



Australian
**Small Business and
Family Enterprise**
Ombudsman



Supply Chain Finance Review

FINAL REPORT

MARCH 2020

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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.

The Ombudsman released a position paper on 7 February 2020 outlining the key preliminary findings of the Supply Chain Finance Review.

There has been **21** formal submissions made to the position paper which have been published and can be found on our website at <https://www.asbfeo.gov.au/reviews/supply-chain-financing>.

We have conducted **44** consultations and these are listed in Appendix D.

Foreword

When the review into supply chain financing was initiated by my office, no-one would have anticipated the situation in which the Australian and global business community now finds itself. In times of economic downturn and global uncertainty, small businesses suffer significantly. These businesses are often the first to have their payment times extended, and as they usually have less bargaining power, they are forced to either accept less favourable terms, or lose desperately needed customers. The current period of business closure and reduced trade due to the necessary responses to the COVID-19 outbreak are no different, and the coming months will be extremely difficult for the small business community.



Supply chain financing products, where used appropriately to offer faster payments than 30 days, can be a good option for small businesses wishing to speed up their cash conversion cycle. It is important, however, that these products are offered as a true choice, and always in addition to appropriate payment times (30 days or less). Small businesses also need to be clear about the ability for firms to collect data on them and manipulate the platforms to their detriment, as highlighted in this report. It is essential that these products are never used to manufacture compliance with voluntary or mandated payment codes.

Flexibility and ensuring businesses work together is critical, and particularly at a time like this. Following the release of our position paper, I received calls from a number of large businesses in addition to Telstra and Rio Tinto, advising that they are moving to shorten payment times to small business, as well as expanding their definitions of small business. I applaud these companies for their commitment to the small business community, and encourage other large businesses to show corporate leadership and do the same.

The efforts made by both government and some large businesses to support the small business community in recent weeks are gratefully received. The Department of Defence has moved to paying suppliers in 2 business days, ensuring money enters the supply chain at record rates. In the private sector, the announcement by Australia's banks that they will put a hold on small business loans was a welcome relief to many. I would also like to particularly commend businesses who have implemented immediate payment options for their small suppliers. These businesses understand the need to work with their suppliers to achieve an outcome that will benefit all, not just a few.

Businesses and communities operate in an ecosystem. Large businesses rely on their small business suppliers to continue providing essential goods and services, whether it is as an importer of products for a supermarket's 'home brand' products, a cleaner that continues to service offices after hours, or a contractor that provides specialist advice. Similarly, these small businesses rely on their large customers to continue procuring their goods and services, and importantly to pay them promptly and on time.

I have been extremely disappointed to receive numerous reports of large businesses extending payment times, or even suspending payments to small businesses in a time of significant pressure for the business community. These businesses, many of which have turnover in the hundreds of millions of dollars per year, are pushing the pain felt by the current economic climate on to small suppliers who can least afford it. There is no doubt that this behaviour by large players will not pass

the pub test. Those that do this should be on notice that behaviours that damage their small business suppliers will, in the end, damage them too.

It is always disappointing when some of Australia's most trusted brands such as Myer and David Jones offer payment terms that require a settlement discount to be paid by their small suppliers, on top of payment terms that, in the case of Myer, can be as late as four months following the end of the month in which the goods were delivered. It is equally disappointing to see retail groups owned by prominent Australians such as the Just Group, or the Sussan Group, increase their payment times to as much as six months during this time of crisis. While these Australians are looked up to in many ways for their philanthropy and employment of Australians, their behaviour towards small business operators leaves much to be desired. Companies such as CIMIC Group, which are responsible for building much of this country, are in many ways working to undermine our strong foundations by extending payment terms to their small suppliers and pushing supply chain financing on those suppliers, to sure up their cash flow at the expense of those down the supply chain. And when brewers such as Carlton United Breweries claim to support small businesses through this crisis by offering a 'buy one get one free' beer promotion, it is easy to point to their track record of seriously impacting small business suppliers with their poor payment practices.

Over the coming months we will see businesses, large and small, having to work together more closely to negotiate changes to their contracts, and these may include payment terms adjustments. I strongly urge all large businesses to maintain 30 day payment terms (or better) to their small business suppliers. Indeed, in this report I am calling for the introduction of legislation to require all large businesses to pay their small business suppliers in 30 days. I recognise this will be a significant shift in business practice for some entities, but the evidence from Australia and overseas shows that voluntary codes and gentle encouragement simply do not work. While those businesses that believe in supporting their small business ecosystem are already choosing to do the right thing, those that see their suppliers as expendable will not change their behaviour until they are legally required to.

I would like to reiterate that supply chain financing products themselves provide benefits to both small suppliers, and large buyers, when used in ethical ways. Where small businesses require early funding over the coming months, supply chain finance may be a way for them to secure no-recourse payments in reasonable time frames. However, abuses of small businesses through misuse of this product must be urgently addressed, and I look forward to continuing to work with the Government and the business community to ensure small businesses are supported in their funding and cash flow decisions.



Kate Carnell
Australian Small Business and Family Enterprise Ombudsman

Recommendations

1. **Consistent small business definition for the purpose of payment times and Unfair Contract Terms:** The small business definition adopted by Government for the purposes of payment times legislation and Unfair Contract Terms legislation should be \$10 million turnover per annum, to be reviewed every three years to ensure appropriate levels are maintained. This figure is consistent with the Australian Taxation Office and Payment Times Reporting Framework's definitions.
2. **Transparent payment times:** The Commonwealth Government's Payment Times Reporting Framework (PTRF) be promptly implemented with that Framework being administered and enforced by an appropriately funded, empowered and proactive entity.
 - a. The efficacy and operations of the Framework should be independently reviewed 12 months following its commencement.
 - b. Any payments (kickbacks) from Supply Chain Financing (SCF) providers to large businesses should be fully disclosed in the PTRF.
 - c. Any use of artificial intelligence (AI) to maximise discounts accepted by small business suppliers should also be disclosed in the Framework.
 - d. Should the Business Council of Australia (BCA) choose to retain their Supplier Payment Code, any businesses that report payment times longer than 30 days to the Framework should be publicly sanctioned, together with a statement as to how the businesses have agreed to change practices to avoid late payments in the future, by the BCA.
3. **30 day payment standard:** Maximum payment terms of 30 days from receipt of invoice from small businesses should be legislated. Businesses should be encouraged to pay all suppliers within 30 days, however no legislated outcome should be imposed for businesses falling outside of the small business definition.
4. **SCF as a real choice:** SCF should be available to small business to reduce payment times from 30 days to better. Where SCF providers wish to avoid sector regulation, they should undertake not to provide their products to companies extending payment times to small businesses beyond 30 days.
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.
 - a. The Australian Accounting Standards Board (AASB) should provide further education on guidance notes, including that companies are required to address SCF in financial reporting.
 - b. The ASX should provide further directives to companies about disclosure of SCF offerings.
 - c. Disclosure or otherwise should be monitored by the AASB, and should companies fail to appropriately disclose SCF arrangements, further clarity should be introduced.
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.

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.¹ This leads to increased pressure on small business and a stall on money circulating in the economy.

Illion's Late Payments September Quarter 2019 analysis revealed late payments in Australia are improving and are at a historic low, with an average of 10.4 days late. However, this best level of achievement sees Australian businesses receiving their payments almost 11 days overdue. For a business on 30-day terms that means on average more than a full third longer. Larger businesses (200 to 499 and 500+ employees) are above the average with 11.6 and 14.1 days respectively.² Payment performance should be better in an environment of historically low interest rates, government mandated lower terms and increased technology capability for automated payments.

One would think that if we are seeing low rates of late payments that the economy is moving in the right direction. Unfortunately since the onset of the COVID-19 crisis, blowouts in payment times have increased. This reinforces the fact that without legislative protection, small businesses will always be on the receiving end of poor behaviour when it suits many larger players. Small businesses can no longer be expected to act the part of cheap credit providers for large domestic and multinational businesses.

A recent East and Partners survey of 1200 SME owners has found SMEs are waiting an average of 56 days to be paid. Further stress is on the small business in the \$1 to \$10 million revenue range who are waiting an average of 66 days.³ This reinforces the need to increase efforts to ensure there are prompt payment times for small businesses.

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. We have been, and will continue to work with Government in developing the Payment Times Reporting Framework to help address transparency around payment terms performance from large business to small.

Supply Chain Financing

When used to the benefit of both the supplier and buyer, SCF is a real choice for small businesses. SCF is often used to improve certainty around their payment times and can be used as an alternative to other, more expensive financing options such as invoice factoring, bridging loans, and using a credit card to cover business expenses.

Government action

The Federal Government is working to encourage shorter payment terms, and on-time payments, 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;

¹ SME Growth Index, Scottish Pacific Business Finance, September 2019

² Late Payments September Quarter Analysis 2019 Australia, Illion

³ <https://www.scottishpacific.com/media-releases/new-national-research-shows-sme-average-payment-times-are-double-what-ombudsman-is-seeking-with-smaller-businesses-hit-hardest>

- A requirement that businesses in receipt of government contracts adhere to the same payment terms as government for sub-contractors whose contracts are under \$1m;
- 5 day payment terms where both government and business are using the e-invoice PEPPOL framework from 1 January 2020; and
- Introduction of a Payment Times Reporting Framework requiring large businesses to publicly report on their payment times performance to small business suppliers.
- Both the Australian Competition and Consumer Commission (ACCC) and the Australian Securities and Investments Commission (ASIC) have indicated that they are reviewing the use of and reporting on SCF by large entities respectively.

Updates since position paper

Industry Improvements in the landscape

Following our consultations and media coverage, several large Australian businesses, including Telstra and Rio Tinto, announced that they will improve their payment terms and times for small business.

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.’⁴ Following the release of our position paper, Greensill Capital have announced that they will not allow their product to be used by large businesses that push out payment terms to SME suppliers beyond 30 days.⁵

At the Australian Financial Review Business Summit on 10 March 2020, Lex Greensill said in response to a question about Greensill terminating contracts with large corporates that extend their payment terms, “We will not support big companies bullying their [small and medium-sized business] suppliers and if they do yes we will [terminate those contracts].”⁶

We are looking forward to seeing the evidence of significant improvements made by Greensill and the other SCF providers in this regard.

Another supply chain finance provider, C2FO, has stated that they are collaborating with their Australian corporate customers to standardise all their SME payment terms to a maximum 30 days (20 days where possible).⁷ C2FO notes that any such initiative needs to be coupled with an optional early payment program from SMEs to access when they need it.

Government

On 21 February 2020 Minister Cash opened public consultation for the Draft Payment Times Reporting Framework legislation that will require businesses with over \$100m turnover to publish information on their small businesses payment times, reporting on how quickly they actually pay their small business suppliers. Consultation closed on 10 March 2020 with legislation expected to be introduced to Parliament before the winter recess.

⁴ <https://www.afr.com/companies/financial-services/greensill-won-t-be-used-to-bully-small-business-20200123-p53tz3>

⁵ <https://www.greensill.com/news/making-finance-fairer-for-all/>

⁶ AFR Business Summit, 10 March 2020

⁷ <https://c2fo.com/newsroom/c2fos-commitment-to-our-australian-customers/>

Supply Chain Finance

What is Supply Chain Finance?

