Australian Government

Australian **Small Business** and **Family Enterprise** Ombudsman

Working Paper 1

Trade credit, Australian Government policies and overseas responses to payments practices

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Payment times and practices

1. The Office of the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) conducted its first self-initiated inquiry from November 2016 to March 2017 on Payment Times and Practices in Australia. The Inquiry came as a result of feedback from small business and family enterprise during 2016 saying that late and extended payments is their number one problem. The Inquiry was conducted in consultation with a reference group with representatives from the state-based Small Business Commissioners, the Council of Small Business Australia (COSBOA), The Australian Institute of Credit Management (AICM) and the Institute of Public Accountants (IPA).
2. The Terms of Reference were to consider:
    - the practice of corporations setting payment terms particularly for small businesses;
    - trends in payment terms and late payment with emphasis on commercial dealings between small business with large corporations;
    - the effects and impacts that long payment times have on small businesses; and
    - potential regulatory and market-based responses available including recent developments such as unfair contracts legislation.
3. This working paper is part of a suite of working papers prepared to report on the Inquiry process and data results. The working papers are to be read in conjunction with the Payment Times and Practices Inquiry Final Report which sets out the recommendations of the Inquiry. This paper outlines the Inquiry's research into:
    - background, characteristics and developments in trade credit;
    - payment policies of Australian governments; and
    - overseas responses to the issue of late and extended payments.

Background to trade credit

4. Trade credit is the practice of supplying goods and services to a business or individual with an agreed payment at a later date. Not all businesses use trade credit instead requiring upfront or pre-payment for goods and services supplied. For example, some sole traders require upfront payment or cash on delivery. In allowing a delayed payment, businesses are providing their customers a form of credit financing and in doing so accept a degree of risk associated with that financing.
5. The nature of trade credit between businesses varies by industry and the businesses within that industry. Businesses can vary trade terms to suit their competitive needs, their assessment of the risk profile of their customer and/or their financial limitations.
6. Trade credit is largely a business to business practice governed by contract law. There is no government regulation regarding the provision of trade credit nor do businesses need any financial licensing to offer trade credit. Legislation exists which regulates aspects of trade credit such as payment times, for example, state-based security of payment legislation for the building and construction industry.
7. Academic literature on the topic of credit looks at the rationale and reasoning as to why businesses offer trade credit and the associated costs and benefits to businesses. Importantly,

the literature[1] highlights the types of relationship between businesses offering trade credit and the dual characteristics of trade credit in terms of both a commercial relationship (trade between parties) and a financial relationship (the extension on credit between parties).

8. Viewing the provision of trade credit through these two distinct lenses (financial and commercial) enables a simple analysis of the dilemma faced by a business providing trade credit. The relative value of the relationship can be assessed against the commercial benefit of the customer to the business plotted against the cost of supplying the credit incurred by the supplier. This is shown in Figure 1 below.

