Inquiry into the impact of supply chain financing on the small business and family enterprise sector

Australian Small Business and Family Enterprise Ombudsman

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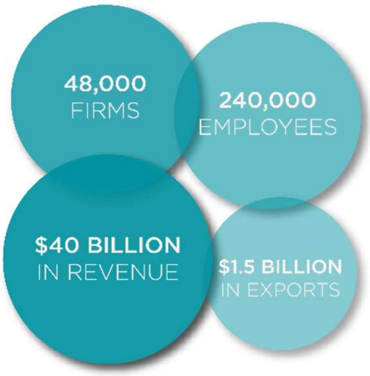

Consult Australia is the industry association representing consulting firms operating in the built and natural environment sectors. These services include design, engineering, architecture, technology, survey, legal and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments. We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $40 billion a year.

Some of our small business member firms include:

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Practical, Reliable, Power Solutions

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TEG

FIELD ENGINEERS

COMMITTED TO INNOVATION
PEAK CONSULTANTS PTY LTD

EDG consulting

Surface Design

Executive summary

On 30 October 2019, the Australian Small Business and Family Enterprise Ombudsman ('the Ombudsman') announced a review into the impact of supply chain financing on the small business and family enterprise sector, examining:

- the ways in which small and family businesses use supply chain finance as a means to better manage their cash flow and fund growth; and
- supply chain finance offerings being used by larger businesses to offset extended payment times.

In February 2020 the Ombudsman released a Position Paper setting out preliminary findings. This submission addresses the draft recommendations in the Position Paper.

To inform this submission, Consult Australia sought feedback from our small business member firms operating throughout Australia on both local and interstate projects. Our small business member firms service a range of clients; home/property owners, local councils, state governments as well as medium and large residential, agricultural and industrial developers. They offer a range of professional services including (but not limited to); civil, electrical, communications, mechanical and structural engineering, renewable energy solutions, project management, environmental advisory, fire systems as well as road and traffic services.

Our small member firms advise that they do not use supply chain financing/reverse factoring. They do however regularly face clients who extend payment terms, sometimes up to 90 days after the end of the month. Small businesses face significant challenges enforcing payment terms when clients hold more market power – whether because the client is a larger business or a government entity. Timely payments to small businesses and family enterprises are essential for cashflow, noting that for these firms the biggest business cost is wages (paid either fortnightly or monthly).

Looking to past incidents in overseas markets, there is a concern that reverse factoring can hide the true health of a company or even a whole industry. Carillion PLC in the UK was a large construction services company that, before its collapse, had extended payment times out to four months and under a reverse factoring arrangement were in significant debt which was not obvious to the market or lenders. The fallout from Carillion's collapse was felt through the entire supply chain. It is reported that its supply chain of 30,000 was owed £1.5bn and numerous suppliers which worked almost exclusively for Carillion filed for insolvency. When this level of financial instability can be hidden by a major player, there are real concerns for the entire supply ecosystem.

Consult Australia members support the draft recommendations in the Position Paper, especially those that ensure that fair contract payment times are enforced and that financial arrangements are transparent. Noting that the market takes its lead from government, we call on government clients to take up the draft recommendations and thereby become Model Clients.

Small firms often subject to extended payment times and rarely use supply chain financing

As outlined by the Ombudsman in the Position Paper, supply chain finance can be a means for small and family business to better manage their cash flow and fund growth. That is, it allows them to get payments faster, by offering a discount. In practice, our small member firms advise that they do not use supply chain financing, and frequently have their payment times ignored – even by government clients. Small businesses face significant challenges enforcing payment terms when clients hold more market power. Some small businesses also hold concerns that supply chain financing could lead to discounts to otherwise reasonable costs. It is also noted that reverse factoring can be risky where it is used to hide the health of a particular company or a whole sector.

Extended payment times are often imposed on our small member firms

Generally, consultants seek payment within 30 days, which considers the cash flow needed to keep the business running. Our small member businesses report being subjected to extended payment times by clients. Extended payment terms puts significant stress on small businesses and family enterprises. Numerous members report that they have turned down large projects for this reason alone.

Extended payment times are reportedly 30, 35, 45, 60 and even 90 days after the end of the month. Some clients also claim to need invoiced by a specific day of the month and if missed the small business needs to wait 30 days until the next payment cycle before the invoice will be at least acknowledged. This can in effect lead to payment times of up to 120 days. Clients expect these extended payment times irrespective of the consultant's payment terms.

Our firms also experience conflicts with clients over the definition of 'days' – one party believing it to be calendar days and another arguing for business days.

Small member firms advise that a broad range of clients expect these extended payment times, including:

- Engineering Procurement Construction firms;
- larger consultancy firms;
- local governments; and
- state government agencies.

