Australian Government

Australian Small Business and Family Enterprise Ombudsman

Working Paper 2 – Submissions, consultations and large business practices

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Overview

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 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 times particularly for small businesses;
    - trends in payment times and late payment with emphasis on commercial dealings between small business with larger businesses;
    - 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.
4. This working paper presents the findings from a submission and consultation process conducted with larger businesses, small and medium size businesses, industry associations, government and academia. It also outlines the Inquiry's research findings in response to a letter campaign to 109 larger businesses and multinational corporations requesting details of:
    - payment times offered;
    - payment practices and how these impact actual payment times;
    - the main issues they identify regarding payment times and practices; and
    - possible solutions.
5. The attached appendices provide details regarding submissions, consultations and the research data provided to the Inquiry.

Key findings

Extended payment times

6. The core finding by the Inquiry is that larger and multinational businesses are extending payment times to their suppliers. The typical payment time of 30 days is moving out to 45, 60, 90 or 120 days. Conversely, these businesses require their customers to pay faster to maximise their cash flow.
7. There is evidence of a knock on effect through supply chains with examples of large and medium businesses extending payment times to their suppliers.

8. As a result small businesses are experiencing significant cash flow pressures. The Inquiry findings include cases of small and medium sized businesses restructuring, reducing staffing and delaying decisions to employ staff, invest or innovate.
9. Multinationals and larger businesses are extending payment times to maximise efficiencies in managing working capital to essentially source cheap trade credit. This financing strategy works most effectively without limitations set by legislation and also where an asymmetry of power exists between the businesses. The Inquiry was informed of proposed multinational payment times to suppliers as long as 365 days.
10. Multinationals confirmed that their procurement policies are set globally subject to modifications for local laws that limit payment times such as in the UK, Germany and France.
11. National managers within Australia have limited ability to modify the global policies although there is some scope for ‘exception’ requests to their global headquarters. Little discretion rests with the national managers as the multinationals have global treasuries that regulate working capital.
12. There is a significant asymmetry of power between businesses and multinationals. Generally both larger and small businesses cannot negotiate payment times with multinationals with few exceptions. Exclusions include critical suppliers or those meeting specific criteria such as supplying to remote regions.
13. In addition, unilateral contractual changes extending payment times of multinationals are often imposed on short periods of notice. To offset the impact these changes may also include alternatives for faster payment such as a discount for early payment or supply chain finance.
14. Small businesses saw supply chain finance as imposing additional operating costs and complexity compared with faster payment of their invoices, particularly where conditions to access the financing require some acceptance of a discount. Some small businesses did not meet the eligibility to use the supply chain finance due to the low value of their supply or not being an ongoing supplier. It was noted that supply chain finance can be beneficial for suppliers in some situations outside of faster payment as cheaper finance to a supplier.
15. Numerous examples were provided of multinationals and larger businesses imposing additional costs by requiring invoice submissions through designated online portals then requiring the supplier to meet recurring payments for using these systems.
16. Small businesses saw these charges as unfair and short notice periods of changes limited the time and choices to adjust to variations. Small businesses described slim profit margins arising from supplying to highly competitive markets or receiving a restricted price within profit limits set by their larger business customer.
17. It is with interest that during the course of the Inquiry Telstra Corporation pledged to reduce its payment time for small business suppliers to 30 days and Coles announced it will pay small suppliers in 14 days (contracts total less than $1million per annum provided invoices are submitted electronically).

Late Payments

18. Small businesses are experiencing a growth in late payments creating cash flow pressures with most late payments coming from larger business and multinationals. Also identified in the survey results, detailed in the associated working paper, which aligns

with the Dun & Bradstreet late payments data for the quarter ending December 2016[1] which shows an increase in late payments with larger business the slowest to pay invoices. [2]

19. The cause of late payments is often a result of a lack of transparency on payment practices. A lack of visibility of the internal accounts payable processes and policies cause extensions to the 'face value' of the payment times in the contract. Overlays regarding when the payment time commences, payment cycles, definitions of a 'day' and the process to resolve queries or anomalies each extend the time to actual payment.