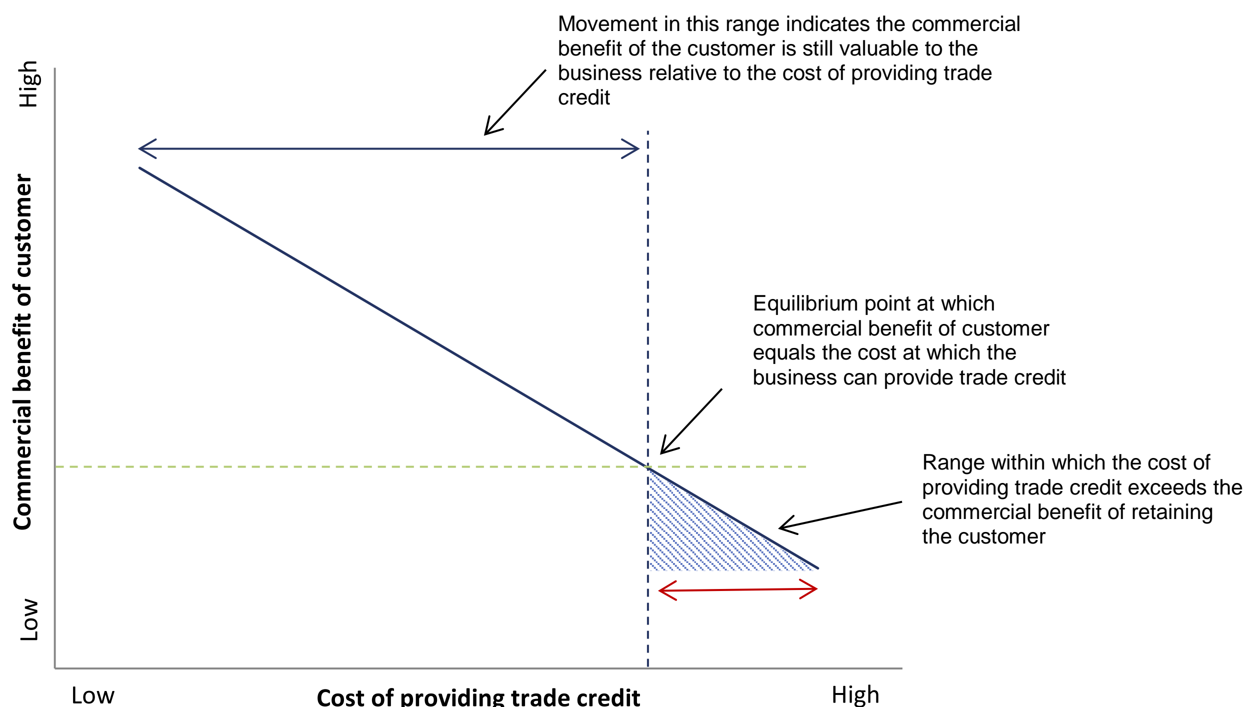

Figure 1 - Value of customer to business offering trade credit

9. Factors influencing the commercial benefit of the customer include the relative importance of the customer to the supplier business and the profitability of the relationship to the supplier business. Factors influencing the cost to the supplier business include the cost of financing and the certainty of payment.

10. Along the line there is a range where there is value in retaining the customer as measured by the commercial benefit to the business against the cost of providing the trade credit to the customer. This benefit bottoms out at an equilibrium point where the cost of providing the trade credit equals the benefit received from supplying to the customer. It is movements past this point where issues such as late or extended payment times impact on the factors (cost of finance and certainty of payment) influencing the cost of providing trade credit. This is to the detriment of the supplier and from this point on the cost of providing trade credit outweighs the commercial benefit of the customer relationship. At this point it is in the suppliers benefit to find an alternative customer.

[1] See Cuñat, V (2007)

11. In commercial dealings an asymmetry of power exists between larger and small businesses. The asymmetry of power between the two parties can lead to situations where the smaller, less powerful supplier will move close to, and even beyond, the equilibrium point due to late or extended payment times from the larger customer. The 'danger zone', is an area close to, and extending past the equilibrium point. This situation suits the larger customers' needs to the detriment of the smaller supplier. The smaller supplier has limited choices, particularly in relation to late payments, especially if they want to retain the customer relationship. It is in this 'danger zone' which a suppliers' business is likely to experience significant financial strain.

Trade credit and bargaining power

12. Larger businesses can demand their trade credit terms from suppliers. This is a well-established practice as they seek to use their size and power to their benefit. In Australia, for a large number of industries and businesses, the 30 day net[2] payment term is a traditional term. However, there is a growing trend that businesses, particularly larger businesses, are demanding extended trade credit terms. Payment times of 45, 60, 90 and even 120 days are being reported by businesses as a contract condition for supplying to larger businesses. Comments from submissions also show that intermediary businesses, subject to extended payment terms, gradually restructure their payment terms to their own suppliers using their bargaining advantage. This cascades the extended payment terms through the supply chain ultimately resulting in suppliers at the end of these supply chains being under considerable financial strain.

13. There is little academic research which explores the micro- and macro-effects of larger businesses imposing trade credit terms on smaller businesses. The available research[3] indicates that suppliers with weak bargaining power will extend trade credit and will allow an important customer to extend payment terms beyond its standard terms. The same suppliers will also delay imposing penalties on important customers not meeting payment terms. This can be attributed in part to wishing to maintain the relationship. In addition, other sources and survey data indicate when faced with illiquidity, businesses will delay paying back their trade credit. This causes a knock on effect as it filters through the supply chain, particularly during periods of financial crisis.[4] Submissions to the Inquiry and survey data support these behaviours.

14. The flow on effect of late payments and extended payment times is of concern to the efficiency of supply chains and the wider economy. Advice from researchers suggest that it is inefficient if, seemingly larger, liquid and less credit-constrained businesses, seek to demand extended trade credit terms from smaller, less liquid and credit-constrained businesses. The flow-on effect impedes the decisions which businesses further down the supply chain can make. This limits their ability to hire staff, pay staff more or grow their business. Instead investment decisions are concentrated with a smaller cohort of larger businesses at the top of the supply chain, which represent only 6% of Australian businesses, in effect restricting further economic growth to decisions made by this small pool of businesses.

