Business Council of Australia

SUBMISSION

Submission to the Australian Small Business and Family Enterprise Ombudsman on the Supply Chain Finance Review

February 2020

ABOUT THIS SUBMISSION

This is the Business Council's submission in response to the Australian Small Business and Family Enterprise Ombudsman's draft Position Paper for the Supply Chain Finance Review. The Business Council manages the Australian Supplier Payment Code, an industry-led voluntary initiative that is improving payment times to small businesses across Australia (see www.supplierpaymentcode.org.au).

Summary of the Business Council's response

The Business Council is disappointed that the Ombudsman has not provided more guidance on the use of supply chain financing (SCF) and instead has used this report to criticise and argue against the Australian Supplier Payment Code (the Code).

As the Ombudsman says, SCF can be beneficial to small business under the right circumstances. An opportunity has been missed in the position paper to provide more guidance around the appropriate use of SCF to market participants. More guidance should be included in the final position paper.

We reject the criticisms of the Code in the paper. The Code has 124 signatories with over $680 billion in revenue. Under the voluntary Code, small business suppliers are paid within 30 days and paid on time. Supply chain financing can only be used for small business suppliers when payment terms are 30 days or less. These commitments are entirely consistent with the Ombudsman's aims to improve payment times to small businesses.

Since the Code was introduced many small businesses have benefited from faster payment. Large businesses have upgraded their systems to support these arrangements and offer electronic trading and improved payment services. There is more to do, but the Code has meaningfully contributed to an improving payment culture. Late payments across the economy in the September 2019 quarter have declined to 'lowest on record' (illion). illion also reports that 75 per cent of payments by firms across the economy are made promptly (i.e. on time) – a rise of 3 per cent on the previous year. Australian businesses have the shortest payment terms in Asia Pacific (Atradius).

Peter Strong, CEO of Council of Small Business Organisations of Australia (COSBOA), has said about the Code: "there were many payment problems which are now being fixed by the Code; it's a lot better than what we had before".

We disagree with the Ombudsman's assessment of the Code and reject the recommendation for the government's mandatory reporting framework to replace the Code. We believe the mandatory payment reporting framework and the voluntary Code sit alongside each other, they are not mutually exclusive. The genuine commitments to pay small business faster under the Code will not be replaced by a reporting framework. Instead a reporting framework will support the voluntary code.

The alternative approach of a mandatory payment standard will be costly and difficult to enforce. It will require a penalty regime, which will be another deterrent to investment as it will add more red tape to an already crowded regulatory environment. It will require long lead times and substantial cost to develop systems to accurately monitor performance and ensure compliance to the mandatory standard.

Instead of proposing more regulation the Ombudsman should use the final report to endorse the voluntary Code coupled with the government's mandatory reporting framework, and encourage more companies and government entities to sign the Code.

Comment on specific findings and recommendations

We **agree** with these findings and recommendations in the Ombudsman's report:

- Finding #4: that SCF is able to be appropriately used when a small business chooses to use it to bring forward good payment terms.
- Finding #5: that SCF is inappropriately used to reduce prolonged payment times. The Ombudsman is concerned with SCF being inappropriately used to extend payment terms to small business beyond 30 days, which is not permitted under the Code.
- Draft recommendation #1: that there is a need for a consistent small business definition. The Code defines a small business as an Australian business with annual turnover up to $10 million.
- Draft recommendation #4: SCF as a real choice, that SCF should be available to small business to reduce payment times from 30 days to better.

We **do not agree** with these findings and recommendations in the Ombudsman's report:

- Finding #1: manipulation of the definition of a small business under the Code. This is not borne out by the evidence as there are only a handful of Code signatories using the headcount definition and is an unreasonable finding given that same definition is used by the Australian Bureau of Statistics and appears throughout Commonwealth legislation.
- Finding #2: unenforceability of supplier payment code. The Code is self-enforced by signatories' who make their commitments in good faith and in public and risk potential reputational costs if they do not comply with the letter and the spirit of the Code. This is often a more powerful mechanism than regulatory enforcement and works, as borne out by the number of large companies signing on to the Code and the reduction in payment times.
- Draft recommendation #2: replacement of the supplier payment code with the Payment Times Reporting Framework. This recommendation is confused and misguided. It would remove the commitment by many large businesses to pay small business within 30 days and is against the interests of the Ombudsman's small business constituency. The reporting framework will complement the Code. The Business Council is strongly committed to growing take up of the Code.

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The rest of this submission responds in more detail to matters raised in the position paper.

Supply Chain Financing

This inquiry was established to examine various supply chain finance options in Australia and how they may assist, or negatively affect, small businesses.

Supply chain financing (SCF) is defined by the review as “financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions”. As the review finds, this can take many forms and there is often confusion about what it means for suppliers and customers.

The Ombudsman’s review focuses on the use of SCF provided “through a buyer-led program”, such as reverse factoring and dynamic discounting. Typically, these programs involve a supplier to a large business being invited to access early payment of their invoice at a trade discount, which is often set with reference to the buyers’ cost of borrowing.