20. Examples of these overlays were provided in the responses received from larger businesses and multinationals. The payment time was triggered when the customer approved an invoice and entered it into its system or once it was received by a central office rather than the branch that dealt with the supplier.

From invoice or end of month

21. A key overlay is the point at which the payment time commences, from receipt of an invoice or from end of month. Importantly from receipt of invoice means when the customer accepts the invoice as valid, not when the supplier provides the invoice. This is the first hurdle a supplier must overcome. This is further extended where a mismatch occurs between the details on a purchase order compared to the delivery receipt and invoice. A customer may take days or weeks to resolve the discrepancy. Only when accepted will the agreed time from receipt of invoice begin.

22. The number with payment times from acceptance of invoice is shown below in Figure 1 (note some businesses offer both):

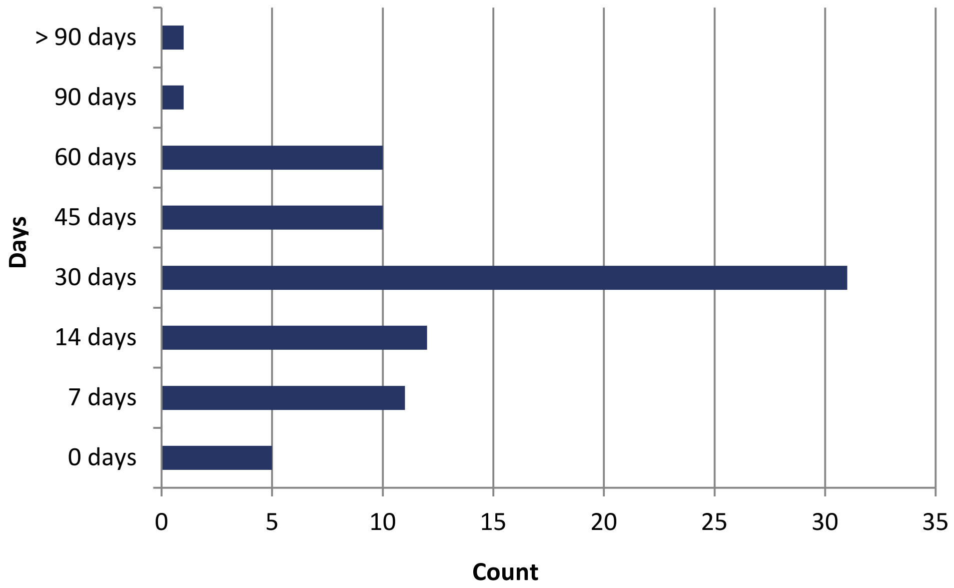

Figure 1 - Businesses with payment times from acceptance of invoice

[1] Big Business in the slow lane – Late Payments in Australia Dun & Bradstreet 4th Quarter Analysis 2016

[2] The Inquiry survey included non-employing small businesses, while Dun & Bradstreet 4th Quarter Analysis 2016 does not include this category of small businesses and has a larger proportion of businesses with 20 or more employees, (15.6 per cent), while the Inquiry survey had 6.1 per cent in that category (excluding Inquiry survey respondents who did not nominate a business size category).

23. Where payment is from ‘end of month’ the time to receive payment can be much greater than the agreed. The date of actual supply is disregarded. Where a supply if made, say, on the 2nd with invoice submitted and accepted by the 4th, the time frame of 30 days will not commence until the 1st of the next month. In effect, payment time becomes 56 days.