Trade credit and working capital management

15. From an individual business perspective, cash flow is the most critical component to its success and management of working capital (the management of current assets and current

[2] 30 days net is a common payment term indicating payment is expected in 30 calendar days from supply.

[3] Fabbri and Klapper (2013)

[4] Love et al (2007) and Love and Zaidai (2010)

liabilities to ensure sufficient liquidity for daily operations) will often determine its on-going viability and success. Data from the Australian Securities and Investment Commission (ASIC) lists poor cash flow as the leading reason for business insolvency in Australia.

16. The management of working capital is increasing in sophistication and focus, particularly for larger businesses, as they seek to optimise their cash flow, minimise their costs (particularly financing costs), focus on customer experiences, improve returns to shareholders, and to gain a competitive advantage over peers. This is especially true in the Fast Moving Consumer Goods (FMCG) sector where product prices for consumers are highly competitive and businesses must seek to control their costs and maximise their working capital efficiency by extracting more favourable terms from their suppliers.

17. There is a global trend in multinationals maximising efficiencies in their working capital arrangements. Large advisory firms in Australia are now offering services to review the working capital arrangements and processes for clients to identify the areas which would optimise the businesses working capital. Australia is seen as a market with untapped potential for such advice. In optimising working capital, it was revealed that advisory firms can examine over 150 areas of business processes and procedures to assess working capital management.

18. There is no regulation of this practice and it is a commercial decision to structure a business on a more cash efficient basis. However, it is noted that extensions to ‘payment terms’ attract attention. There is growing attention by the media, public and industries of the practice by larger businesses extending payment terms. This is often portrayed in the media as larger businesses using suppliers as a cheap source of finance and highlights the lack of corporate social responsibility and fairness in treatment of supply chains. In FY16 these same large advisory firms won more than $510 million in Australian Government contracts which are usually paid by on a 30 day term.

Australian governments payment times and policies

19. The value of government procurements across Australia is over $100 billion collectively each year. The Australian and the majority of State and Territory governments have publicly recognised the importance of prompt payments either through prompt payment policies or contract terms. The majority have policies which pay penalty interest, subject to conditions, for late payment. A 30 day payment term is common, usually on a net basis. Depending on the type and complexity of the procurement a range of different payment terms and options are used.

20. An example of the terms applying to a $100,000 non-Information Communication Technology (ICT) procurement of services is presented in Table 1. This example compares the State, Territory and Australian Government terms and payment applicable.

Australian Government

21. The Australian Government has a variety of standard form templates for procurement including the Commonwealth Contracting Suite and the ASDEFCON Suite (used for Defence purposes). These are part of an overall Commonwealth Procurement Framework. Policy guidance establishes the criteria upon which these contracting suites are applicable. These standard form contracts usually include 30 day payment terms.

22. The Australian Government maintains a ‘Pay on time’ policy. The current policy[5] sets out a 30 day payment policy upon receipt of a correctly rendered invoice for contracts up to $1 million

[5] Supplier pay on-time or pay interest policy see [http://www.finance.gov.au/resource-management/spending/pay-on-time-policy/]

(GST inclusive) for any government supplier. The policy came into force on 1 July 2014. The policy has a number of exclusions and applies only to non-corporate Commonwealth entities and excludes government business enterprises. The policy includes a provision for penalty interest to be paid automatically (i.e. without requiring the business to apply for it) once the amount of interest payable reaches $100.

23. Prior to 2014, the previous 'Pay on time' policy applied only to small business suppliers for payments valued up to and including $5 million (GST inclusive). Entities were required to adopt payment terms of 30 days or less from the date of receipt of a correctly rendered invoice and pay interest on late payments once the value of interest reached $10.

24. The Australian Government's performance against this policy is monitored by the Treasury through an annual survey. The most recent survey comprises data from 32 departments and shows the average percentage of invoices paid on time is over 97% against a benchmark of 90%.

25. Presently, the benefits of the 'Pay on time' policy only flow to the business which is directly contracting with the Australian Government. Subcontractors who do not have a direct commercial relationship are subject to the prime contractor's payment terms and other conditions. Similarly, the 'Pay on time' policy applies to non-corporate Commonwealth entities meaning commercial government entities do not have to follow the policy. The design of the policy means that a late paying entity does not pay penalty interest until it accumulates to $100, essentially suspending the penalty for a period of time. Finally, the policy does not require any reporting and there is no policy obligation for departments to participate in the annual survey on performance against the policy.