Consultations both prior to and following the release of our position paper have raised concerns that media coverage of the issue has unfairly damaged perceptions of the product. It is important to understand that many different products are referred to generically as ‘supply chain financing’. These products have different features and may be suitable for some businesses where others may not. For the purposes of this report we are focusing on the 3 major types of Supply Chain Finance, Reverse Factoring, Dynamic Discounting and Marketplace variations (with a need to distinguish buyer led v supplier led arrangements).

For the most part, this paper will describe all of these products as ‘supply chain finance’, while highlighting differences where relevant.

It is also important to understand that each of these products has a place in a modern business financing environment. As made clear in our position paper, it is often the behaviour of large businesses in imposing SCF on small business suppliers that needs to be addressed.

What does it look like?

Reverse Factoring

Establishing the Program: A Buyer company will enter into an early payment program for its suppliers with a third-party SCF provider. An ‘application programming interface’ (API) is installed on the buyer company’s internal systems which interacts with the buyer’s ERP systems, providing visibility of supplier invoices.

Joining the Program: The buyer company, not the SCF provider, 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 at a discount and the buyer pays the third party the full amount on the due date.

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. The terms reflect the credit rating and risk profile of the buyer, as this reflects the buyer’s ability to reimburse the SCF provider at the end of the buyer’s standard payment term.

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

Market Place

Invoice receipt and Invoice approval: The Buyer 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. 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

Establishing the 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: 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.

Marketplace Version III

Establishing the program: Buyer selects the early payment platform, which all suppliers are then eligible to use. Invoices approved for payment in the Buyer's ERP system are automatically uploaded to the platform

The Financing Facility: Marketplace clearing – uses a volume weighted average price (VWAP) bidding model, the marketplace matches eligible bids to the committed supply of working capital. This averages the discount rate across all approved invoices payable to an individual supplier. If the VWAP discount rate exceeds the minimum rate required by the Buyer, and the stated cash limit has not been exceeded, that particular supplier will be granted early payment. The competitiveness of discount rates within the marketplace is entirely determined by supply and demand dynamics

Joining the Program: Suppliers wishing to access early payments register and verify themselves on the platform without requirement for 'Know Your Customer' protocols.

Buyer action: Buyer determines amount of surplus cash they are able to make available for early payment and the discount rate required for early payments to be accepted (based on own marginal cost of funds). A portion of these funds are allocated for early payment to small business only.

Supplier Action: Suppliers are able to view when their invoices will be paid. If they want early payment (prior to contractually agreed payment term), they submit a request into the marketplace platform by nominating a discount they are willing to accept on their invoices.

Buyer cash utilised: Early payments are made on a daily basis from the Buyer’s corporate bank account directly to the supplier’s bank accounts, with no third party financing required.

Supply Chain Finance as a real choice

Used correctly, SCF unlocks the shackles around business trade and is a mobiliser of liquidity. Every business requires financing at some stage in their growth, and small businesses often have very limited options. Many businesses struggle to obtain working capital financing, including Trade Finance. Unlike commercial mortgages or equipment term loans, working capital is self-liquidating when done correctly.⁸ SCF is another option available to small businesses, which provides more flexibility and gives them more clout in negotiations. In particular, SCF can help bridge gaps and short term shortfalls. When used properly, SCF should allow the small business supplier to access working capital without the time and cost of applying for finance.

A truly collaborative SCF program does not discriminate against particular suppliers. Its use must be at the control of the supplier and they should have the freedom not to use it. As one large business stated in their submission, SCF is beneficial ‘if it is offered in addition to – rather than as an alternative to – fair payment terms.’⁹ SCF allows supplier-led determination of discounts they may be willing to offer for guaranteed payment, earlier than (what should be) the standard 30 days. The product can also be of use to vendors seeking to secure earlier payments than their contracted terms to align with major cash flow events or strategic objectives.

Critically, most SCF providers agreed that the product works best when it is a choice for suppliers to use it. As stated by FIFO Capital’s CEO in his submission:

“The most important point, over and above any other matter, is that smaller businesses should have freedom of choice. Freedom to selectively choose which client invoices they wish to finance through Invoice Finance/Factoring or through Supply Chain Finance where available. It does not need to be any more complicated than that.”¹⁰

Consistent feedback from SCF companies was that SCF programs should not be led by treasury divisions within large companies, as the focus will then be on improving the cash position of the large business. Instead, it was suggested that these programs should heavily involve procurement teams from the start so as to ensure the focus is on supplier relationship development and mutual benefit. The view of SCF providers was that without this, the implementation of SCF programs would provide short term benefit, but long term harm for the supplier.

Consultation with small business suppliers, large business purchasers, and SCF companies suggest that good principles for SCF programs should include:

- Transparency and full disclosure of practices employed.
- Education around the offering and how it may benefit a business.
- Collaboration on implementation of the platform, to enhance supplier-buyer relationships.

⁸ US Department of Commerce Trade Advisory Council, ‘SBA Export Program Response’, 29 January 2020

⁹ Lion Beverages, Submission to ASBFEO Supply Chain Financing Review, 24 February 2020.

¹⁰ Fifo Capital, Submission to ASBFEO Supply Chain Financing Review, 26 February 2020.

- SCF should always be an efficient source of funding for small business suppliers, allowing them to:
 - Access capital when needed with suppliers able to opt in or out freely; and
 - Have the freedom to select which invoices to trade, and when to get paid.
- No kickbacks. A number of companies stated that where a kickback is paid by the SCF company to the large buyer implementing the program, conflicts of interest arise and the use of artificial intelligence to maximise discounts becomes a problem.

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 SCF arrangement also typically benefit from a shortened payment cycle.

Given that SCF (as opposed to factoring or other forms of financing) can leverage the strong credit rating of the Buyer, it is one of the least expensive financing alternatives for small businesses who typically rely on overdrafts, credit cards and factoring to access funds. The table below, provided by Greensill Capital in their submission to the position paper, illustrates the breakdown in costs of small business finance options, which circumvents the known small business barrier of traditional bank loans requiring bricks and mortar as collateral.

Small Business Finance Options	
Finance type	Cost *
Overdraft	6.5% - 9%
Business credit card	13% - 14%
Factoring	12% - 30%
Term Debt	7% - 36%
Supply-Chain Finance	2% - 7%

* Cost is based on \$1 million of finance, unsecured, and expressed as an APR (annual percentage rate).

Source: Bank and comparison websites

Working capital

The adoption of SCF arrangements helps capital that is locked up in supply chains to be released into the economy. Estimates are that something in the order of \$42 trillion is tied up in approved but not yet acquitted payments globally at any time.

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 to ongoing viability. The different SCF options can provide certainty of payments allowing businesses to better plan as well as allowing money to be reinvested in the business. It allows small businesses the flexibility to meet their own business costs, such as payroll that may run on shorter cycles than their receivables.

SCF can be a way to improve the cash conversion cycle by minimising delays that naturally occur in the processing of invoices. This can play out at all stages of the lifecycle not just the accounts receivable conversion to cash. By being able to track invoices on tech platforms (whether or not they also offer SCF), incoming payments can be received and processed as quickly as possible as well as keeping track of payables outstanding allowing businesses to better predict and measure its flow of cash.

Example – Case Study

Platform: EarlyTrade

Buyer: Lion Beverages

Port Macquarie Workwear (PMWW) is a clothing and apparel manufacturer that supplies uniforms and customised workwear to Lion, a leading adult beverages company in Australasia. As a small business, they are often forced to accept extended payment terms from some large commercial customers, meaning their business cash flows can be difficult to manage.

In 2017, recognising these issues faced by their small business suppliers, Lion became one of the first signatories to the Australian Supplier Payments Code, rolling out 30- day payment terms to all suppliers subject to their standard terms and conditions. Lion also gave their suppliers access to early payments via the Earlytrade platform.

Small businesses like PMWW are able to log on to the Earlytrade platform to view when all of their approved invoices are due to be paid by Lion. If their business has cash flow requirements before these due dates, PMWW can offer a discount rate that works for their business to access early payment. If PMWW do not require early payment, they will be paid the full invoice amount on the original due date.

The Earlytrade Marketplace calculates the volume weighted average discount offered by PMWW across all of their approved invoices. The marketplace then aggregates bids from all Lion suppliers and compares them to the minimum discount rate required by Lion (based on their marginal cost of funds). If PMWW's bid (discount rate) is greater than the required rate, they will be paid on the following day. The competitiveness of discount rates in the Earlytrade marketplace is entirely driven by the supply of cash from Lion and the demand from suppliers for early payment, so PMWW knows they may be able to access cheaper rates at certain times.

¹¹ EarlyTrade submission to the ASBFEO Supply Chain Financing Review, 28 February 2020.

*Example – Case Study***Provider: Apricity Finance****Supplier: Synclift**

Initially, Synclift mainly worked for a large business and had negotiated a 30 day net payment term. However, this often extended to 45 and 60 days with the large business' administration having issues with accessing invoices. Invoices were often pushed to the end of the month then 30 days. Synclift try hard not to have invoices funded as their margins are reduced.

Synclift now work directly for the larger organisations not through the large business. Utilising Apricity Finance they have been able to fund contract wages for up to 95 employees at a time. Without the use of their facility they could not have progressed with a large number of contractors. The flexibility is provided where you can choose which invoices to advance, by highlighting which invoices to fund and the rate is reasonable.

Additionally, an unintended benefit is that Synclift use their assessment of new clients when Synclift submit the new clients' details to Apricity for approval. This allows Synclift to review whether they take on the risk of a potential new client.

*Example – Case Study***Platform: EarlyTrade****Buyer: Lion Beverages**

Beston Global Food Co is an ASX listed company and has contracted payment terms with Lion of 90 days. Beston was initially sceptical of the Earlytrade platform and didn't have a good understanding of how it worked. They were looking for something to ease cash flow pressures as their cash flow had inter-month crunches.

Beston have now used SCF for about \$2m worth of invoices over an 18 month period at a cost to them of between \$20 – 30K. There is no retainer fee or monthly fee. Beston will select invoices on an as-needs basis to improve their cashflow. If they didn't use Earlytrade they would pay their suppliers later.

Earlytrade came to Beston to discuss Beston's experience with Lion and supply chain financing. Earlytrade and Beston discussed the opportunity for mid-month payments for Beston suppliers. Now Beston only offers part month payment as supply chain financing. This is voluntary and it is the only offer if they want a mid-month payment. The cost of this to the farmer is an annualised 6-8%. A third party is the payer, Beston advises that it receives no payment from the third for the third party transaction with the farmer.

Farmers like the mid-month payment as this allows them the ability to negotiate cheaper feed for cows and purchase of cows with upfront payments. It provides a point of difference, including:

- Mid-month payments for future deliveries
- Securing supply was the opportunity to have a brought forward payment for estimate milk supplies for up to 1 month and can have up to 3 months advance.
- Offer alternative benefits such as
 - Interest free loans for fodder
 - Low interest loans for on farm asset purchases

Supplier-buyer relationship

SCF options have the potential to strengthen supplier-buyer relationships by making early payment of invoices available to the supplier. This assists with cash flow at times when the supplier may need debtor collections inside of agreed payment terms. Through our consultations we heard that the provision of low cost financing through SCF can contribute to building a more robust supply chain.