24. The number with payment times from end of month is shown below in Figure 2 (note some businesses offer both):

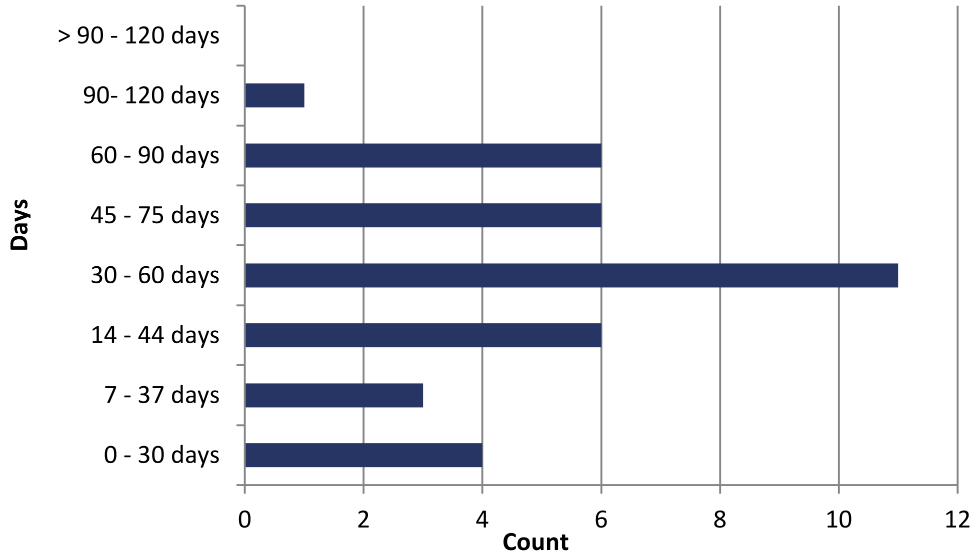

Figure 2 - Businesses with payment times from end of month

Payment cycles

25. Another overlay which can further extend the time is the payment cycle of the customer. For example if payments are made on the 21st of a month it will add a further 21 days until payment. The example below shows how 30 days from end of month can actually mean 66 days between an invoice being accepted and the supplier being paid.

26. Example of the actual days compared to the term 30 days from end of month:

- Supply goods or services and lodge the invoice on the 15th of a month
- Customer accepts the invoice on 20th of that month
- On 1st of the next month the payment time of 30 days is triggered (now at 15 days)
- On the 1st of the next month invoice flagged as payment due (now at 45 days)
- On the 21st of this month payment is made (now 66 days since invoice lodged)

27. This discrepancy between the days of the payment time and actual days taken is even greater where the term is 60 days or more from the end of month. Of note, four corporations that responded only offer 60 days from end of month. In line with the example above, a supplier on 60 day terms will actually wait up to 96 days to receive payment, a supplier on 90 day terms up to 126 days.

Causes

28. A summary of the most common causes to delay payment is shown in Figure 3. The most common cause cited (76%) by larger businesses and multinationals, was the receipt of an incorrect invoice from a supplier with many saying small businesses are the main offenders. Most errors appear to be related to the purchase order, not being on the invoice or incorrectly quoted.

29. The next most common cause was disputes over the quantity or quality of the goods and services provided.

30. From the actual policies provided it appears that clauses allow the buyer to withhold payment when any aspect of supply is in dispute. None contained a definitive time frame for resolution.