State and Territory governments

26. State and territory governments have a variety of standard form contracts in their procurement frameworks which are used to simplify and streamline procurement. The variety of templates include public works/building and construction templates, ICT templates as well as long and short form templates for procurement of goods, services and consultancies. These standard form contracts usually include a default 30 day payment term but several allow for other payment times to be agreed.

27. State and territory governments have policies, contract terms or legislation requiring their entities to "pay on time or pay interest" to suppliers, subject to conditions. These conditions could limit the application of the policy to businesses of a certain size, a contract value amount or a combination of both. To claim penalty interest, some require the supplier to lodge the request while others automatically apply the penalty interest once it reaches a certain threshold.

28. The benefits of the prompt payment policies will often not flow to sub-contractors, who are bound to the prime contractor's terms and conditions. Similarly, policies do not apply to all entities as highlighted in submissions that hospitals and government commercial entities regularly pay late.

29. The requirement for performance reporting against pay on time policies or late payment is varied as not all publicly report on the information. Those that do report use a number of different mechanisms including annual reports, and specific publications like websites. The most common form of reporting is to a central agency. There is no consistent format for reporting or the type of information required for reporting.

Local government

30. Local government authorities across Australia, in general, have a broader range of payment terms. As with the Australian, state and territory governments a variety of standard form contracts are used to simplify the contracting process. A sample of publicly available payment terms is provided in Table 2.

31. From the range shown 30 days appears to be a common term. An equal number use 'net term" and "end of month". The latter can lead to extended payment time for suppliers of up to 60 days depending on when they lodge their invoices.

32. There was limited public information as to local government authorities policies for "paying on time" or to reporting payment performance. The exception to this was a number of NSW local government authorities participating in the Small Business Friendly Council program.

33. The Small Business Friendly Council program is a joint initiative developed by the Office of the NSW Small Business Commissioner in partnership with the NSW Business Chamber and commenced in 2014. One of the undertakings of participants is to implement a pay on time policy and some include simple, late payment interest provisions.

Improvements to government policies

34. Improvements at all levels of government can be made. These can include:

- formal articulation of a payment policy (outside of contract terms and conditions) for both prompt payment and late payment interest;
- ensuring late payment penalty interest is automatically applied without requiring a supplier to apply or request penalty interest payments;
- expanding the range of entities and criteria to which prompt payment policies apply; and
- accurate, consistent and regular monitoring and reporting of performance against these policies.

Comparison of Commonwealth, State and Territory Standard form contracts for a one-off procurement of non-ICT services priced at $100,000 in value for under 3 months work.

State	Commonwealth Contracting Suite	Commonwealth - Defence (ASDEFCON Suite)	ACT	NSW	NT	QLD	SA	TAS	VIC	WA
Timeframe for Payment applicable	30 days from correctly rendered invoice	30 days from correctly rendered invoice	Payable within 30 days of receipt by the Territory of an invoice	Within 30 days of receipt of a valid claim for payment, in the form of a tax invoice and including any supporting documentation	30 days from non-disputed invoice.	The Customer will pay each correctly rendered tax invoice within 30 days of receipt	Not specified in template but able to be tailored.	As negotiated in contract. If under 50,000 contract would be paid in 30 days.	Will pay the invoiced amount within 30 days of receipt of an accurate invoice.	Within 30 days of receipt of a valid claim for payment, in the form of a tax invoice
Late payment interest	Yes – for any business with contracts under $1 million, applied automatically when reaching $100. Outlined in RMG-417 Supplier Pay On-Time or Pay Interest Policy	Yes – for any business with contracts under $1 million, applied automatically when reaching $100. Outlined in RMG-417 Supplier Pay On-Time or Pay Interest Policy	Yes – for any commercial debt. Outlined in *Government Procurement Act 2001* and the Interest on Commercial Accounts circular (2007/12)	Yes – for small businesses payments must be made within 30 days of receipt of a correctly rendered invoice, unless an existing contract or standing offer. Outlined in NSW Treasury Circular 11/12.	Yes – outlined in contract and NT Government 30 Day Payment Policy. Companies must apply for the interest within 90 days of the late payment being made. (	Yes – for small businesses payments must be made within 30 days of receipt of a correctly rendered invoice. Outlined in Queensland Government – Late Payment Policy	Yes – for small business if payment made after 30 days. Outlined in *Late Payment of Government Debts (Interest) Act 2013* and Treasurer's Instruction 11 Payment Of Creditors' Accounts	Yes – for purchases under $50,000 only. Outlined in Treasurer's Instruction 402 Cash Management	Yes - outlined in standard terms and conditions and in Fair Payment Policy (2004).	Yes – outlined in contract terms and conditions and Premier's Circular 2009/03 and Treasurer's Instruction - 323 - Timely Payment Of Accounts
Public reporting of performance against policy	Yes – Survey of Government Agencies conducted by Commonwealth Treasury	Yes – Survey of Government Agencies conducted by Commonwealth Treasury	None publicly available	Yes – quarterly reporting to Dept. of Treasury & Finance and in Agency Annual Reports. Outlined in in NSW Treasury Circular 11/21.	Yes – Annual report of Department of Corporate and Information Services	Yes - Departments are required to be report and publish on a quarterly basis on a Government website	Yes – quarterly reporting to Dept. of Treasury and Finance, published annually on DTF's website. Reporting required in Treasurer's Instruction 11 Payment Of Creditors' Accounts	Not apparent - Agencies are encouraged to incorporate relevant measures into agency performance indicators by Treasurers Instruction 402. Dept. of Treasury and Finance Payment of Accounts (2014) policy requires departments to report their annual report but this does not appear to be occurring.	Yes – Victorian Small Business Commissioner has undertaken reviews of compliance with policy in the past.	Yes – Office of Auditor General has conducts periodic reviews of performance against the policy.