SCF is described by the Ombudsman as a “legitimate and effective tool to free up cash flow for small and family business”. However, the review finds that “too many large businesses have extended payment times and then offered SCF “to the detriment of the supplier.

The Business Council agrees with the Ombudsman’s draft findings in relation to the acceptable use of supply chain financing for small business suppliers. These are:

- Finding #4: that SCF is able to be appropriately used when a small business chooses to use it to bring forward good payment terms (ie so long as the terms are not lengthened beyond 30 days)
- Finding #5: that SCF is inappropriately used to reduce prolonged payment times.

SFC offers benefits to both buyers and suppliers under certain circumstances. The Ombudsman’s review is a missed opportunity to provide a set of guidance around when, and how, SFC should be used. The Ombudsman should provide this guidance in the final report.

Using the Code to promote better use of SCF

One way to achieve better use of SCF is to encourage companies to adopt the voluntary standards under the Code, which are highly consistent with the Ombudsman’s views.

The Ombudsman’s view is that “where large businesses offer reasonable payment terms (30 days or less) to their small business suppliers (businesses with less than $10 million turnover) and pay on time, offering optional SCF products can provide significant benefits to their suppliers”. This is consistent with the rules under the Code.

The Code requires that small business suppliers be paid the full amount owing within 30 days of receipt of a correct invoice by the code signatory. The Code also allows the use of supply chain financing to reduce actual payment times when payment terms are 30 days or less.

The inappropriate use of supply chain finance to extend payment terms to small businesses beyond 30 days does not meet the requirements of the Code, which was a clear finding by the 2019 Independent Review of the Australian Supplier Payment Code.

In his foreword to the Independent Review, then Business Council President, Grant King, wholly endorsed this finding:

> “Code signatories make a genuine commitment to pay small business suppliers within 30 days. It is not acceptable to meet the commitment by setting payment terms beyond 30 days and then using financing to make a discounted payment within 30 days. Exceptional arrangements should be rare and only where there is mutual agreement between the parties.”

Australian Supplier Payment Code

We reject the criticisms of the Code

The Business Council is disappointed that a review that was meant to examine supply chain financing has instead attacked an initiative that is designed to change the culture of payment times between big and small companies.

The Code now has 124 signatories with $680 billion in revenue. The signatories include Australia's largest companies with the country's largest supply chains which means thousands of suppliers are benefiting from the operation of the Code (see all current signatories at https://www.supplierpaymentcode.org.au/view_the_signatories).

Successful small businesses are the lifeblood of communities and supply chains. It is critical for their cashflow that they are paid the full amount of their invoices quickly and on-time.

Code signatories make a public and voluntary commitment to pay their small business suppliers within 30 days. Signatories also commit to on-time payment for all suppliers and to work with their suppliers to shift to more efficient electronic trading.

The Business Council developed the Code in consultation with the Council of Small Business Organisations of Australia (CoSBoA) and the State Government of Victoria.

The Code is working to bring down payment times and strengthen relationships between big and small business. Signatories have told us how signing the Code has led to lower payment terms, faster payment performance, upgrades to IT and payment systems and the innovative use of e-invoicing and payment portals. These are material changes to business practices and systems that can require significant investments in time and resources.

The Ombudsman claims that only businesses that already pay within 30 days would sign the Code. This is incorrect. The Independent Review of the Code in 2018 heard from numerous signatories that reported reductions in their payment times and improved practices since signing the Code.

The Ombudsman's recommendation to replace the Code

The Ombudsman has recommended replacing the Code with the federal government's soon to be legislated Payment Times Reporting Framework. This recommendation is seriously misguided.

The Code and the reporting framework are different, but complementary, measures. The Ombudsman has confused the role of mandatory reporting and a voluntary code that drives culture change.

The government's reporting framework is designed to create greater transparency. However, unlike the Code, it is not a tool that will set the payment policy of a business.

The Ombudsman would be aware of the limitations and difficulties with solely prescribing payment times reporting from its experience with its own National Payments Transparency Register, which is no longer available on the ASBFEO's website.

In the meantime, the Code has had a growing, positive impact on the cashflow of small businesses across Australia.

Replacing the Code would potentially remove genuine commitments to pay small businesses within 30 days and on time which would not be replaced by the reporting framework.

The Ombudsman's recommendations to replace the Code with the reporting framework are contrary to the interests of small business and should be removed from the final report.

In the United Kingdom a payment code and reporting framework operate side by side. The same complementary arrangements will soon be in place here in Australia.

The best way to ensure small businesses are paid faster and on time is for large business and government to genuinely commit to these outcomes. The Code is Australia's primary mechanism for making these pledges in public. We continue to urge all major entities to sign on to the Code.

Enforceability

The Ombudsman criticises the 'unenforceability' of the Code. We reject this criticism of self-regulation.