The experience of our small member businesses indicates that the larger the business the more onerous the payment terms and the less flexible they are to changes to the terms. Significant time is wasted by small business constantly chasing payments from big business. It seems that a lack of processes and a lack of accountability contribute to slow payers.

While the Ombudsman's Position Paper indicates improved payment terms at the Commonwealth level, this does not seem to be reflected at the state/territory and local government level. When working with government clients, internal procedures often impact payment times. For example, the approval of the government project manager on each invoice might be required before the invoice is forwarded to the finance department for payment. Government clients expect consultancy firms to accept these internal procedures, but rarely do they negotiate on terms. Therefore, in addition to already holding much more market power than small businesses and family enterprises, they make very few concessions to their standard practice for this sector. This is disappointing as the benchmark for fair and ethical behaviour should be government, as other participants in the market take their lead from government. Consult Australia has published its Model Client Policy that sets out how government clients can act fairly in engaging with the market (this is discussed below).

Delayed payments are not the only difficulty faced by small businesses in getting paid. Members advise that large businesses are increasingly outsourcing their payment systems with third party providers issuing invoices. Our members advise they are required to use platforms such as payapps and pay a fee for invoices to be issued. Noting the significant impacts delayed payments and unnecessary fees have on small businesses and family enterprises, these entities need more support to ensure that fair payment terms can be enforced.

No discounts seen by our small member firms

Our members report only limited use of the exchange of discounts for timely payments – our small member businesses who provided comment for this submission advised they had not been offered or made an offer of discounts. While the government anticipates positives for the small business and family enterprise sector flowing from reverse factoring used by larger businesses, our members feel that benefits often do not flow through the supply chain.

Some members feel that supply chain financing is a mechanism for large companies to force discounts from small businesses rather than paying reasonable costs for services within reasonable terms. There is significant risk of supply chain financing creating a power imbalance – a small business may feel they have no choice but to agree to discounted pricing, even if it means a loss to the business. This pressure may well be exacerbated by the fact, as discussed in the Position Paper that reverse factoring is used to improve unreasonable payment terms.

The risk of reverse factoring – hiding the health of a company or a sector

The Position Paper articulates a key concern of Consult Australia about reverse factoring – the ability to mask the true financial situation of a company. This masking can affect a whole supply ecosystem and extensive payment terms could almost be seen as litmus test on the health of the industry.

We see this in the collapse of Carillion in the UK, which had before its collapse extended payment times out to four months. It had significant debt which was not obvious to the market as it was mark of a reverse factoring arrangement. When this level of financial instability can be hidden by a major player, there are real concerns for the entire supply ecosystem.

Feedback on the draft recommendations

In February 2020 the Ombudsman released a Position Paper with seven draft recommendations. Consult Australia asked our small business member firms their views on those draft recommendations. As a result, Consult Australia can support the recommendations, particularly those that provide more certainty and transparency to the process. Each recommendation is dealt with below.

Draft Recommendation 1 – Consistent small business definition

The Position Paper suggests that there should be a consistent small business definition across government. We support this recommendation, to bring certainty to all processes, not just supply chain financing. There are already multiple definitions of small business:

- for taxation purposes, the Australian Taxation Office (ATO) defines a small business entity as having less than $10 million aggregated turnover;
- for employment purposes, Fair Work Australia defines a small business as one that has less than 15 employees;
- the Australian Bureau of statistics defines small business as one that employs fewer than 20 people;
- under the *Corporations Act 2001*, as small propriety company is one that has:
    - annual revenue of less than $50 million;
    - less than 100 employees at the end of the financial year; and/or
    - consolidated gross assets of less than $25 million are the end of the financial year.

We do support use of one of the existing definitions rather than a new definition. Our members have divergent views on which definition is best suited for the purposes of payment terms. Some have rightly pointed out the significant difference between employing 100 people and employing 12 people. Given payment terms are about financial matters it would make sense to go with either the ATO or *Corporations Act 2001* definition. Our small business members that work in engineering have advised that a $10 million turnover is not overly high and therefore support the ATO definition.

Draft Recommendation 2 – Enforceable payment times

The Position Paper suggests that the Business Council of Australia's Supplier Payment Code ('Code') should be replaced by the Commonwealth Government's Payment Times Reporting Framework, being administered and enforced by a proactive entity.

It is clear that the non-mandatory Code is not overly effective in guaranteeing on-time payment for small businesses, especially given there are no auditing or compliance mechanisms even for those that have voluntarily signed up for it.

Our small business members support a mandated set of minimum payment terms. There is a potential for a properly established scheme to bring confidence and transparency to the market, the availability of public facing information identifying repeat offenders should be considered. As stated above, small businesses must make difficult decisions about the jobs they can accept when they know clients do not pay within reasonable times.