Table 1 - Comparison of Government contract terms

Council	Wollongong City Council	Inner West Council - Leichhardt	Lismore City Council	Whitehorse City Council	Boroondara City Council	Greater Shepparton Council	Townsville City Council	Brisbane City Council	Central Highlands Regional Council	City of Adelaide	Roxby Council	City of Palmerston	City of Launceston	City of Swan	City of Belmont
State	NSW	NSW	NSW	VIC	VIC	VIC	QLD	QLD	QLD	SA	SA	NT	TAS	WA	WA
Payment term	30 days end of month.	28 days net from receipt of valid invoice	30 days net from receipt of valid invoice	30 days net for undisputed invoices	Invoices must be submitted by 28th of the month for payment on the last day of the next month (approx. 30 days end of month).	30 days from receipt of invoice	30 days net for undisputed invoices	30 days net for undisputed invoice	30 days end of month from receipt of valid invoice	Invoices must be submitted by last business day for payment on the last business day of the next month (approx. 30 days end of month).	30 days end of month for goods and works	28 days from receipt of invoice	30 days end of month for goods and 30 days net for other purchases	30 days net from receipt of valid invoice	30 days end of month

Table 2 - Comparison of Local Government payment terms

Learnings from overseas experiences

35. The challenges confronting businesses from late payments and extended payments are not confined to Australia. Overseas jurisdictions have sought to tackle both issues through industry, government policy, legislative responses or a combination of these approaches. Significantly, many jurisdictions sought to address these issues only following the 2008 Global Financial Crisis (GFC). Common to each jurisdiction's response is the recognition that late payments and extended payment times have a greater impact on small businesses which in turn inhibits growth in the economy.

The United Kingdom experience

36. The United Kingdom first tackled the issue of late payments in 1998 with the introduction of the *Late Payment of Commercial Debts (Interest) Act 1998*. This Act provided a statutory right which enabled businesses to charge interest on overdue commercial debts. The Act does not interfere with a business' right to contract freely nor is it compulsory for businesses to claim.

37. Through its European Union (EU) membership, the UK is also subject to EU directives on late payment. The first directive was Directive 2000/35/EC of 29 June 2000 which sought to allow businesses to impose penalty interest and allow recovery of debt collection costs. Implementing the EU directive expanded the scope of the UK law and brought forward the timeframe for full compliance.

Prompt Payment Code

38. In 2008 the UK government along with industry developed the Prompt Payment Code. The Code aims to set the standards for payment practices and is a principle based approach whereby signatories seek to address late payment culture. The core principles of the code are:
    - pay suppliers on time;
    - give clear guidance to suppliers; and
    - encourage best practice throughout their supply chain.

39. The Code is administered by the Chartered Institute of Credit Management (CIMC). The CIMC seeks to maximise awareness through publicity for changes to the Code, new signatories or the removal of non-performing signatories to keep the debate for prompt payment times in the public arena. The Department for Business, Energy & Industrial Strategy refers to the Code as a representation of the best practice standard for industry to mitigate late payments and reduce extended payment times.

40. The Code has been criticised on several fronts including its voluntary nature, the lack of incentive to sign up, sporadic monitoring of compliance by signatories and the lack of enforcement options. While recent changes including the addition of a compliance board, a requirement for signatories to provide five supplier referees and applications to be endorsed by a board member try to address the criticism the Code has only 1,947 signatories from a possible 5.5 million businesses in the UK.