In an economy moving towards full digitalisation including e-invoicing, one of the benefits of SCF platforms is the associated provision of integrated software that facilitates easier administration of invoices between the parties and reduced invoice disputes.¹² We also heard that many large businesses feel that SCF is an important step towards improving transparency and trust between them and their small business suppliers.

Example – Case Study

Prime Revenue – DFDS shipping Testimonial

A Supplier Early Payment Program through Prime Revenue is used in the UK supply chain of Danish shipping company DFDS to help build relationships with suppliers and benefit cash flow. Big industrial customers were driving payment terms later and later and DFDS needed to find a solution to balance cash flow. SCF offered to sub-contractors provided the opportunity for DFDS to grow their fleet and make it more sustainable and there is more incentive for subcontractors to stick with DFDS allowing them to grow their own business on the back of quicker payment. It offers a competitive cost compared to major banks and other lenders. As cash flow is king, the quicker subcontractors get money, the quicker they can invest back in business makes them more viable;

- Bramhall Transport Services - Easy process as platform allows you to pull money off as and when you need it, can have it immediately on fixed term. Also, have flexible terms, as and when you need it or if needed to buy something or invest. Use inflow of cash to buy and expand as a result of the platform and this can be as much or as little as you need.
- Brit-Pol - business started with 3 trucks when working with DFDS, then after using Prime Revenue, within 3 months up to 25 trucks in fleet.
- Owner driver (S.T.A. Transport) – running a vehicle that costs anywhere between 1200-1500 pounds a week in diesel alone before other outgoing costs, it's very difficult when initially starting off to be waiting 30 days to be paid money. Using this platform, was able to work a week, then the following week money was in the bank account.

Need to be Aware

As with any type of product, SCF can be weaponised. SCF is a good product in itself to benefit the ecosystem of the supply chain. However, SCF arrangements should never be set up to create a competitive relationship between the supplier and buyer. True SCF focuses on the income statement to generate extra cash into the business, and it shouldn't be looked at for improving the balance sheet of a big business buyer.

¹² <https://blog.apruve.com/how-can-your-business-benefit-from-reverse-factoring>;

Supply chain “bullying”

We have received considerable support in consultations and submissions to the intention to expose unethical commercial behaviours, bullying and manipulation of suppliers and “lift the lid” on subjugator tactics. One of the worst forms of supplier bullying is the example of an SME being told “deal with our SCF provider or wait for your funds”. That is, being precluded from accessing their own debtor finance solution to gain payment earlier than agreed terms and potentially sustain a higher rate of discount.

We also heard from big business who offer SCF options to suppliers for what they perceive to be the ‘right’ reasons, and as a result are indifferent to whether they participate or not. It is clearly preferable for no supplier to be forced or coerced into using SCF. It is important that their decision either way, is not a factor in determining future procurements.

Occasionally, small business suppliers may have an existing relationship with a finance provider and are forced to use the big business buyer’s finance provider rather than have a choice. This loss of choice for a small business to select their own finance provider inappropriately restricts the ability of small business to manage their cash flow in the best way possible for them. This is compounded by the fact that small businesses have difficulty in navigating the market if they supply to multiple big businesses who each have different SCF arrangements. This imposes extra administrative burden and time required to understand how they all work and what it means financially for their business, whereas large business systems can more easily cope with the complexity of multiple SCF providers

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. 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 terms¹³. Using SCF to offset extended payment terms is not acceptable commercial practice.

There is also the issue of multinational businesses imposing their international payment terms and not modifying these for the Australian market. This is currently visible in the construction, food & beverage, and pharmaceutical industries. For example, our office has been told by small business suppliers to the pharmaceutical industry that unless the suppliers are government or electricity, the large multinationals will not budge on their payment terms. Where there is no legislation that requires multinationals to pay in a particular time frame, those businesses will continue to adopt practices that best suit them. Procurement teams are known to have informed the small business when they attempt to negotiate that if legislation is implemented requiring 30 day terms, those procurement teams will be able to go to the global head office to push for change. Otherwise, long payment times will persist.

The impact on small business is made even worse since international pharmaceutical companies often require breakdowns of hourly rates per role within the supplying company so that they can see what the company’s margins are. The large companies are then known to request discounts on the total invoice amounts of 4-5%. When tendering for a job, master service agreements are issued where the rate is broken down by role, invoices have different rates for different clients and the payment terms are at the date of receipt, not when raised. This can blow terms out to 120 days before being paid as offshore processing often takes some time to be completed.

¹³ <https://pure.tue.nl/ws/files/3620999/387399093290135.pdf>

A small business contacted our office highlighting a similar issue in construction industry. The large firm they were dealing with was bought out by Spanish-owned CIMIC, and immediately moved from 30 days EOM payment terms to 60 days EOM. They were offered a deal through Greensill Capital to be paid within 10-12 working days. The small business was forced to open and carry a \$1m overdraft with the move to 60 days EOM. Previously the business could sustain '60 days net' terms with \$300,000 turnover per month. At the time of the change in terms, mining was in a downturn and the small business required a line of credit, having to use their family home as collateral. The small business owner was left with a choice to use the Greensill SCF offering or go out of business.

Mandated payment terms in Australia

The question of whether we need mandated payment terms in Australia has been one of fierce debate. The experience of both the UK and many European nations shows that voluntary codes of conduct requiring improved payment times to small business suppliers do not work. Several countries in the European Union have mandated payment terms, some across the economy and some between large and small businesses. New Zealand is currently considering legislating a maximum payment term of 20 days. Their discussion paper highlighted the problems with a voluntary code of practice, pointing out that 'generally, voluntary codes seem to have very low levels of uptake and there is scant evidence they are effective'.¹⁴

We have already highlighted our concerns around the efficacy of voluntary codes and have seen no evidence during consultations that would change these views. The New Zealand Government also holds the view that current technology means 60 or even 30 day payment terms are no longer reasonable. Technology gives businesses the ability to process invoices almost immediately.¹⁵

Legislating a maximum payment term carries the risk that businesses that currently pay on terms less than the proposed maximum may see that legislated term as a *recommended* term and *increase* their terms to the legislated maximum. That is, in the attempt to remedy long payment terms, we might inadvertently increase the payment terms of some businesses. However, mandated 30 day terms minimises that risk.

Consultations provided mixed views on the efficacy of legislating payment times, and many large businesses raised issues they believe were unique to their industry. It was made clear that large businesses do not require regulatory intervention in their payment terms as they are able to negotiate these terms on a commercial basis. The feedback from small business owners, however, was overwhelmingly in favour of mandated payment times. The consultation received communications almost daily from small business owners operating in diverse industries, putting the case for mandated payment terms.

It is clear that if mandated 30 day payment terms were to be introduced, these should initially be limited to payments made to small businesses.

What does it look like?

It is clear that a common definition of small business is required in Australia, to ensure clarity for large and small business alike. Once a definition is agreed (noting that the strong recommendation of this office is an annual turnover of \$10 million or less), legislation should be introduced requiring all businesses falling within that definition to be paid within 30 calendar days of receipt of a correct invoice. Businesses falling outside of the definition would have freedom to negotiate individual terms, however all businesses should be encouraged to move to maximum 30 day payment terms where possible.

¹⁴ New Zealand Ministry of Business, Innovation & Employment Discussion Paper February 2020 p22

¹⁵ New Zealand Ministry of Business, Innovation & Employment Discussion Paper February 2020 p5

As with any arbitrary definition, the \$10 million turnover definition of small business will lead to some businesses that are close to that figure being outside of it and therefore not covered by legislation. For that reason, legislated payment terms should be reviewed within 2 years of implementation, with a view to expanding the coverage should large business payment terms worsen.

It is important to note that any such legislation would set a maximum only, and should not be viewed as setting a new ‘normal’ for payment terms. Further, as technology advances and capacity to move money quickly increases, the mandated maximum terms will need to be reviewed to ensure they are in line with technological capabilities.

Payment Terms legislation and mandated terms and the International experience

“Late payments permeate all levels of a business’ functioning from cash flow to access to finance to employment strategies. This in turn has repercussions for the wider economy with growth, employment, financial stability and competitiveness severely impacted by the phenomenon.”¹⁶

Strengthening SME’s payment rights within the UK and the EU has been a goal following the global financial crisis, which caused significant operational challenges to SMEs. Late payments and the disproportionate reduction in access to main stream credit banking facilities caused ongoing barriers to small business growth. Our discussion considers the UK separately to the EU as Member States are required to adopt the EU standards as a *minimum* and in January 2020 the UK exited the EU.

The United Kingdom:

Prompt Payment Code

In 2008, the UK Parliament introduced the Prompt Payment Code (PPC). The PPC was developed on behalf of the Department for Business, Energy and Industrial Strategy and is administered by the Chartered Institute of Credit Management (CICM). Organisations based outside the UK can become a signatory if they trade in the UK or with UK suppliers. As at the end of 2019, more than 2,380 organisations had registered. Almost 75% of FTSE100 companies have signed up.

Signatories to the PPC undertake to;

- pay 95% of all supplier invoices within 60 days;
- work towards adopting 30 days as the norm;
- avoid any practices that adversely affect the supply chain;
- pay suppliers on time without attempting to change payment terms retrospectively and without changing practice on length of time for payment for smaller companies on unreasonable grounds.

A feature of the PPC website is an online form where a person or organisation can “challenge” a signatory’s status. The challenger and the signatory can “enter into a dialogue” and CICM can facilitate the dialogue. This has been credited with resulting in faster settlement of invoices and improved communication and agreement between the parties.

Upon the strengthening of the PPC in 2015, the PPC’s Compliance Board, which includes the UK’s Small Business Commissioner, regularly reviews the payment performance of those organisations

¹⁶ Commission Staff Working Document Evaluation of the Late Payment Directive 2011/7/EU 26 August 2016 p3

that are signatories. Those not conforming to the code are suspended until they submit an action plan to achieve future compliance. For example:

- In July 2019, 18 firms were barred from using government branding that signifies prompt settlement of supplier bills. Organisations including BAE Systems, Prudential, BT and British American Tobacco were penalised for failing to pay suppliers on time;
- In November 2019, 20 firms including AstraZeneca, IBM and Unilever were suspended;
- In February 2020, a further 11 firms were suspended including organisations from the military, aerospace and defence sectors;

CICM said *“We will continue to challenge signatories to the code if the obligatory Payment Practice Reporting data suggests that their practices are not compliant”*

Many of these businesses have since been reinstated to the code upon submitting action plans towards achieving compliance. Data shows that overall late payment debt has fallen considerably since the PPC was introduced. Figures reveal that UK SME’s are owed GBP 14.2b in contrast with five years ago when the total was more than double at GBP 30.2b.

A complaint from the small business sector has been that paying over 60 days can be easily explained away. While the 60 day payment term is a positive step in addressing the issue of late payment, the Code has set 30 days as a best practice target which all signatories should work towards. Critics have said the government has not done enough to properly fund the scheme or put in place strict enough deterrents.