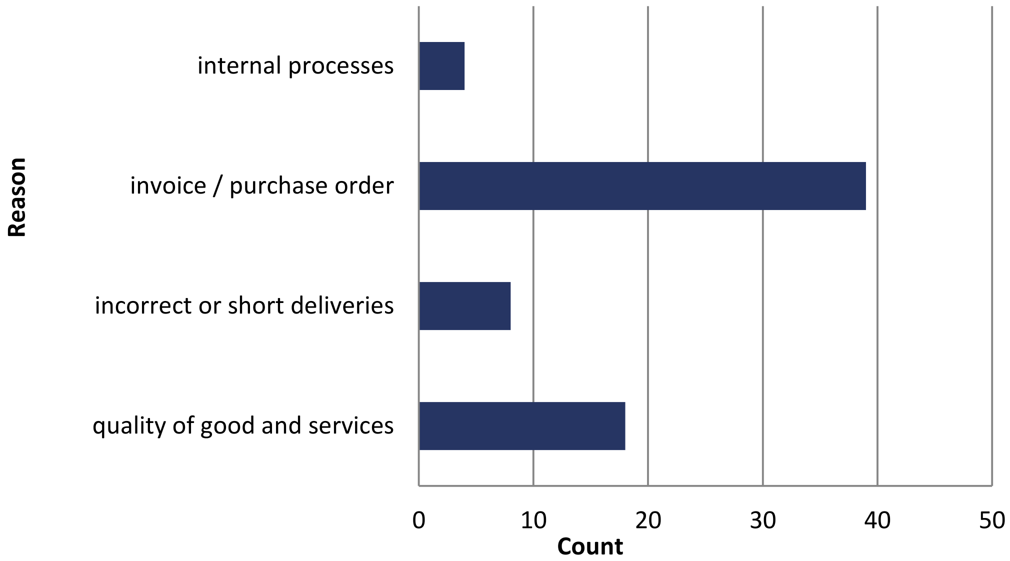

Figure 3 - Common causes cited for delaying payment

31. Irrespective of the reason, once a dispute arises the resolution becomes a manual process. Ironically one business that requires a supplier to submit invoices electronically will write to a supplier by conventional mail when they reject an invoice.

32. Conversely, some of the respondents have a dedicated team to follow up issues with the aim to resolve these and make payment within the agreed payment time. For one larger business the need to address issues immediately is contained in its procurement policy. Staff must address an issue, and if it cannot be resolved within 5 days, escalate to management. Another prioritises resolving issues arising for small business suppliers.

33. Often such a delay will mean the supplier has missed a payment cycle and will not be considered to have submitted an invoice until an agreed, amended, invoice is accepted.

Invoices

34. Invoices are problematic to larger businesses and multinationals if they are not electronic. Some systems did not have processes to integrate paper invoices into their accounts payable processing stream until a telephone query was raised by the supplier. Other larger businesses outsource paper invoices for scanning into their systems to initiate the payment processes causing delays to payments while this occurred.

35. Late payments also arise when suppliers do not follow or understand the customer processes for correctly submitting invoices. Small businesses related the multiplicity of requirements set by different customers as a cause for delays in submitting invoices. Both industry and peak bodies strongly advocate for small businesses to use electronic accounting as a tool to manage these processes.

Communication

36. Breakdowns in communication will also extend payment times. Breakdowns arise from practices including off shore accounts departments, use of robotic accounts processes, use of email only points of contact (loss of telephone contact to speak to a person), use of online portals and lack of transparency of the complex overlays of accounts payable policies and processes.

Suggested remedies

Legislation

37. Small businesses strongly advocated for a legislated maximum payment time ranging from 7 to 30 days. This reflects the view that larger businesses and multinationals lack an incentive to voluntarily reduce payment times. Instead they will seek to maximise profit with their asymmetry of power.

38. Consultations with international governments and their instrumentalities emphasised that any regulatory response would need a legislated payment time and measures to address transparency of payment practices to work together to monitor actual payment times. Experiences in their jurisdictions have demonstrated that voluntary schemes have been embraced by businesses with fair payment times but ignored or gamed by businesses seeking to maximise their profits irrespective of the cost along the supply chain.

Faster payment by government

39. Both small and larger businesses called for government to be the exemplar of fast, on time, payments. Where overseas governments have taken up the mantle such as USA, Germany and the UK, faster payment by government saw cash flow through its supply chains and impact the economy resulting in an increase in employment and investment. These consultations and findings are discussed in detail in the working paper on trade credit.

Faster Dispute Resolution

40. Currently many businesses write off outstanding payments under $10,000 as the time and cost to chase payment through the courts will exceed the debt. Many others are written off as the relationship with the customer is considered more important than an unpaid invoice Small businesses called for faster and cheaper dispute resolution outside the supply chain participants to maintain the business relationship. A fast process will also assist to identify insolvent businesses and reduce their impact on other businesses.

Existing Industry Codes

41. Submissions from peak industry bodies supported the inclusion of best practice payment times and practices in existing industry codes as an alternative to legislation. They emphasised the importance to large business and multinationals of their supplier relationships and that this sufficiently incentivised adherence to industry codes which will reduce payment times and incidents of late payments. Consistently they advised that an explicit payment time cannot be mandated only best practice for that industry.