41. The impact of the GFC and the subsequent EU's economic recovery response led to EU Directive 2011/7/EU of 16 February 2011. This directive sought to address late payment and extended payment terms by setting a 60 day payment term with conditions, and a 30 day payment term for public entities. The UK legislation adopted the *Late Payment of Commercial Debts Regulations 2013* in March 2013 which implemented the EU directive. Entities are able to contract to terms greater than 60 days provided it is agreed by both parties and not grossly unfair to the supplier.

Duty to report

42. These measures saw some improvement in some businesses payment times but did not impact businesses who use late and extended payment times to their advantage. Acknowledging that voluntary measures and a legislated guideline did not change poor practice the government has introduced further legislation, the *Small Business, Enterprise and Employment Act 2015*. The Act places a duty on larger business to report on its payment practices. To further support small businesses the government is also establishing a Small Business Commissioner.

43. The duty to report targets larger companies and large partnerships and came into effect from April 2017 under the *Reporting on Payment Practices and Performance Regulations 2017*. The aim of the reporting is to improve transparency around the practices of larger businesses as the reports will be publicly available.

44. Increasing the transparency of payment practices is anticipated to yield a twofold benefit. Firstly, businesses will be required to disclose their performance against its payment times and practices which will highlight to the board poor practices that may impact reputation and competitiveness. Secondly, it will allow potential suppliers to assess the cost of trading with the business, particularly if the larger business has extended times and consistently pays late.

Other UK Government initiatives

45. In 2009, the UK Government Construction Board sought to address the issue of security of payment and late payment on government construction projects through the introduction of Project Bank Accounts (PBA) under Policy Procurement Note 2/2010 effective from October 2010. This was further strengthened by the inclusions on the use of PBAs in the Construction Strategy released in 2011.

46. PBA's require the principal contractor to establish a trust account for subcontractor payments with the principal and sub-contractors as beneficiaries. This quarantines the monies for future payment (in case of insolvency of the principal) and largely removes the 'control' over the funds from the principal and assists in reducing payment times for sub-contractors. Initial research[6] identified savings in the supply chain of up to 2.5% relating to reduced costs associated with sub-contractors cash flow certainty and a reduction in finance costs.

47. The government also has a fast payment policy for its suppliers. The Central Government Prompt Payment policy, first outlined in 2010, requires most government departments and agencies to pay 80% of undisputed and valid invoices within 5 days with the remainder paid in 30 days.[7] The policy does not impart a legal obligation on the agencies to adhere with the policy and requires agencies to report on a quarterly basis via a government website. The government is also moving to rollout an e-invoicing process to maximise payment process efficiency and reduce processing costs.

48. Complementing PBAs and the Prompt Payment Policy is Regulation 113 of the *Public Contracts Regulations 2015*. This requirement, introduced in 2015, requires payment of undisputed invoices within 30 days throughout the government supply chain. It requires the principal contractor to include similar payment times in their subcontracts and those subcontractors to also include similar contract clauses and practices.

49. Advice from the UK Department for Business, Energy & Industrial Strategy, which has responsibility for administering policy for private industry payments legislation and measures, noted the combination of hard and soft measures to address the issues of late and extended payments. The combination of the legislated payment times, the statutory rights for interest

[6] See Office of Government Commerce "Guide to Best 'Fair Payment' Practices" Annex A
[7] See Central Government Prompt Payment Policy at https://www.gov.uk/guidance/prompt-payment-policy

and debt collection cost recovery, the voluntary industry payment code, transparency around large business payment practices, project bank accounts, flowing through of payment practices in government supply chains and central government payment policy provide a comprehensive approach to address late and extended payments.

50. Each measure addresses a specific business to business power imbalance issue, or a statutory right for creditors, irrespective of size or bargaining power, and demonstrates the government's commitment to act as a leader to change late payment culture.

The European Union experience

51. The European Commission first recognised late payments as a common market issue in 1993 in examining internal EU market subcontracting and SME participation in public procurement. In May 1995, the European Commission issued a recommendation regarding payment periods in commercial transactions which sought to improve transparency and practices. These early efforts proved ineffectual and led to the first directive (Directive 2000/35/EC) issued in June 2000 which sought to impose penalty interest and allow recovery of costs by creditors. Member states had until 8 August 2002 to incorporate the directive into their legislation.

52. This was followed by EU Directive 2011/7/EU of 16 February 2011, which stemmed from a recommended action from the European Commission's European Economic Recovery Plan communique in November 2008. It sought to promote SMEs by ensuring cash flow through payment of invoices within one month.