Analysis of government data conducted by the Chartered Institute of Procurement & Supply (CIPS) in early 2019 found those companies signed up to the code pay 12% of their invoices later than 60 days on average, only slightly better than businesses who are not signed up to the code (15%). Malcolm Harrison, group CEO, CIPS, said then that: *“The government must begin its policy of delisting companies who don’t pay their suppliers promptly to demonstrate that there will be direct business consequences for not maintaining a prompt payment policy.”*¹⁷

Small Business, Enterprise and Employment Act 2015

Seven years after the PPC was introduced, the UK legislated for large companies (large private companies, LLPs and all quoted companies) to report on their payment practices and policies by passing the *Small Business, Enterprise and Employment Act 2015*. That duty to report came into force on 6 April 2017 and is actively monitored by CICM.

The semi-annual reporting requirement was touted as allowing organisations with good payment records to highlight and celebrate their payment performance, whilst raising public awareness and scrutiny of poorer payers. The provisions were seen to have potential to cause a fundamental shift in the payment performance of the UK’s large organisations. The six-monthly reporting obligations cover:

- Standard payment terms, including any changes in the last reporting period;
- Average time taken to pay;
- Proportion of invoices paid beyond agreed terms;
- Proportion of invoices paid in 30 days or less; paid between 31 and 60 days with any payments beyond 60 days representing bad practice;
- Amount of late payment interest owed and paid;

¹⁷ <https://www.cips.org/en-AU/supply-management/analysis/2019/october/times-up-for-late-payers/>

- Whether financial incentives were required to join or remain on supplier lists;
- Dispute resolution processes;
- The availability of e-invoicing, supply chain finance, preferred supplier lists; and
- Membership of a Payment Code.¹⁸

The UK government provides a search facility on their website that allows businesses, customers and suppliers to understand the payment history of the organisation they supply so they can determine whether to engage with this business or not. This service also allows SME's to adopt best practice credit management.

There is provision in the Late Payment legislation, for a small business to invoice and recover interest and a debt recovery charge from a late payer. If the customer is a private sector organisation the fee is GBP 70 and the interest rate is 8% over the Bank of England base rate, calculated daily. The website of the office of the UK Small Business Commissioner hosts an easy calculator.

However, the collapse of Carillion in early 2018 acted as a catalyst for the UK to conduct a new consultation into late payment, especially down the supply chain to subcontractors. New rules commencing in September 2019 mean that any supplier bidding for government contracts above GBP 5million per annum would expect to be questioned about their payment practices and performance. Firms unable to demonstrate that they are paying 95% of invoices within 60 days may be excluded from the bidding process.¹⁹

Small Business Commissioner and Late Payments etc Bill 2019-21

The "*Small Business Commissioner and Late payments etc Bill*" had its first reading in the UK Parliament's House of Lords on 21 January 2020 and is awaiting a second reading. This bill will make amendments to:

- the statutory limits for payment of invoices;
- the statutory time limit for resolving payment disputes;
- the interest rate for late payments;
- the penalties for persistent late payments and noncompliance;
- prohibit specified payment practices, on-boarding and pay-to stay;
- require payments becoming due under public sector construction projects to be held in project bank accounts;
- the remit, role and powers of the Small Business Commissioner in regard to late payments; and
- provide for a duty on auditors to publish late payment data and for connected purposes.

The Bill aims to address the problem of late payments experienced by small and medium-sized enterprises (SMEs) and seeks to introduce a framework to ensure that large businesses and public authorities pay their SME suppliers on time. The Bill proposes strengthening the powers of the Small Business Commissioner to enforce a new uniform 30-day statutory limit for payment of invoices, underpinned by financial penalties for persistent late payment or non-compliance by large businesses and public authorities, including up to 50% interest where non-payment has exceeded 60

¹⁸ Speech delivered on 20 March 2015 by The Rt Hon Matt Hancock MP "Prompt payment: implementing the duty on large companies to report on payment practices and policies"

¹⁹ "Government rebukes FTSE giants for late supplier payment" published Wednesday 17 July 2019, Sky News. <https://news.sky.com/story/government-rebukes-big-ftse-giants-for-late-supplier-payment-11765174>

days. The Bill specifically prohibits ‘prompt payment discounts’ whereby purchasers demand discounts for early payment of invoices.

The European Union (EU)

The European Commission is the executive branch of the European Union, responsible for proposing legislation, implementing decisions, upholding the EU treaties and managing the day-to-day business of the EU. The Commission first adopted recommendations around late payment in commercial transactions as far back as 1995, recognising the heavy administrative and financial burden on businesses; particularly small and medium sized ones.

Directive 2000/35

The EU acts to strengthen legislation by way of Directives, such as Directive 2000/35/EC²⁰ of 29 June 2000. This Directive highlighted the heavy administrative and financial burdens placed upon SMEs as a result of excessive payment periods and late payment. The directive stated that these problems were a major cause of insolvencies and job losses in the SME sector.

Recognising there had been, at best, no improvement in late payments in many EU Member States since 1995, this directive recommends the EU combats late payments in commercial transactions by allowing SMEs to charge penalty interest and damages. Whilst this directive set up a framework for a common approach to combat late payment, its provisions were frequently ruled as too vague.²⁰

Directive 2011/7

In February 2011, the EU declared the need for ‘*a decisive shift to a culture of prompt payment*’ and updated the directive by issuing Directive 2011/7/EU which was due to be integrated into national law by EU countries no later than 16 March 2013.²¹ It took until May 2016 for the directive to be fully and correctly transposed in the national laws of all Member States. The 2011 Directive enacts strict measures which, when properly implemented, were expected to contribute significantly to employment, growth and improved liquidity.

The main provisions of the directive include:

- Public authorities have to pay for the goods and services that they procure within 30 days or, in very exceptional circumstances, within 60 days;
- Enterprises have to pay their invoices within 60 days, unless they expressly agree otherwise and provided it is not grossly unfair;
- Automatic entitlement to interest for late payment and €40 (fluctuates, but approximately \$65.70 AUD) minimum as compensation for recovery costs;
- Statutory interest of at least 8% above the European Central Bank’s reference rate (currently 0%); and
- EU countries may continue maintaining or bringing into force laws and regulations which are more favourable to the creditor than the provisions of the Directive.

Evaluation of the Directive

A study was commissioned to gather data on the implementation of the 2011 Directive and through evaluation, determine whether the needs of creditors (suppliers) are being adequately addressed. Specifically, the evaluation sought to assess if the directive is fit-for-purpose in terms of

²⁰ Commission Staff Working Document Evaluation of the Late Payment Directive 2011/7/EU 26 August 2016 p4.

²¹ <https://op.europa.eu/en/publication-detail/-/publication/fa62d6ac-7050-4b33-9173-149c442d88f5/language-en>

effectiveness, efficiency, relevance, coherence and EU added value. This was a challenging task for several reasons, not least of which was the lack of a compulsory and common monitoring system across Member States. A report, including the results of this study was given to the European Parliament in March 2016.

One negative outcome that surfaced was the fact that in some Member States that have traditionally had a prompt payment culture, the directive is perceived to have normalised longer payment periods. Other industry sources alleged that some public entities known for being 'good payers' have extended their payment terms to reach the maximum allowed under the directive.²²

Further, reductions in average payment periods have been minimal since the directive came into force, but the trend is decreasing. While isolating the direct impact of the directive is challenging, the knock-on effect following its adoption in the form of changes in attitude towards late payment is a clear achievement.²³ Prior to the directive's implementation, small businesses were unlikely to push for their rights around payment terms:

*"Creditors, particularly small business, gave as the main reason for not exercising their rights the need to maintain good commercial relationships with their customers. The risk to lose future business by tarnishing a relationship with a customer is very often too costly."*²⁴

The directive has removed uncertainty with regards to payment practices and created a level playing field for businesses operating in the single market. It is widely acknowledged that these objectives could not have been achieved by Member States acting individually.

Security of Payments Legislation

Small business subcontractors perform over 80% of all work in the Australian building and construction industry. They are at the bottom of the supply chain pyramid and are often squeezed on margins and payments from poor operators higher in the supply chain. The need to maintain relationships for future business makes small business reluctant to raise disputes with their contractor, or to access existing state and territory security of payments dispute resolution options.

Those higher up the chain often have little regard for the impact of the pressures of the next subcontractor. Those with the greatest amount of power and the deepest pockets regularly dismiss payment disputes, challenge adjudication decisions, or take action to prevent subcontractors being able to obtain work if they take action under available security of payment laws.²⁵

Reasons for structural imbalance of power between contractors and subcontractors in the building and construction sector include:

- vast differences in financial, legal and human resources, particularly as it relates to contractual negotiations;
- access to legal advice to review contract conditions;
- fierce competition between subcontractors, which leads to a 'lose a soldier, send in another one' mentality among head contractors; and

²² Commission Staff Working Document Evaluation of the Late Payment Directive 2011/7/EU 26 August 2016 p17

²³ Commission Staff Working Document Evaluation of the Late Payment Directive 2011/7/EU 26 August 2016 p22.

²⁴ Ibid.

²⁵ Senate Economics Reference Committee Executive Summary at page 13

- a reticence among subcontractors to push back against onerous contract conditions through fear of being excluded from future tenders.²⁶

To rectify poor payment practices and reduce insolvency in the Australian building and construction industry, each state and territory government has enacted ‘security of payment’ (SOP) legislation. The SOP legislation gives specific rights and protections to contractors and prescribes a statutory mechanism for recovering progress payments, thus preserving cash flow and providing access to rapid adjudication where there are payment disputes.

Despite specific legislation for the building and construction sector, late payments to subcontractors and insolvencies of large companies continue in each State and Territory. Subcontractors have low visibility of the SOP legislation and their rights to progress payments and adjudication where there are disputes. Where there is awareness of the legislation, there is a power imbalance between the parties impacting on a sub-contractors ability or willingness to ‘push back’.

State and Territory SOP Payment Times

There are differences in how the different State and Territory SOP laws operate in relation to payment arrangements. Queensland, NSW, Western Australia and the Northern Territory stipulate payment within certain timeframes.

NSW	Queensland	Western Australia	Northern Territory
To Head Contractor (HC) by 15 business days after payment claim submitted. HC to Sub Contractor, by 20 business days after payment claim submitted; or lesser date prescribed by contract.	As prescribed by contract. The BIF Act voids terms longer than 25 days for a trade subcontract. If contract silent, then 10 business days after payment claim submitted.	As prescribed by contract. However cannot be longer than 42 days after payment claim submitted. If contract silent, within 28 days of receiving payment claim.	As prescribed by contract. However cannot be longer than 50 days after payment claim submitted. If contract silent, within 28 days of receiving payment claim.

In the remaining jurisdictions – Victoria, Tasmania, ACT, and South Australia – the SOP legislation allows the contracting parties to determine when a payment falls due, with most assigning a default due date if the contract is silent.

Commonwealth Legislation

Overlaying State and Territory legislation, the Commonwealth Government sets out standards for conduct for building and construction participants (Code covered entities) involved in Commonwealth funded building work in the *Code for the Tendering and Performance of Building Work 2016 (the 2016 Building Code)*. The Code applies to all Commonwealth funded building work for which an EOI or tender has been submitted on or after 2 December 2016.