Technology

42. Financial technology companies and industry bodies strongly called for small businesses to implement accounting software to dispense with paper invoicing. This measure was advocated as a major step to assist small businesses to manage their cash flow and to

minimise errors in invoices. In tandem, small businesses must value being educated in cash flow management and the tools available to manage extended payment times such as supply chain finance.

43. Larger businesses are using technology to provide greater transparency to suppliers through their online portals. . These portals include the contract payment time, the payment cycle to be applied and the anticipated payment date. Suppliers can track information on all invoices submitted to assist with reconciliation and quickly address queries from accounts payable departments. Business must make the use of its portal free of charge if it requires suppliers to lodge invoices through the portal.

44. This summary of the key findings in the submissions forms part of the information used to inform the Payment Times and Practices Inquiry and was used to formulate the recommendations in the Final Report.

Appendix A Submissions

1. The Inquiry received 137 submissions comprising 31 formal submissions and 106 informal submissions. The informal submissions were invited from small business through the ASBFEO website. The submissions from small businesses came from a wide range of industries as shown in Figure 4 below.

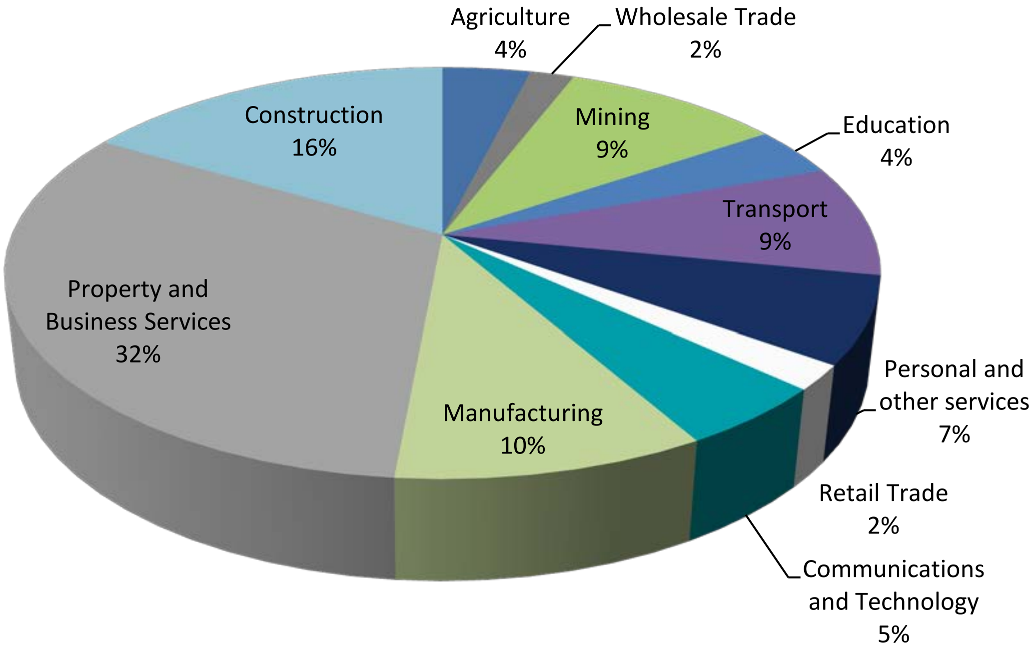

Figure 4 - Submissions by Industry Category

2. Most small business submissions raised issues on payment times and practices with other businesses with: 66% related to issues with large business, 28% related to government and 8% related to other small businesses. Almost all small business submissions required their details remain confidential with many relating their need to avoid compromising commercial relationships.
3. The formal submissions comprised detailed submissions from:
   - government bodies;
   - industry groups representing transport, construction, primary producers, food retailing, accounting, mining, engineering and financial technology; and
   - small businesses that also provided database extracts illustrating recent trends in late and extended payments.
4. The formal submissions were predominantly from industry associations with a spread of submissions from others as shown in Figure 5 below.

