business more flexibility (often at a higher cost).

Payables finance:

Is provided through a “buyer led” programme by which the sellers in the buyer’s supply chain are able to access finance by means of receivables Purchase. This technique provides a small business seller with the option of receiving the discounted value of receivables ***prior*** to their actual due date and typically at a financing cost aligned with the (better or stronger) credit risk of the big business buyer.

Loan or Advance-based SCF category

Loan or Advance against receivables:

Financing made available to a party involved in a supply chain, to be repaid from funds generated from current or future trade receivables (sales invoices issued). Usually made against the security of such receivables. May be secured or unsecured.

Distributor Finance:

Is financing for a distributor of a large manufacturer to cover the holding of goods for resale and to bridge the liquidity gap until sales invoices to end customer are collected.

Loan or Advance against Inventory:

Is financing provided to a buyer or seller involved in a supply chain for the holding or warehousing of goods. The finance provider usually takes a security interest or assignment of rights and exercises a measure of control.

<u>Pre-Shipment Finance:</u>

Is a loan provided by a finance provider to a seller for the sourcing, manufacture or conversion of raw materials or semi-finished goods into finished goods/ stock before it is delivered to a buyer. A purchase order from an acceptable buyer is a key ingredient in motivating the finance – in addition to the seller's ability to perform the contract.

General Terminology

Artificial Intelligence	Refers to the simulation of human intelligence in machines that are programmed to think like humans and mimic their actions. Machines may exhibit traits associated with a human mind such as learning and problem-solving whilst using its ability to rationalise and take actions to have the best chance of achieving a specific goal.
ACCC	The Australian Competition and Consumer Commission.
ASIC	The Australian Securities and Investments Commission.
Event Driven	Finance providers offer their services in the context of the financial requirements triggered by purchase orders, invoices, receivables, other claims and related pre-shipment and post-shipment processes along the supply chain.
External financing	Business finance sourced from lenders and or investors that are outside the business. These can include banks, credit unions, Fintech lenders, etc.
Fintech lenders	Fintech lenders are non-bank small and medium sized business lenders who are an alternative source of business finance through seamless and highly automated online application, assessment and decision processes. These lenders often require less documentation for lending facilities however their costs and ongoing fees may be higher than the regular banking sector.
Liquidity	Liquidity is the amount of money that is readily available for investment and spending. It consists of cash and any other asset that can be sold quickly. Understanding liquidity and how it can help businesses and individuals understand trends in the economy and stay on top of their finances.
Misuse of market power	Section 46 of the Competition and Consumer Act 2010 (CCA) has been revised. Section 46 now prohibits a firm with a substantial degree of market power from engaging in conduct that has the purpose, effect or likely effect of substantially lessening competition in a market.
Open Account Trade	Refers to trade transactions between a seller and a buyer where the buyer is directly responsible for meeting the payment obligation. An

	invoice is usually raised and the buyer pays within an agreed time frame.
Payment terms / Payment times	Payment Terms are the legal or contractual stipulation by a business as to when payment is to be made for goods or services supplied, e.g. cash with order, payment on delivery, or within a particular number of days of the invoice date. Payment times are when invoices are actually paid.
Reverse factoring	Generally a financing option led by a buyer where both the buyer and the supplier receive a short term credit against an invoice. It is a three way finance process between supplier, buyer and a financial institution. The supplier will get access to cash more quickly than their normal trading terms with the buyer but they will be required to accept a discount on the invoice amount to be paid early.
Small business and family enterprise (SBFE)	Under the ASBFEO Act 2015 a small business and family enterprise is defined as fewer than 100 employees or revenue in the previous financial year is $5,000,000 or less
Supply chain	A supply chain is a network that operates between a business and its suppliers to provide a product or service for redistribution or sale. A supply chain may include producers, warehouses and retailers.
Supply Chain Finance (SCF)	The use of financing and risk mitigation practices and techniques to optimise the management of working capital and liquidity invested in SCF processes and transactions. Typically applied to "open trade" accounts and triggered by supply chain physical events. Need to appreciate that SCF includes a broad range of established AND evolving techniques.
Working Capital	The capital of a business which is available for use in its day-to-day trading operations. Calculated as the difference between current assets and current liabilities.

Appendix B: Terms of Reference

SUPPLY CHAIN FINANCE REVIEW

Project Plan

Purpose

ASBFEO to review the impact of supply chain finance (SCF) in the economy, including the products being used as part of strategies offered by large businesses to offset extended payment times. Also, to examine the ways in which small businesses and family enterprises (SBFE) can use SCF to manage their cash flow and fund growth.