A Code covered entity who breaches the requirements of the 2016 Building Code may be excluded from tendering or being awarded Commonwealth building contracts for up to one year. The 2016 Building Code is administered by the Australian Building and Construction Commission (ABCC).

Reverse Factoring in the Building and Construction Industry

There is little data indicating the extent to which reverse factoring is used in the building and construction industry. However, there has been much press recently about a large construction contractor who has extended contract terms to their subcontractors from 30 days to 65 days and in turn, offered a SCF product.²⁷

²⁶ AMCA, Submission in Senate Economics Reference Committee Report, p 45.

²⁷ Wiggins J, Australian Financial Review, 20 September 2019.

Issues to be considered in offers of reverse factoring by a contractor to their subcontractor would include whether or not the activities:

- complied with State and Territory SOP legislation;
- was a breach of the Unfair Contract (UCT) provisions in the Australian Consumer Law; and
- was a breach the 2016 Building Code.

SOP Legislation

The SOP legislation in jurisdictions which do not specify payment within certain timeframes and allow the contracting parties to determine when the payment falls due (such as Victoria, Tasmania, South Australia and the ACT), may provide a greater incentive for a contractor to increase payment times and offer reverse factoring. However because SOP legislation allows the contracting parties to determine when a payment falls due, the availability of SCF does not replace the right of subcontractors to fair payment times, nor should it be compulsory for subcontractors to enter into an SCF agreement to get paid.

In jurisdictions where SOP legislation determines payment timeframes to subcontractors, such as NSW (20 days) and WA (not more than 42 days) there is less incentive for subcontractors to enter into SCF agreements. Nationwide, however, building and construction subcontractors lack awareness of SOP legislation, or are reluctant to access rights when there is a dispute. A survey of the construction industry conducted by the NSW Small Business Commissioner found that most of the 693 respondents were either not aware of SOP legislation (37.8%), or said they would like more information (32.7%). Similarly, 42.7% said they did not know when to enact SOP legislation.²⁸

The asymmetry of power in the building and construction industry is well documented. It is reasonable to believe that the balance of power is such that some subcontractors may choose not to access SOP legislation and instead accept the terms of the contract offered by the contractor.

UCT provisions in the Australian Consumer Law

A term will be considered unfair if the following criteria were satisfied in a standard form contract:

- it would cause a significant imbalance in the parties' rights and obligations;
- it is not reasonably necessary to protect the benefiting party's interests; and
- it would cause detriment to the small business if applied.

A construction industry contract is likely to be presumed to be a standard form contract unless proved otherwise. This is because those higher up the contracting chain with more power frequently propose contracts to building subcontractors on a 'take it or leave it' basis, with little opportunity to negotiate. Also, contracts in the construction industry tend to be long, lengthy and highly technical in nature, placing a significant risk on the other party's shoulders.²⁹

However, there are thresholds in the UCT protections which may limit UCT reach. A small business contract falls under the UCT law if the upfront price payable does not exceed \$300,000 – or \$1 million if the contract is for more than 12 months. Furthermore, there are no monetary penalties for having unfair terms in standard form small business contracts and it requires court action for an unfair term to be declared void

The 2016 Building Code

²⁸ NSW Small Business Commissioner, Survey of Construction Industry.

²⁹ ACCC, Unfair Contract Terms [put in link to criteria for standard form contracts].

In States where SOP law does not stipulate maximum payment times, a contractor may contract to provide for 65 day payment terms.

Much turns on whether or not the SCF arrangement was imposed on a subcontractor on a non-voluntary basis. The 2016 Building Code includes provisions stating that a Code covered entity must not threaten or coerce a contractor or subcontractors in certain ways.³⁰ The relevant sections of the 2016 Building Code would apply if the coercion or undue influence constituted an attempt at having the subcontractor not exercise their rights under SOP laws, or exercise their rights in a particular way.

Also, if a contractor sought to vary an ongoing contract to extend the payment terms and a subcontractor did not consent, the contractor must follow their contractual dispute settlement process. A mandatory early payment program and an alleged unilateral variation of contract may breach the code, and may also be issues that the ABCC could refer to ASIC or the ACCC on the basis that they constitute unfair use of market power and unconscionable conduct. During the course of the Inquiry, we heard from one subcontractor to a state government project who alleged that he was not given a choice but to accept SCF or he would not be awarded the contract. The contractor, when questioned, denied that this was the case.

Project Bank Accounts (PBAs)

Both Queensland³¹ and Western Australia³² have implemented and extended PBAs which are put in place by the Head Contractor and protect the next level subcontractor. The legislation in both States indicates that the head contractor must pay the progress payment to the subcontractor entity named in the contract. This appears to exclude a financier in an SCF arrangement receiving the payment from the head contractor.

Despite the building and construction industry having specific SOP legislation and a Commonwealth Building Code, there are issues with the effectiveness of the legislation in delivering timely payment in this industry, highlighted in numerous reviews and reports.

Artificial Intelligence

Artificial Intelligence (AI) is “a collection of interrelated technologies used to solve problems autonomously and perform tasks to achieve defined objectives without explicit guidance from a human being”³³. At the core of AI is machine learning (ML), together with other fields of science and technology such as knowledge representation and human language technologies.

Data collected by businesses by way of SCF arrangements should be used responsibly. If information is to be collected and disclosed to third parties, the small business supplier must be advised of this before entering into the SCF arrangement. Full disclosure of the type of data being collected and shared is necessary. Protections around data collection and use must be same as for individuals.

Data has become a valuable commodity not only to businesses understanding their performance and ways to improve, but also for external parties gaining insights on how to compete and interact with competitors and maximise value from interactions with their customers. We know that AI is already being used in many areas and will increasingly be the underlying technology that allows devices to

³⁰ 2016 Building Code s11D(3)(a) and s11D(3)(b).

³¹ QLD - From 1 July 2020 PBAs will be extended to all government and Health and Hospital services’ building contracts of =>\$1 million. A further phased roll-out will occur.

³² WA - expanded PBAs for WA Government building and construction contracts that exceed \$1.5 million for contracts after 1 July 2019.

³³ Dawson D and Schleiger E, Horton J, McLaughlin J, Robinson C, Quezada G, Scowcroft J, and Hajkowicz S (2019) Artificial Intelligence: Australia’s Ethics Framework. Sydney: CSIRO Data61

run, communicate and analyse data.³⁴ It follows that as AI becomes more advanced, its applications will become increasingly complex. In recent years over \$86 billion has been committed to focused AI programs and activities internationally, mostly by governments. It has been estimated that digital technologies such as AI could add \$315 billion to the Australian economy within 8 years and that AI alone could add over \$22 trillion to the global economy within a decade.³⁵

There are a number of businesses within the SCF industry that espouse the benefits of being able to use artificial intelligence that include:

Kyriba Corp

Kyriba Corp is a financial technology business that provides cloud-based treasury, cash, risk and payment management solutions. In December 2019 the online trade magazine, SCF Briefing, carried an article about AI in SCF:

*“Fintech Kyriba has been running different use-cases, testing how to use AI in its SCF offerings and other Kyriba products. The company has an initial focus on cash forecasting, with a product due to launch next year offering the ability to predict supplier cash flow shortages. Edi Poloniato, global head of working capital solutions at Kyriba has publicly stated that based on historical data of supplier financing requests, the system can suggest when the supplier needs financing, the amount range and the dates in the month”.*³⁶

Taulia

Despite strenuously denying the use of AI following the release of our position paper, Taulia, a platform offering dynamic discounting, SCF, and invoice management services, continue to promote their use of AI in their marketing material. Further, our consultations have shown that many of Taulia’s customers have been impressed with the AI capabilities shown to them through the sales process. Taulia’s website includes such statements as the following:

³⁴ https://acola.org/wp-content/uploads/2019/07/hs4_artificial-intelligence-report.pdf

³⁵ <https://data61.csiro.au/en/Our-Research/Our-Work/AI-Roadmap>

³⁶ SCF Briefing, “Could AI define a new era for supply chain finance?”, 4 December 2019

A smarter dynamic discounting solution

Predictive analytics can have a hugely positive impact on the success of your program. We use artificial intelligence to boost programs through efficiency gains and predictive modeling.

We've analyzed more than a billion transactions across our platform. We augment this with external big data sets, such as cost of capital and credit ratings. Our models predict the best ways to drive adoption, the best terms and rates to offer, and the probability of early payment acceptance in different scenarios.

Use a more data-driven approach to generate results.

Accessed 16 March 2020.

In March 2019 the Global Trade Review (GTR) website carried an article about Taulia's use of AI which included such quotes as:

- Taulia has implemented an artificial intelligence capability on its working capital platform to help buyers better assess supplier behaviour and risk;
- ...The new AI tool aggregates a range of data on supplier behaviour to enable Taulia clients to make better decisions around their early payment programmes. This includes data such as the historic timing of payments, the annual percentage rate accepted by suppliers when taking early payment, as well as fluctuations in their financial position;
- Vincent Beerman, the company's senior director of product, tells GTR the solution collects data from 'myriad sources' including S&P Capital IQ, which provides information about a company's financial standing, credit rating and cash conversion cycle metrics, as well as Data.com, Synthio and LinkedIn; and
- The solution also analyses each invoice to determine why an early payment was, or was not selected, helping buyers understand how to drive and adjust their programmes."³⁷

Greensill Capital

Greensill Capital is another entity that has attempted to deny the use of AI to maximise discounts taken by small suppliers. However, in an article on Greensill Capital's website the following observations were made regarding the use of data and AI:

- "As the suppliers who have provided invoices to Greensill over the past seven years automatically feed information into the firm's systems, troves of data accumulate that become a vital resource in providing an even more efficient route to unlocking capital.

³⁷ <https://www.gtreview.com/news/fintech/taulia-uses-ai-to-help-buyers-optimize-their-supply-chain-finance-programmes/>

- The quantities of data are so large, in fact, that the only way to analyse them and put them to the most effective good use is with artificial intelligence and machine learning.
- Greensill pays buyers for historic and real-time data so the artificial intelligence can make a forecast on each invoice based on the most up to date information available.”³⁸

From a November 2017 report by Financial Stability Board, which is funded by the Bank of International Settlement:

*“banks and other lenders are increasingly turning to additional, unstructured and semi-structured data sources, including social media activity, mobile phone use and text message activity, to capture a more nuanced view of creditworthiness, and improve the rating accuracy of loans. Applying machine learning algorithms to this constellation of new data has enabled assessment of qualitative factors such as consumption behaviour and willingness to pay. The ability to leverage additional data on such measures allows for greater, faster, and cheaper segmentation of borrower quality and ultimately leads to a quicker credit decision. However, the use of personal data raises other policy issues, including those related to data privacy and data protections.”*³⁹

Robobai

Robobai is an invoice management system that is implemented by large businesses, which then require their small business suppliers to pay an annual fee to use the platform. Robobai also promote their use of AI on their website, and in testimonials from their clients. Robobai has recently started working with Inghams, who provided the following testimonial:

*“Robobai has been working closely with Inghams to classify spend using AI, enabling spend visibility at most granular levels with over 95% classification accuracy identifying predictive saving insights not seen before. The contract lifecycle management (CLM) application on the platform has greatly helped keep Inghams procurement and the wider business more informed and better able to manage the supplier contracts. The CLM provides alerts for expiring contracts well in advance which helps category managers to take a proactive approach, in addition to running a range of contract analytics to improve contracts and supplier performance. Now we have our spend and our contracts in one platform, we can now measure supplier and contract compliance, we can see savings leakage and risk so we can act fast. It has been [an] exciting journey alongside Robobai to unlock the potential of spend data analytics, unleashing cost saving opportunities for the organisation”.*⁴⁰

Capacity of Artificial Intelligence

To understand the full capacity of AI in platform SCF, Associate Professor Rob Nicholls, Director of the UNSW Business School Cybersecurity and Data Governance Research Network, provided a paper on the use of machine learning in SCF. The full paper is available at Attachment C.