The scheme will need an easy way for small business to notify the enforcement entity of potential breaches. The enforcement mechanism should also be carefully thought out so as not to unduly impact negatively on parties in the supply ecosystem, as there may be justifiable reasons a party misses a payment deadline in discrete circumstances.

The key concern with a Commonwealth scheme is how it will apply throughout all jurisdictions in Australia and whether it will apply to government clients. As stated above the existing policy requiring 20-day payment terms for government contracts only applies at the Commonwealth level, meaning small businesses that work with state/territory and local governments can still face significant time delays for payments.

Draft Recommendation 3 – 30 day payment standard

The Position Paper asks if there should be an economy wide 30 day payment term mandated. Our small business member firms support arrangements that bring certainty to the market and a mandated payment term would alleviate a significant amount of negotiation our members currently undertake seeking fair payment terms. There is support for 30 days as a maximum.

Our members do note however that a payment standard of 30 days should be clearly articulated as 30 calendar days, as they have seen clients push payment times out to 45 calendar days by reading '30 days' as 30 business days. Noting again that the biggest cost for small businesses is wages, which is paid either fortnightly or monthly, it makes sense that the payment standard be 30 calendar days.

We support that the payment standard should apply to all businesses and enterprises as well as government to ensure a level playing field. The Position Paper asks how 30 day payment terms in government contracts could be made to flow down the supply chain to small suppliers. Our members indicate that transparency is a key issue here – often small businesses at the end of the chain are told of the terms on which the larger firms have been engaged by government clients. This lack of transparency makes it difficult for the small business to challenge the longer payment terms expected by the bigger business. If the payment standard was applied universally, small businesses could rely on that fact to push for the same.

Once again, the key concern with a payment standard is how it will apply throughout all jurisdictions in Australia and whether it will apply to all government clients – not just the Commonwealth Government.

Draft Recommendation 4 – supply chain financing as a real choice

The Position Paper asks if supply chain financing should be available to small business to reduce payment times from 30 days to better. It is vital that reverse factoring is, as indicated by the Ombudsman, a real choice. Real agreement between the parties will be difficult when one party holds more market power than the other. It is inappropriate to use supply chain financing to make unreasonable payment times appear more reasonable – in these situations the small business is under considerable pressure. As detailed above, our small business member firms report extended payment terms of up to, in extreme cases, 120 days.

We support the proposal by the Ombudsman that supply chain financing be used only to improve on an already reasonable payment terms (e.g 30 days). This will assist to equal the power balance between parties.

However, it should be noted that some small businesses do worry about discounting, as there is a risk that their professional services will be undervalued.

Draft Recommendation 5 – Appropriate coverage by accounting standards

The Position Paper asks:

- Should the Australian Accounting Standards Boards be consulting with its international counterparts to provide clarity as to how to capture and treat supply chain finance in financial reporting?
- Should auditors be given formal guidance to ensure consistency in the financial reporting (by note or otherwise) of entities using any form of supply chain financing?
- How do small and family business accountants become educated as to what supply chain financing is and what its implications are for reporting?

Consult Australia agrees with proposals that enhance transparency in accounting. As stated above, there are real and significant risks to the entire supply ecosystem when one party can mask financial issues – as demonstrated in the UK with Carillion. Utilising the expertise of international counterparts and giving formal guidance to auditors are essential to ensure that accounting for supply chain finance is done properly.

In respect of small business education on supply chain financing, we support independent education. As indicated above very few of our member firms currently utilise supply chain financing and we would urge our members, particularly small business members to ensure they understand the issues before engaging.

Draft Recommendation 6 – Further review from competition perspective

The Position Paper suggests that the ACCC should review supply chain financing provider activity form a competition law perspective. The Ombudsman indicates that some large businesses may be sharing data about small business to third parties.

We support more transparency about supply chain financing and given the market power differences between a small business and a large business, it is vital that the ACCC plays a role regarding unconscionable conduct.

Draft Recommendation 7 – Further review from regulated financial product perspective

The Position Paper suggests that Treasury and ASIC should review whether supply chain financing should be a regulated financial product with coverage of rate setting.

As stated above enhanced transparency is supported, and no doubt making supply chain financing a regulated financial product would bring more comfort to business to utilise it in appropriate circumstances.

Call on government clients to be Model Clients

As stated above, many of our member firms have government clients. Given that the rest of the market takes its lead from government actions, it is vital that government acts ethically, fairly, and honestly in their dealings with the private sector. Consult Australia's Model Client Policy sets out how governments can do this when engaging consultants, it is available on our website here. Importantly one of the twelve points in the policy is to 'settle invoice payments and payment claims on time'.

Therefore, we reiterate our call for all government clients to become Model Clients, including the take up the recommendations by the Ombudsman in the Position Paper regarding fair payment times.

CONTACT

We would welcome any opportunity to further discuss the issues raised in this submission. To do so, please contact:

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