53. The Directive sets a time frame of 60 days for business to business transactions and 30 days for business to public entity transactions. As noted above businesses can agree to longer contract terms provided they are not "grossly unfair". 'Grossly unfair' terms are to be determined by a judge but the directive includes some examples such as contracting out of penalty interest or compensation for recovery costs.

54. Member states had till 16 March 2013 to implement EU Directive 2011/7/EU with the capacity to implement how it best fits each jurisdiction. Following is a sample of responses by member states.

Country	Response
Austria	60 days (parties are able to negotiate a longer term but this is likely to be considered unreasonable if a dispute arises)
France	60 days or 45 days from the end of month
Germany	30 days (parties are able to negotiate a longer term but this is likely to be considered unreasonable if a dispute arises)
Ireland	60 days (parties can negotiate a longer term as long as it is agreed in writing and not grossly unfair to the creditor)
Spain	60 days
Sweden	30 days (parties can negotiate a longer term as long as it is agreed in writing and not grossly unfair to the creditor)

55. Some member states went further. Spain implemented a payment time corporate reporting obligation for trading companies to publish in the notes to their consolidated accounts, and on

its website, the average period of time for payments to suppliers.[8] The UK duty to report requirement has taken a similar approach requiring large companies to publicly report similar information.

56. The EU has monitored the implementation of the Directive into member states legislation and has taken action against any which have not incorporated the minimum provisions adequately.

57. Recent reports on the effectiveness of the Directive show that there has been some improvement with average EU payment period slowly decreasing. An evaluation[9] found that the cost to the trading companies is more than offset by the benefits reaped through clear legal payment obligations and statutory rights.

58. Evaluation also noted that businesses still accept late payments and extended payment times for fear of upsetting their commercial relationship. This was considered to reflect a supplier's position in the supply chain, relative bargaining power and degree of dependency on the business from the customer. The evaluation also calculated that the Directive, though still in its infancy, for each day reduced in payment times, saved approximately €158 million in financing costs.

"der Deutsch-Ansatz" - The German approach

Germany implemented the directive through changes made to the German Civil Code (*Bürgerliches Gesetzbuch*) to limit individual contractual arrangements to 60 day payment terms at a maximum and 30 days maximum for standard terms and conditions.

Longer payment terms on individual cases are possible but only in exceptional circumstances. In addition, the code includes strict criteria for private businesses which in effect limit payment times to 30 days. It also includes strict time limits on verification of receipt of goods and services required for claims to be paid.

Other changes included statutory agreement on when a default occurs, increases in statutory interest rates on late payments, fixed compensation for late payment and modifying the modifications to the law for when injunctions on invalid terms and conditions can be brought in.

The Irish experience

59. As an EU member, Ireland implemented the first EU directive (Directive 2000/35/EC) providing a statutory right to charge interest on commercial transactions through the *European Communities (Late Payment in Commercial Transactions) Regulations 2002 (S.I. No. 388/2002).* Following the second EU directive (EU Directive 2011/7/EU), Ireland implemented the directive into several acts to give effect to the directive's minimum requirements in *European Communities (Late Payment in Commercial Transactions) Regulations 2012 (S.I. 580/2012)*.

60. The Department of Jobs, Enterprise and Innovation, which has policy responsibility for late payments policy, noted that there was considerable interest from small business groups to move the translation of the EU directive to a 30 day maximum payment time instead of the 60

[8] Information required by the third additional provision of Law 15/2010, of 5 July (amended by the second final provision of Law 31/2014, of 3 December) approved in accordance with the resolution of ICAC (Spanish Accounting and Audit Institute) of 29 January 2016
[9] European Commission Staff Working Document "Evaluation of the Late Payment Directive/REFIT Evaluation" SWD (2016) 278 final, pp 27-30.

days in the Directive. Ultimately, the government implemented the Directive in consideration of internal common market competition noting that a lower term could act as a disincentive for businesses to invest in Ireland.

61. The government introduced a 15 day payment policy for its departments and agencies in 2009. This policy committed government departments to pay suppliers in 15 calendar days from receipt of an invoice. This policy was extended to all government authorities including local authorities as a condition of the EU/International Monetary Fund (IMF) Program for Ireland bailout package. The Department of Jobs, Enterprise and Innovation publishes performance against the policy on a quarterly basis.

A tale of two codes – The Irish Prompt Payment Code

Ireland launched a prompt payment code in 2015 based following promotion of the idea by an advisory body to the Irish Small Business Minister in 2011.