Associate Professor Nicholls notes:

“in general, a lender or finance provider will seek to evaluate the highest returns for the lowest risk. In the case of SCF, the return represents the discount that the supplier is willing to take in order to be paid in a timely fashion. SCF offered by a buyer in a closed loop system with suppliers (referred to in the literature as SME closed-loop supply chain finance) creates a

³⁸ <https://www.greensill.com/whitepapers/artificial-intelligence-financing-the-future/>

³⁹ <https://www.fsb.org/wp-content/uploads/P011117.pdf>

⁴⁰ <https://robobai.com/our-clients/> accessed 16 March 2020.

very low risk to the SCF provider.⁴¹ This means the SCF providers tend to use machine learning to focus on increasing margins.

It is likely that all three forms of machine learning will be used. However, the SCF provider will need to build as large a set of data as it can about prospective SCF users. This data is likely to come from both the businesses that seek to promote SCF to their suppliers, but also other sources.

One of the outcomes of the application of all three forms of machine learning is the ability to target groups or classes of business which are more tolerant to higher margins. For example, a SCF provider could use reinforcement learning to change the regression analysis based on the initial data. This might show, for example, that architects are prepared to discount by 3% for 5 day payment of an invoice, 2% for 10 day payment of an invoice and 1% for 15 day payment of an invoice. On the other hand, suppliers that import fasteners are prepared to discount by 2% for 5 day payment of an invoice, 0.5% for 10 day payment of an invoice and are not prepared to discount for any later payment.”

Algorithms

In the context of machine learning, an algorithm is “a set of mathematical processes used by machines to perform calculation, processing and decision making”.⁴²

Generically, algorithms are any form of automated instruction. The data being fed into the algorithms can be:

- directly sourced, eg for an exercise in profiling a small business, the data may be about the number of larger businesses the small business trades with or the usual payment terms the small business accepts; or
- indirectly sourced, often obtained from data brokers or data intermediaries. The data may have been retrieved from cookies on websites visited by associates of the small business, or from industry chat pages, or media exposure of the small business or businesses it trades with.

The access and use of these types of data in such powerful and complex systems raises a number of ethical considerations, such as to do with privacy, transparency and discrimination (caused by algorithmic bias). Of concern is that AI systems sometimes operate opaquely, or as “black boxes” whether for technical or proprietary reasons. This opacity further limits the ability of regulators and other stakeholders to scrutinise the systems and their controllers. Consequently, AI gives rise to a number of potential risks that need to be monitored and governed.⁴³

Approaches to regulating the use of AI

In 2017, the ACCC recognised the potential for e-collusion from the rise of big data. ‘ACCC is considering cases where algorithms are deployed as a tool to facilitate conduct which may contravene Australian competition law’.⁴⁴ The ACCC created a Data Analytics Unit to look at how to respond to data driven innovation.

Some argue that in the right market conditions, pricing algorithms may be used to more effectively engage in and sustain collusion, whether ‘tacit’ or not, reducing competition but without

⁴¹ Cheng Zhang, ‘Small and Medium-Sized Enterprises Closed-Loop Supply Chain Finance Risk Based on Evolutionary Game Theory and System Dynamics’ (2016) 21(3) *Journal of Shanghai Jiaotong University (Science)* 355.

⁴² https://acola.org/wp-content/uploads/2019/07/hs4_artificial-intelligence-report.pdf

⁴³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819055/Landscape_Summary_-_Bias_in_Algorithmic_Decision-Making.pdf

⁴⁴ <https://www.accc.gov.au/media-release/new-competition-laws-a-protection-against-big-data-e-collusion>

contravening competition laws. It is said that a profit-maximising algorithm will work out the oligopolistic pricing game and, being logical and less prone to flights of fancy, stick to it.

“To further complicate matters, the development of deep learning and artificial intelligence may mean that companies will not necessarily know how, or why, a machine came to a particular conclusion. To this end, it is argued that if similar algorithms are deployed by competing companies, an anti-competitive equilibrium may be achieved without contravening competition laws.”⁴⁵

In his statements in 2017, ACCC Chairman Mr Rod Sims noted his confidence that Australian laws, particularly with the addition of the then new concerted practices provision under section 45 of the *Competition and Consumer Act 2010*, but also the new misuse of market power provisions, can deal with a situation in which the use of algorithms substantially lessen competition. Mr Sims cited a hypothetical of a learning algorithm deployed by a firm with substantial market power to determine profit-maximising downstream prices and engage in a margin squeeze:

*“It may be difficult to establish that a firm with substantial market power had a proscribed anti-competitive purpose when deploying that algorithm, but by focusing on the effect or likely effect of conduct, however, the new misuse of market power provision is fit-for-purpose to prohibit this conduct.”*⁴⁶

Fully informed consent

A key principle in the use of algorithms and AI is that of transparency. Companies and people should be informed when an algorithm impacts them, particularly when data they are providing may be used to manipulate outcomes against them in the future. Ensuring that small businesses are providing fully informed consent is difficult for a number of reasons, including:

- Power asymmetries, where the small business has little choice but to consent to the use of their data. For example, where a small business joins a SCF program. Clarity is required around what a business owner is consenting to, and how that data will be used.
- Information asymmetries, where a small business owner may consent to their data being stored and used without properly understanding the nature of this use.
- Secondary uses of data, where data that is collected for a given purpose may be put to additional or new uses at a later stage. It is imperative that the conditions under which such uses are appropriate are made clear. While the *Privacy Act* indicates that consent be “current and specific”⁴⁷, it is difficult for a small business to assert whatever rights they may have due to the cost and knowledge required to pursue legal action.

Self-regulation options including Australian Standards and industry codes

Standards by themselves are voluntary documents. Where there is no legislative reference to particular standards, there is no requirement for businesses operating in Australia to comply with them. Australia is a net importer of the AI technology and as such we are a standards taker rather than a standards maker. Through our active participation in the international standardisation process, we can contribute and influence the outcomes.

In 2017 the international standardisation bodies created a body to address AI, Subcommittee 42 – Artificial Intelligence (JTC 1/SC42), and in late 2018 Standards Australia established a local version, or “mirror committee”, of JTC1/SC42, with representation across the Australian Government, industry

⁴⁵ Ibid.

⁴⁶ Ibid.

⁴⁷ https://about.unimelb.edu.au/__data/assets/pdf_file/0020/102791/UoM-response-_Standards-

[Australia-Discussion-Paper-on-AI.pdf](#)

and academia. Besides the nine separate standards being developed there is a focus on the governance of AI within organisational settings.

An approach different to that of a standards-based framework is an ethics-based framework. Examples of the latter are two documents released in April 2019:

- the CSIRO Data61 and Department of Industry discussion paper, “Artificial Intelligence: Australia’s Ethics Framework”, referenced above, and,
- the European Commission’s High-Level Expert Group on Artificial Intelligence’s “Ethics Guidelines for Trustworthy AI”.⁴⁸

Both documents were released in April 2019.

In November 2019 the Australian government began construction of a voluntary AI Ethics Framework to help guide businesses and governments looking to design, develop and implement AI in Australia.⁴⁹ More recently Google, IBM, the UN Food and Agricultural Organisation, and the Italian Government have developed a “human-centred” initiative for AI development, “The Rome Call for Ethics”, which had been developed by the Vatican.⁵⁰

Quasi-regulation: Australian Standards endorsed by government

A more interventionist approach is seen in the initiatives by Singapore’s central bank and the Monetary Authority of Singapore (MAS). In collaboration with a number of major industry stakeholders MAS produced “Principles to Promote Fairness, Ethics, Accountability and Transparency (FEAT) in the Use of Artificial Intelligence and Data Analytics in Singapore’s Financial Sector”.⁵¹ In November 2019, MAS announced it was working with financial industry participants to develop a framework, “Veritas”, that will provide financial institutions with a verifiable way to incorporate the FEAT principles into AI and data analytics products. The development of the Veritas framework remains a collaborative effort but one in which Singapore’s corporate regulator is taking the initiative.⁵²

In Australia, the work done by MAS primarily falls under the remit of the ACCC. ASIC has expressed excitement about the possibilities of AI, but as a user of the technology rather than as a regulator of it.⁵³ In July 2019, the ACCC released the final report from its digital platforms inquiry which focused on the mainstream platforms, Google and Facebook and their impact on competition in the advertising and media markets, and on consumers. Amongst the recommendations in the report was for a strengthening of protections in the Privacy Act and a broader reform of Australian privacy laws, prohibitions against unfair contract terms and certain unfair trading practices, the creation of a statutory tort for serious invasions of privacy and the development of enforceable privacy codes for digital platforms. All of these recommendations could have application to governing the use of AI.⁵⁴

Included in the Government’s response to that report, was an undertaking to “further strengthen Privacy Act protections, subject to consultation and design of specific measures as well as conducting a review of the Privacy Act.”⁵⁵

⁴⁸ <https://ec.europa.eu/digital-single-market/en/news/ethics-guidelines-trustworthy-ai>

⁴⁹ <https://www.industry.gov.au/data-and-publications/building-australias-artificial-intelligence-capability>

⁵⁰ <https://www.bbc.com/news/technology-51673296>

⁵¹ <https://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Monographs%20and%20Information%20Papers/FEAT%20Principles%20Final.pdf>

⁵² <https://www.mas.gov.sg/news/media-releases/2019/mas-partners-financial-industry-to-create-framework-for-responsible-use-of-ai>

⁵³ <https://www.investmentmagazine.com.au/2019/10/asics-shipton-excited-about-ai-phone-monitoring/>

⁵⁴ <https://www.accc.gov.au/publications/digital-platforms-inquiry-final-report>

⁵⁵ <https://treasury.gov.au/publication/p2019-41708>

Co-regulation: Australian Standards called up in regulation

The ACCC is also the lead regulator in the introduction of a consumer data right, aiming to give consumers greater access to and control over their data. The ACCC worked with the Office of the Australian Information Commissioner (OAIC) and the Data Standards Body (DSB) in the development and implementation of the CDR. The DSB are responsible for the creation of the technical standards for the sharing of consumer data. The OAIC are the primary complaints handler under the CDR scheme. The technical standards developed by DSB are enforceable under the CDR legislation.