Scope

- To describe the various SCF options available in the economy;
- To explain and calculate how these SCF options may assist SBFE, particularly cash flow management and funding for growth;
- To research and describe SCF within specific industry sectors, and whether specific industry sectors use particular SCF options;
    - To examine whether the use of specific SCF options to the exclusion of other options negatively affects SBFE.
- To research the incidence of SBFE losing the element of choice in which SCF provider they might use because of big business Debtor SCF arrangements/contracts;
    - To research the incidence, if any, of SBFE being coerced, pressured or disadvantaged by a big business Debtor in relation to the timely payment of SCF invoices;
    - To conclude as to the impact on cash flow of those SBFE who are bound by SCF arrangements;
    - To research potential kickbacks to big business Debtors using a particular SCF entity;
- To consider any broader impacts on SBFE who use SCF – ability to borrow;
- To research and discuss the reporting of SCF arrangements on the Balance Sheet (more broadly, the financial reporting) of big business Debtor companies to investigate the existence of SCF being utilised as a strategy to manipulate the reporting of working capital and cash reserves by big business; analyse any resulting detriment to investors and SBFE suppliers in the form of systemic risks or uncertainty;
- To research and learn from the International Experience of SCF, in particular the UK, EU and discover if Australia is different to international examples;
- Investigate why there is an increased adoption of SCF offerings in the market;

Investigate the potential impact of SCF on meeting mandated government payment terms.

Appendix C: Survey Questions

This survey is to collect experiences from small businesses and family enterprises that have utilised supply chain finance arrangements.

The case studies provided will help identify, and form recommendations to address, the opportunities and challenges faced by small businesses and family enterprises when adopting supply chain finance arrangements.

The survey should take approximately 10 minutes to complete. We ask broad questions about your business and provide a free-text box for further information you may like to provide.

The survey should take approximately 10 minutes to complete. We ask broad questions about your business and provide a text box for your outline.

About your business (mandatory):

1. What industry sector(s) do you operate in?
2. Metropolitan or regional centre?

About your experience:

3. Please outline your experience(s) with supply chain financing.

The following questions are to understand how you use Supply Chain Finance.

4. Have you found supply chain financing an effective tool to better manage your cash flow or as a method for funding business growth?
   a. No
   b. Yes. How did it help?
5. Have you been required to agree to extend 'standard' payment terms in order to access supply chain financing options?
   a. Yes
   b. No
6. Did you have a choice in which supply chain finance supplier to use?
   a. Yes
   b. No. Was there a reason given as to why there was no choice?
7. Did you seek, and if so who from, advice about using supply chain finance?
   a. No
   b. Yes. Who did you receive advice from?

Contact Details

8. If you are willing for your case to be referred to in our report, please provide your contact details

Close

Thank you for taking the time to complete this survey.

Appendix D: Consultations

Regulator	ACCC
Banking	ANZ
SCF Provider	Apricity Finance
Regulator	ASIC
Banking	Australian Banking Association (ABA)
Small business	Australian Sub-contractors Association
Big Business Debtor	BHP
Big Business Debtor	Boral
SCF Provider	C2FO
Banking	CBA
Big Business Debtor	CIMIC
Big Business Debtor	CPB Contractors (CIMIC subsidiary)
Big Business Debtor	Thiess (CIMIC subsidiary)
Big Business Debtor	UGL (CIMIC subsidiary)
Big Business Debtor	Coles Myer
Adviser	Deloitte
Big Business Debtor	Downer
SCF Provider	EarlyTrade
Adviser	Ernst & Young
SCF Provider	FIFO Capital
Big Business Debtor	GFG Alliance (Gupta)
SCF Provider	Greensill Capital
Adviser	KPMG
Big Business Debtor	Microsoft
Banking	NAB
Big Business Debtor	Nestle
Big Business Debtor	Pacific National
SCF Provider	PrimeRevenue
Adviser	PwC
SCF Provider/Platform	Taulia
Big Business Debtor	Telstra
Big Business Debtor	Visy
Big Business Debtor	Vodafone
Big Business Debtor	Wesfarmers
Big Business Debtor	Bunnings (Wesfarmers subsidiary)
Big Business Debtor	K-Mart (Wesfarmers subsidiary)
Banking	Westpac
Big Business Debtor	Woolworths
Various Industry stakeholders	

Key	
	Consulted with
	Pending consultation
	Reached out and no response to date, further contact will be attempted