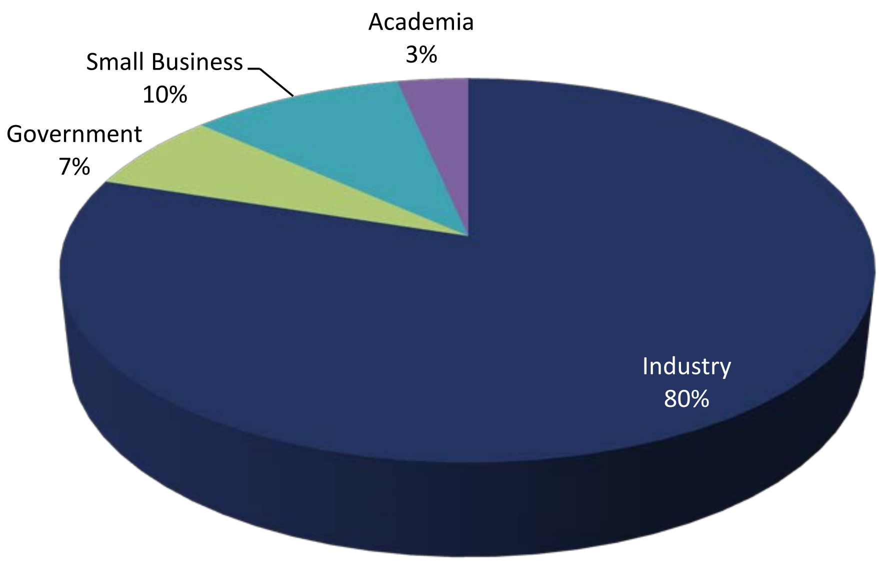

Figure 5 - Composition of Long form submissions

Case Study Primary Producers

Submissions from primary producers highlighted the importance of maintaining industry norms regarding trade credit terms in the supply chain. These norms reflect the fixed timeframes associated with production of these goods to maturity for sale or as an input into manufacturing processes such as wine production. The norms also reflect practices allowing instalment payments to suppliers along the chain where there is a long ‘time to cash’ with the endpoint consumer.

Some categories of primary production are managed through boards that collectively bargain regarding supply contracts. Collective bargaining can be authorised by the ACCC and an industry association advocated for small businesses to understand and use this as a tool to counter asymmetry of power.

Case Study Construction Industry

Submissions were provided by numerous small businesses in the construction industry and also from industry associations representing members involved in this industry. The submissions emphasised the ongoing issues regarding late payments especially in the case of subcontractors dependent on head contractors conducting major projects including significant government funded contracts. They detailed the extensive multi-jurisdictional schemes covering the construction industry. The submissions focussed on delayed payments arising from disputes on quality or other factors regarding retention monies and warranty provisions and the need to speed up dispute resolution.

There was evidence of ongoing issues associated with insolvent head contractors and the need for trust accounts/project bank accounts and faster and cheaper dispute resolution to expedite payments. The Inquiry notes the current Murray Inquiry regarding terms of reference associated with security of payments legislation and other matters relevant to this industry.

Case Study Road Transport Industry

This industry has a high proportion of small business operators working as independent contractors.

There are many different requirements regarding invoicing and payment times including numerous other charges and rebates to be applied regarding any transport contracts. Sometimes trucking companies delay payments because they are waiting on payments further up the supply chain from larger businesses and multinational corporations before paying the owner operators that are subcontracted to their business.

There is a strong call for a mandatory code of conduct for the Industry administered by the ACCC that includes legislated payment times and practices appropriate for fairness in the Industry.