Foreign Law

The EU

Amongst the leading efforts in regulating for data protection, the General Data Protection Regulation (GDPR) was introduced by the EU in 2016 but came into force from 25 May 2018. It casts a wide net, affecting any entity that collects or processes the personal data of residents of the EU, whether or not that entity is itself located within the EU. The GDPR is intended “to protect the privacy, security, and personal rights of EU citizens from unfair or unsafe data collection and processing”. It applies to any entity that offers goods and services in the EU or monitors the behaviour of individuals in the EU.⁵⁶

The GDPR only applies to the personal data about individuals, not companies or other legal entities. However the rules may apply to the personal data of sole traders and to the data of employees, including their work phone numbers and email addresses, and any cookies that track them.⁵⁷

The UK

In March 2019 the UK’s Information Commissioner’s Office (ICO) “issued a call for input into its development of an auditing framework for AI technologies. This push comes in response to the protections afforded to individuals under the GDPR in situations where personal data is processed, and then used to profile or make decisions about a person, by AI technology.”⁵⁸

California, USA

The State of California’s own data protection legislation, California Consumer Privacy Act, came into effect in January this year.⁵⁹ The Act was designed to emulate certain provisions of the GDPR, providing residents with many of the same rights for their personal data as the GDPR. The enforcement date was 1 January 2020.

The Act provides consumers with the following rights:

- Right to access the personal data collected about them and the identification of any third parties with whom the information is shared.
- Right to erasure of personal information.
- Right to opt out of the sale of personal information.
- Right to equal service and price when any of the above rights are exercised.⁶⁰

⁵⁶ <https://www.freeprivacypolicy.com/blog/gdpr-privacy-policy-template/>

⁵⁷ https://ec.europa.eu/info/law/law-topic/data-protection/reform/rules-business-and-organisations/application-regulation/do-data-protection-rules-apply-data-about-company_en

⁵⁸ <https://www.gtlaw.com.au/insights/uk-regulator-develop-ai-auditing-framework>

⁵⁹ <https://www.wired.com/story/ccpa-guide-california-privacy-law-takes-effect/>

⁶⁰ https://www.ey.com/en_gl/advisory/how-the-california-consumer-privacy-act-compares-to-the-eu-gdpr

Australian Law

The ACCC is the lead regulator of the Consumer Data Right. The ACCC state that “the purpose of these changes is to give consumers greater access to and control over their data. It will improve consumers’ ability to compare and switch between products and services, and will encourage competition between service providers, leading not only to better prices for customers but also more innovative products and services.”⁶¹

The CDR requirements will have a staged implementation, with the first application to be to the banking sector. Within the banking sector the roll-out is being staged with the ‘Big 4’ banks to be the first group required to comply with the CDR and eventually all entities that are registered with APRA as an authorised deposit-taking institution will fall under the CDR regime. Overseas branches of several of the large international banks operating in Australia, HSBC⁶² and Citibank⁶³, are engaged in providing platforms for supply chain financing.

Only specified or particular data will be caught by this legislation e.g. consumer data relating to deposit accounts and personal loans but the CDR seems not designed to pick up on other data, such as relating to credit scoring or loyalty programs or indirectly sourced data. This in contrast with the GDPR regime where any data related to the behaviour of a consumer is covered.

The Current Status of Governance of the use of AI in the SCF sector

It was recently reported that the ACCC chairman, Rod Sims confirmed that the ACCC had investigated several companies that had used SCF, that the ACCC had the power to compel businesses to provide information and documents in relation to allegations of unfair contract terms, and that it was liaising with ASIC. Mr Sims stated that “reverse factoring is also likely to involve the supply of a financial service which would mean some of the alleged conduct may fall for consideration under the Australian Securities and Investments Act rather than the Competition and Consumer Act”.⁶⁴

However on the same day it was reported that the ASIC chairman, John Price had written to the opposition industry spokesman Brendan O’Connor confirming that “Supply chain financing arrangements used by companies are not regulated under the provisions of the [ASIC Act 2001].”⁶⁵

In its discussion paper, “Human Rights & Technology”, released in December 2019, the Australian Human Rights Commission notes that “regulatory lag on the part of government has contributed to a drift towards self-regulation in the technology sector, as laws and regulators have not effectively anticipated or responded to new technologies.” In the discussion paper the AHRC adds support to the ACCC call for the introduction of a statutory cause of action for serious invasion of privacy. AHRC also proposed that the Australian Government engage the Australian Law reform Commission to conduct an inquiry into the accountability of AI-informed decision making.⁶⁶ In releasing the discussion paper, the Human Rights Commissioner, Ed Santow, is quoted as saying “laws that apply in the real world should apply in the digital world, and we need to enforce laws more rigorously to

⁶¹ <https://www.accc.gov.au/focus-areas/consumer-data-right-cdr-0>

⁶² <https://www.gtreview.com/news/sustainability/hsbc-rolls-out-sustainable-supply-chain-finance-programme-for-walmart/>

⁶³ <https://www.businesswire.com/news/home/20191021005152/en/Citi%20AE-Supplier-Finance-Launches-WorldLink%20AE-Payment-Services>

⁶⁴ The Australian “Supplier payday lending draws ACCC scrutiny” 5 March 2020

⁶⁵ The Australian “Company in spotlight over payday lending scheme” 5 March 2020

⁶⁶ https://tech.humanrights.gov.au/?_ga=2.241455361.2031156569.1583363939-1294517734.1583363939

make that happen. An ethics framework can help to make good choices, but it different to the law which sets baselines for proper conduct”.⁶⁷

Impact on Financial Reporting disclosures

Large companies are required by law to prepare a financial report every year which is presented to shareholders and often available publicly to other entities, including banks and suppliers. Financial reports consist of;

- A statement of financial position (balance sheet);
- A statement of comprehensive income (profit and loss account);
- A statement of changes in equity;
- A statement of cash flows;
- Notes;
- A Directors’ declaration and Director’s report; and
- In some cases, an Auditor’s report.

The financial report needs to be prepared in accordance with applicable accounting standards, making the necessary disclosures in order to be transparent and fully inform readers about the activities and financial situation of the entity. The information in a company’s financial report is used by stakeholders to make investment and commercial decisions; whether to buy/hold/sell shares in the company or whether to lend to or trade with the company.

The Australian Accounting Standards Board (AASB) is the independent accounting standard-setter and is responsible for developing, issuing and maintaining a single set of accounting standards that require transparent and comparable information in the financial reports. In their joint submission to our Position Paper, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia explained that Australia is a standard-taker and the International Accounting Standard Board (IASB) is the ‘international counterpart’ for Australia. The AASB uses International Financial Reporting Standards (IFRS) issued by the IASB to develop, issue and maintain the Australian Accounting Standards (AAS).⁶⁸

AASB 101 *Presentation of Financial Statements* states:

*“a fair representation also requires an entity to provide additional disclosures when compliance ... is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance”*⁶⁹

Accounting transactions should be represented and reported in accordance with their substance and economic objective and not merely their legal form. Companies also have obligations under the *Corporations Act 2001* (the Act). Section 296 requires the financial report to comply with accounting standards and section 297 requires the financial accounts and notes to give a true and fair view.

The use of SCF can disrupt the established financial reporting practices by blurring the line between trade payables (trade creditors) and debt. The wide range of variations in SCF programs available

⁶⁷ AFR, “We needs laws about AI, not self-regulation” 17 December 2019

⁶⁸ CA ANZ and CPA Australia joint submission to the ASBFEO Supply Chain Finance Review Position Paper 28 Feb 2020

⁶⁹ AASB 101 – compiled Authorised Version F2018C00358 registered 12 June 2018 para 17

further complicates the accounting and reporting of SCF transactions, meaning there cannot be a one-size-fits-all reporting guidance solution or standard.

For example, when an intermediary exists between the big business purchaser and the small business supplier, and the trade payable of the big business purchaser is factored or paid earlier than normal terms by the intermediary, the current liability “Trade payables/creditors” may better be described as debt to the intermediary (as the trade creditor, the supplier, has actually been paid). Depending on the terms for repayment of the debt, the initial liability may be moved to non-current. Some analysts and rating agencies are inclined to see the purchaser’s liability to the SCF intermediary as a form of borrowing. However, it is not standard accounting practice to account for it as such.

Perhaps, more importantly, is the potential impact of SCF transactions and their accounting treatment on the Cash Flow Statement of the reporting company. The decision as to whether SCF is reported as trade payables or debt is critical in determining whether SCF impacts a company’s operating or financing cash flows. The credit ratings agency Moody’s has said “*companies using reverse factoring should disclose it as a liquidity risk,*” due to the artificial boost it can provide to working capital metrics.⁷⁰ This liquidity risk manifests when, because of the potential size of some SCF programs, the cancellation of the programs can lead to a sudden outflow of working capital over a short period of time, creating liquidity pressure.⁷¹

Because there are no specific disclosure requirements yet in either Australian, US or internationally generally accepted accounting principles or standards concerning these types of programs, there has been limited disclosure even about their existence.

At its meeting in November 2019 the AASB addressed the topic of SCF, particularly “*reverse factoring*” and recognised that inconsistencies in disclosing SCF transactions is an issue and it should be raised with the IASB.⁷²

We are also aware that on 2 October 2019 the Big Four accounting firms submitted a joint letter to the FASB 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”.⁷³ Once the International Financial Reporting Standards are developed on the issue, the AASB will need to consider the application of any new reporting and disclosure standards to Australian reporting entities.

The U.S markets regulator, the Securities and Exchange Commission, is advocating for new rules governing how companies should disclose SCF schemes claiming their rising popularity has masked “hidden risks”.

“Unfortunately, without greater disclosure, many investors are left wondering how sustainable reverse factoring is as a source of capital”⁷⁴

While company management is responsible for preparing the financial report, auditors are engaged to undertake a range of procedures in order to obtain reasonable assurance on whether the financial

⁷⁰ “Solving the reverse factoring dilemma: an ethical guide” published on www.earlytrade.com 15 October 2019

⁷¹ Global Supply Chain Finance Forum “Payables finance – how it helps global supply chains” factsheet

⁷² Australian Accounting Standards Board Cover Memo of November 2019 meeting (M173)

⁷³ Ibid citing Letter from Big Four Accounting Firms to Shayne Kuhaneck, Acting Technical Director, FASB 2 October, 2019 p 4

⁷⁴ Office of the Investor Advocate, U.S. Securities and Exchange Commission, Report on Activities Fiscal Year 2019 p 19

report is free from material misstatement, whether due to fraud or error and to form an opinion on the report.⁷⁵ Users of financial reports rely on auditors to interrogate the robustness of the various accounting statements in the report so it is important for the auditing profession to ensure the accounting principles employed by the company management align with the requirements regarding material misstatement (including by omission) or error.

ASIC regulates compliance with the financial reporting and auditing requirements for those entities subject to the Corporations Act in Australia. ASIC's monitoring of companies seeks to ensure that the financial reports and audit opinions issued are relevant and reliable and help those users and stakeholders to make better informed decisions in the marketplace. There is further work to be done by the AASB, ASX and ASIC on the disclosures by large businesses of their use and impact of SCF programs.