The Code is largely modelled off the UK code as a principles-based voluntary industry code. It is administered by the Irish Institute of Credit Management. The Irish code has not been as successful in signing up private enterprise to the code. This has been in part attributed to a lack of sufficient support by both large and small enterprises from launch despite being proposed by industry groups. Presently most signatories are government entities which sign up to the code as part of government policy.

Recent efforts to reinvigorate the code and market it to businesses have been undertaken including a refresh of the website and active promotion of the code.

The United States of America experience

62. In the US, the *Prompt Payment Act (PPA) 1983* requires federal government agencies pay their suppliers within 30 days of a valid invoice following confirmation and acceptance of the goods and services. The Act also entitled suppliers to receive penalty interest for late payments from Federal Government departments.

63. In 2011, following the GFC and recognising the challenges facing many small businesses in the US economy, the Obama administration introduced the QuickPay initiative via presidential memorandum (M-11-32) which required government agencies to speed up payments its small business suppliers with a goal of within 15 days of invoice receipt and approval. This was a reduction from the 30 day timeframe outlined in the PPA.

64. The initiative recognised the challenges that many small businesses faced following the GFC and sought to use the US$100 billion government spent annually with small businesses to improve cash flow for those small business suppliers.

65. The policy was extended to government prime contractors accelerating payments to their small business subcontractors in July 2012 via presidential memorandum (M-12-16). This memorandum required agencies to report on their progress for implementation and was extended[10] each year until 31 December 2016.

66. Criticism highlighted the fact that it applied from approval of the invoice which could be a while from receipt. Despite this the effect of the QuickPay initiatives were the subject of a Harvard

[10] Extended via Presidential Memorandums M-13-15 and M-14-10

Business School study[11] in 2017 which found the initiative resulted in greater employment and wage growth for small businesses in the government supply chain.

67. Building on the success of QuickPay, in July 2014, the Obama Administration introduced SupplierPay. This initiative required larger businesses to pay small suppliers faster or provide access to cheaper finance for working capital. The initiative started with 21 businesses and expanded in 2015 to include 47 businesses including Apple, Intel, Xerox, Oracle, 3M, Coca-Cola, Lockheed Martin, FedEx, IBM and Toyota.

68. The initiative was designed so that signatories did not use their commercial power to extend payment times but placed value on the importance of their supply chains and the small businesses within those supply chains. Criticism of the initiative noted the lack of enforcement for businesses taking the pledge, and the dilemma facing competing businesses which notes the potential competitive loss (impact on finances or working capital) to first movers signing on to SupplierPay if competitors also do not sign up.

Key themes from overseas experiences

69. Overseas governments have recognised the delicate equilibrium required in business to business trade credit at the micro-level and that when this equilibrium is unbalanced it has impact on supply chains and the economy. These governments have implemented policies and adopted short payment times and practices to drive change to the culture of late and extended payments. The actions of government procurement and payment policies can flow through and benefit the wider economy and this is shown in research which looks at the effects of government policies flowing through the supply chain.[12, 13]

70. In Australia, a holistic strategy is required to address these issues. The design and order of implementation of measures must be carefully considered. A combination of both hard (compulsory) and soft (voluntary) measures are needed as most businesses will comply with legislation but have less incentive when change is voluntary. Where the law is silent, business practices and cultures will exploit the gaps which allow larger businesses to take advantage of their bargaining power to the detriment of smaller businesses in the supply chain.

71. In spite of having legislation and other measures, businesses still value commercial relationships to the extent they will not call upon their statutory rights, particularly in relation to late payment penalty interest and compensation. For voluntary measures to drive change by customers it is crucial to ensure compliance through enforcement options that are real and meaningful.

72. Transparency of payment times and practices and performance against these is a powerful tool to raise awareness of poor practices both to the executive and board of a business and to potential suppliers. An independent small business advocate or commissioner who can publicly raise awareness of issues and practices, such as naming and shaming, is an important policy lever, particularly if the advocate can ensure legislative and voluntary measures are used more effectively. The independent advocate needs to have a legislative foundation with sufficient powers to ensure issues can be investigated and highlighted to government.

[11] Barrot, J. and Nanda, R., 2016. Can Paying Firms Quicker Affect Aggregate Employment. Harvard Business School Working Paper, 17-004

[12] Ibid.

[13] Ferraz C, Finan F and Szerman D, "Procuring Firm Growth: The Effects of Government Purchases on Firm Dynamics" NBER Working Paper No. 21219, May 2015 [http://www.nber.org/papers/w21219]