Appendix B Letter Campaign to large businesses

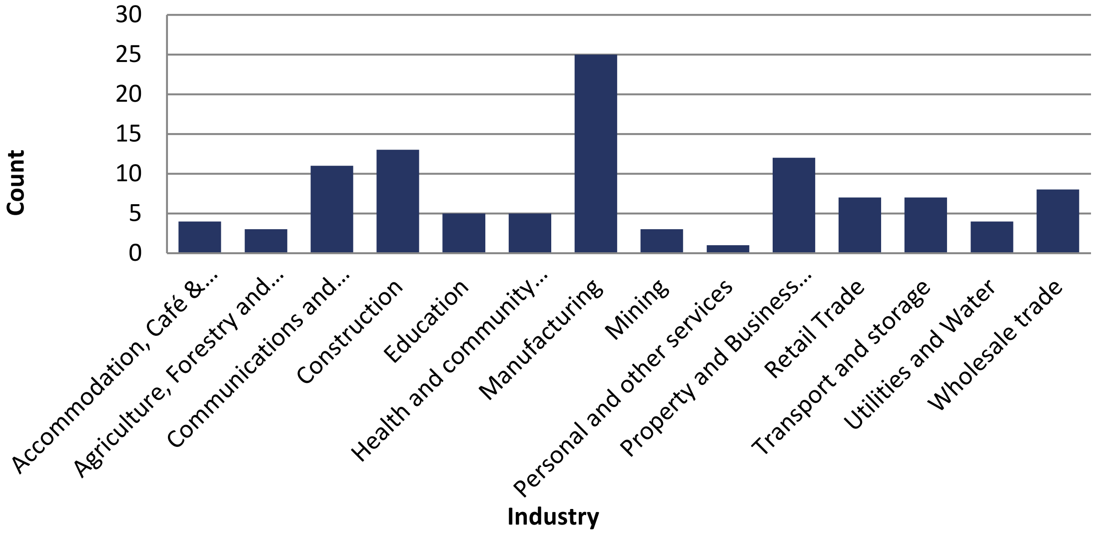

Figure 6 - Composition of Large Businesses by Industry

1. The Inquiry received 74 responses (66%), including 15 that declined to comment. It was of interest to the inquiry that those that declined to comment were mentioned in submissions as having extended payment times (that is greater than 60 days).

74	66.1%	replies from the 109 requests
59	79.7%	respondents provided input
15	20.3%	declined to comment

2. An invitation was also extended to 20 of these large businesses to meet with the Ombudsman and discuss in detail its payment times and practices. Of the 11 businesses that acknowledged the invitation four declined to meet. Again, four that were mentioned in submissions as having extended payment times (that is greater than 60 days). Other respondents extended an invitation to the Ombudsman to meet to discuss in detail their payment times and practices.

22	meetings requested or offered
13	acknowledged invitation
4	declined to meet.

Appendix C Consultations

1. The Inquiry consultations gathered information from:
    - other governments and jurisdictions that have developed recommendations or implemented responses to issues with payment times and practices;
    - experts in the area of trade credit, working capital management and small business accounting and finance;
    - larger business and multinationals to understand their practices and to gather their suggestions for regulatory and market based responses; and
    - peak bodies and industry groups to allow industry and supply chain specific perspectives.

Government

Australian Competition & Consumer Commission

Australian Taxation Office

Department for Business, Energy and Industrial Strategy; (United Kingdom)

Department of Industry, Innovation and Science (Australia)

Department of Jobs, Enterprise and Innovation: (Republic of Ireland)

Academia

Professor Vincent Cuñat- London School of Economics

Karen Mills - Harvard Business School

Industry Groups

Australian Industry Group

Australian Chamber of Commerce and Industry

Australian Food and Grocery Council

Australian Institute of Credit Management

Australian Institute of Company Directors

Business Council of Australia

Certified Practicing Accountants Australia

Chartered Accountants Australia and New Zealand

Chartered Institute of Credit Management : (United Kingdom)

Institute of Public Accountants

Business

Airbus Group Australia Pacific

Austral Mercantile

BHP Billiton

Commonwealth Bank of Australia

Deloitte Australia

Dun & Bradstreet (Australia)

Equifax Inc.

KPMG Australia

Multinationals (Confidential)

PwC Australia

QBE Australia

Submitters to Inquiry (Confidential)

Suncorp Group Limited

Sydney Airport Limited

Telstra Corporation Limited

Xero Limited