Small business suppliers do not have the power to interrogate the financial capability of a big business customer. They rely on media commentary during financial reporting season and more likely, practical indicators such as the volume of orders, price pressure and timeliness of payment. Any scope for big business to manipulate their financial reporting to the market and mask their true financial position increases the risk to the small business supplier. When a big business fails and leaves small business creditors without payment, insolvency can very quickly spread through supply chain participants.

⁷⁵ Australian Auditing Standard (ASA) 700 *Forming an Opinion and Reporting on a Financial Report*

Appendix A: 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 B: Position Paper 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?

Appendix C: Assoc. Professor Rob Nicholls – Director UNSW Business School Cybersecurity and Data Governance Research Network

Machine learning in Supply Chain Finance

Machine learning has been identified as a potential basis for enhancing the efficiency of supply chain finance from the perspective of the lender.⁷⁶

Machine learning

This description of machine learning is based on work on the application of machine learning to regulatory technology.⁷⁷

There are three forms of machine learning. The most commonly used is “supervised machine learning”. Conceptually, supervised machine learning takes a sample of data to create predictions of outputs for specific inputs. Say, for example, that you have data that shows the average number of grey hairs a person will have developed at ages 20, 30, 40 and 50. You could supervised machine learning to predict how many grey hairs a person would have at age 37. Of course, there needs to be sufficient data to enable accurate prediction: one approach to the creation of an initial model is to take about 80% of a data set to create the “training data” and to use the balance as the “testing data”.

Supervised machine learning typically uses one of two tools: regression analysis and classification. In classification, the inputs are divided into groups with potentially common characteristics and the output is a class label. That is, the output is discrete. A discrete variable is something like the number of daily admissions into a hospital, or the number of students at a university; more of a category. In contrast, in a regression, the output is continuous. A continuous output from a regression analysis will be a real number. For example, height or weight. What differentiates this from a category-like discrete output is that regardless of how close two people’s height or weight may be, there will be another whose measurements fall somewhere in between. For price analysis, the approach taken is regression, with its continuous output. It is important to note that this initial model is expected to be improved by reinforcement learning, potentially in real time, which is discussed below. The rationale for this is that there is data “drift” over time.⁷⁸

The second form of machine learning is “unsupervised learning”. This creates a model by finding structures or patterns present in the input data to extract general rules without any associated response. An algorithm restructures data by similarity traits. Unsupervised machine learning can also be used for anomaly detection.⁷⁹ In this case, it is outliers which are of interest (as opposed to

⁷⁶ You Zhu et al, ‘Forecasting SMEs’ Credit Risk in Supply Chain Finance with an Enhanced Hybrid Ensemble Machine Learning Approach’ (2019) 211 *International Journal of Production Economics* 22; You Zhu et al, ‘Comparison of Individual, Ensemble and Integrated Ensemble Machine Learning Methods to Predict China’s SME Credit Risk in Supply Chain Finance’ (2017) 28(1) *Neural Computing and Applications* 41; Ali Zulqurnain, Gongbing Bi and Mehreen Aqsa, ‘Predicting Supply Chain Effectiveness through Supply Chain Finance: Evidence from Small and Medium Enterprises’ (2019) 30(2) *The International Journal of Logistics Management* 488.

⁷⁷ Rob Nicholls, ‘Regtech as an Antitrust Enforcement Tool’ [2020] (Forthcoming) *Journal of Antitrust Enforcement*.

⁷⁸ J Lu et al, ‘Learning under Concept Drift: A Review’ (2019) 31(12) *IEEE Transactions on Knowledge and Data Engineering* 2346.

⁷⁹ K Golmohammadi and O Zaiane, ‘Time Series Contextual Anomaly Detection for Detecting Market Manipulation in Stock Market’ in 2015 *IEEE International Conference on Data Science and Advanced Analytics (DSAA)* (2015) 1; Fei Tony Liu, Kai Ming Ting and Zhi-Hua Zhou, ‘Isolation-Based Anomaly Detection’ (2012) 6(1) *ACM Trans. Knowl. Discov. Data* 3:1--3:39; Ayman Taha and Ali S Hadi, ‘Anomaly Detection Methods for

patterns). Outlier detection is likely to be an important aspect of the application of machine learning to supply chain finance (SCF).

The third form of machine learning is reinforcement learning. In reinforcement learning, algorithms learn to take actions in order to maximise a cumulative reward. The algorithm is not trained as to the best action in a given situation. However, it may receive a reward if a successful action has been chosen. Put simply, it learns through trial and error. The algorithm maximises the expected sum of the discounted future rewards. As is suggested later in this article, there are evidentiary problems with applying reinforcement learning in RPM detection.

Applying machine learning to SCF

In general, a lender or finance provider will seek to evaluate the highest returns for the lowest risk. In the case of SCF, the return represents the discount that the supplier is willing to take in order to be paid in a timely fashion. SCF offered by a buyer is a closed loop system with suppliers (referred to in the literature as SME closed-loop supply chain finance) creates a very low risk to the SCF provider.⁸⁰ This means the SCF providers tend to use machine learning to focus on increasing margins.

It is likely that all three forms of machine learning will be used. However, the SCF provider will need to build as large a set of data as it can about prospective SCF users. This data is likely to come from both the businesses that seek to promote SCF to their suppliers, but also other sources. These other sources are likely to include social media, sales platforms (such as eBay, Amazon Marketplace and AliExpress). This will make use of an application programming interface or API. An API provides the “hooks” by which the SCF provider’s software can call for information. In many cases, these data sources will supply real time data.

Supervised machine learning will identify a range of classifications for businesses. For example, the willingness to pay may be quite different for professional services small businesses than tradespeople. That is the classification provides discrete groups of target customers. For each class of customer, there may be a different willingness to discount depending on the amount due from the acquirer. For example, some business types may be less willing to take a discount for small invoices but more willing for large invoices. Some businesses may not be willing to take a discount when there is a sub-contractor to be paid.

Unsupervised machine learning could be used by the SCF provider to determine particular traits. This might be something as simple as types of business that belong to a Chamber of Commerce or types of business where the owner is a member of Rotary. This type of information can then be used for business targeting by the SCF provider.

Reinforcement learning will be critical for the SCF provider in maintaining and increasing lending margins. Finding what works (higher margins) or what does not (where businesses decline to acquire SCF) helps to improve the business of the SCF provider.

One of the outcomes of the application of all three forms of machine learning is the ability to target groups or classes of business which are more tolerant to higher margins. For example, and SCF provider could use reinforcement learning to change the regression analysis based on the initial data. This might show, for example, that architects are prepared to discount by 3% for 5 day payment of an invoice, 2% for 10 day payment of an invoice and 1% for 15 day payment of an

Categorical Data: A Review’ (2019) 52(2) *ACM Comput. Surv.* 38:1--38:35; Y Cao et al, ‘Adaptive Hidden Markov Model With Anomaly States for Price Manipulation Detection’ (2015) 26(2) *IEEE Transactions on Neural Networks and Learning Systems* 318; Jose Tomas Llanos, *The Data Paradox in Competition Enforcement* (No SSRN 3373553, 15 August 2018).

⁸⁰ Cheng Zhang, ‘Small and Medium-Sized Enterprises Closed-Loop Supply Chain Finance Risk Based on Evolutionary Game Theory and System Dynamics’ (2016) 21(3) *Journal of Shanghai Jiaotong University (Science)* 355.

invoice. On the other hand, suppliers that import fasteners are prepared to discount by 2% for 5 day payment of an invoice, 0.5% for 10 day payment of an invoice and are not prepared to discount for any later payment.

From the perspective of a SCF provider, architects offer a higher margin than importers. As a consequence, the SCF provider might focus more on offering SCF services to large businesses that use professional services in order to obtain a higher margin. That is, the SCF provider uses artificial intelligence to target the small business sectors that are most likely to be prepared to discount invoices for prompt payment. The effect of this targeting will be to change the large business expectations of price from those targeted small businesses and increase pressure on their margins.

As an example, assume that an SCF provider provides services to ACorp, BCorp and CCorp. It may be that a specific small business has been dealing with each of these large businesses and has negotiated a prompt payment discount of 1% for ACorp and BCorp and 2% for CCorp. All of these prompt payment discounts are on a “cash on delivery” basis. When the SCF provider is used by each of ACorp, BCorp and CCorp, then the prompt payment discount for ACorp and BCorp will become 2% on the basis that the small business has an appetite for this level of discount. The effect of the SCF provider’s knowledge about an individual small business is that the SCF provider will use the greatest discount offered as the base discount. That is, there is a “race to the bottom” from the small business perspective and a race to maximumise margin from the perspective of the SCF provider.

Appendix D: Consultations

SCF Provider	C2FO
SCF Provider	Greensill Capital
SCF Provider	PrimeRevenue
SCF Provider	FIFO Capital
SCF Provider	Apricity Finance
SCF Provider	Taulia
SCF Provider	EarlyTrade
Investigative journalist	Financial Times
Big Business Debtor	CIMIC
Big Business Debtor	UGL (CIMIC subsidiary)
Big Business Debtor	Thiess (CIMIC subsidiary)
Big Business Debtor	CPB Contractors (CIMIC subsidiary)
Big Business Debtor	GFG Alliance (Gupta)
Big Business Debtor	Telstra
Big Business Debtor	Wesfarmers
Big Business Debtor	Boral
Big Business Debtor	Carlton & United Breweries
Big Business Debtor	Coles Myer
Big Business Debtor	Woolworths
Big Business Debtor	Downer
Big Business Debtor	Microsoft
Big Business Debtor	Nestle
Big Business Debtor	Pacific National
Big Business Debtor	Vodafone
Big Business Debtor	Visy

Big Business Debtor	BHP
Regulator	ABCC
Regulator	ASIC
Regulator	ACCC
Adviser	Deloitte
Adviser	PwC
Adviser	EY
Accounting	Australian Accounting Standards Board (AASB)
Accounting	Chartered Accounts Australia and New Zealand (CAANZ)
Accounting	CPA
Banking	Australian Banking Association (ABA)
Banking	CBA
Banking	Westpac
Banking	NAB
Banking	ANZ
Industry stakeholder	Consult Australia
Big Business Debtor	Lion
Industry Stakeholder	Law Council of Australia
Industry Stakeholder	Baker Mckenzie
Industry Stakeholder	Business Council of Australia
Big Business Debtor	RioTinto
Industry Stakeholder	ezyCollect
SCF Provider	tim finance
SCF Provider	SAP - ARIBA
International SCF Expert	Robert Fitzharris

Academic expert	Assoc. Professor Rob Nicholls - UNSW Director Business School Cybersecurity and Data Governance Research Network
AI expert	CSIRO Data61
AI expert	Verge Labs
Building and Construction	Western Australia – Department of Mines, Industry Regulation and Safety
Building and Construction	Housing Industry Association
Building and Construction	Master Builders - ACT
Industry Stakeholder	WA SBC Office
Industry Stakeholder	NSW Customer Service
Small Businesses	Small Businesses who utilised SCF programs
Various industry stakeholders	

Key	
	Consulted with
	Made contact, unable to secure a representative for discussion
	Reached out and no response to date.
	Submission provided
	Consulted with and provided a submission