The Code is voluntary and is enforced by the signatories themselves, not by a regulator. Signatories have a very strong incentive to comply with their commitments. Signatories' logos are displayed prominently on a publicly accessible website so they can also be held to account in the media and in public for their conduct. Signatories will therefore respond to criticism because their reputation as a good corporate citizen, which meets its public commitments, is at stake. This is often a more effective mechanism than costly and slow moving regulatory enforcement, which can also be subject to failure.

Should the case arise where a company is regularly breaching its obligations, either deliberately or through negligence, that signatory will be identified (with the assistance of small business suppliers, the Ombudsman and Small Business Commissioners in the States and Territories) and action will be taken to remind them of their obligations and ask them to change their practices. If necessary, certification of a Code signatory can be removed. The Business Council has not been notified of any cases of a signatory regularly breaching its obligations.

Definition of a small business

We agree with the Ombudsman's recommendation for a consistent small business definition. There are two specific actions that government can take to reduce compliance costs for Code signatories and for all other small business policies and programs:

- As suggested by the Ombudsman, there needs to be a single definition of a small business across Australia. We support the suggestion that a small business should be defined as having turnover of $10 million and below.
- The government should establish a small business register or look-up tool, so that small businesses can be easily identified under all small business targeted policies.

A single definition for a small business, set at annual turnover up to $10 million, should replace the numerous definitions of small business that are in place in legislation, policies and programs across Australian jurisdictions.[1] This is the definition that applies under the Code.

A single definition would also enable the establishment of a small business register or look-up tool, which would make it easier to verify the identity of small businesses and improve the workability of small business-targeted policies, like the Code. The register should be updated regularly and should have an Application Programming Interface (API) so that large businesses can match the records with their payment systems. It is encouraging that such as tool is being proposed by the government to complement its payment times reporting framework to support the government's payment times reporting framework.

A definition based on turnover would be superior to a headcount definition, as found by the Independent Review of the Supplier Payment Code. Use of the headcount definition is no longer permitted for new signatories under the Code, after the Independent Review found that headcount is difficult to measure due to the need to account for part time workers and contractors.

The Ombudsman's commentary on small business definition in the report is confusing. In one part of the report, the Ombudsman appears to favour using a headcount definition of 100 employees (draft recommendation 1 on page 5). In another part of the report the Ombudsman appears to favour the definition of turnover of $10 million be used (the 'foreword'). We recommend the final report makes clear that the $10 million turnover definition is preferred.

We reject the accusation of manipulation

We reject the Ombudsman's accusation that "many large businesses" are manipulating the headcount definition of fewer than 20 employees. Only a handful of the 124 signatories now use that criteria under a grandfathering arrangement.

It is also difficult to reconcile accusations of manipulation by business when this same headcount definition remains the definition of a small business in key Commonwealth legislation (e.g. the Corporations Act, ASIC Act and Competition and Consumer Act) and is used by the Australian Bureau of Statistics.

The Business Council led the way by setting a definition of small business at $10 million in turnover. This was a much higher revenue threshold than for most government policy at the time, or for that matter the Ombudsman's $5 million threshold in defining a small business.

We note that the Code covers more businesses with annual turnover up to $10 million than are considered to be small businesses by the Ombudsman. All businesses with turnover between $5 million and $10 million qualify as a small business under the Code. However, any business with turnover in this range that has more than 100 employees is not recognised as a small business under the Ombudsman's legislation.[2]

1. Figure 1 on page 5 of the Financial Services Royal Commission background paper 12 goes through the definitions just in Commonwealth legislation. Most Commonwealth legislation defines a small business as having a headcount of 20 employees or less. https://financialservices.royalcommission.gov.au/publications/Documents/financial-services-and-small-and-medium-sized-enterprises-paper-12.pdf
2. Under the ASBFEO Act 2015 a small business and family enterprise is defined as fewer than 100 employees or revenue in the previous financial year is $5,000,000 or less (see page 25 of position paper)

A mandatory standard?

The Ombudsman asks whether there should be a mandatory payment time standard for all suppliers.

The Independent review, led by Professor Graeme Samuel AC, found that the voluntary code is working to reduce payment times and is preferred to regulation for several reasons.[3]

The voluntary approach outlined in the Code is preferred because business and government purchasers adopt a culture of genuinely acting to reduce payment times and working with their small business suppliers to improve invoicing and payment practices. Signatories take on these commitments in good faith.

By contrast, when regulation is imposed it is difficult to design well and to enforce, it would create compliance costs and risks for business of all sizes and there would be a considerable cost to government in terms of administration and enforcement. There is also the likelihood that regulation would lead to a compliance mindset where businesses do the minimum required under legislation, and pay on the maximum permissible payment terms.

No consultation with the Business Council

Appendix D in the position paper lists 38 individual stakeholders, as well as an unspecified number of ‘various industry stakeholders, with whom the Ombudsman consulted with, or sought consultations with in the preparation of the Position Paper. The Business Council was not included on the list. We are extremely disappointed that the Ombudsman did not consult with the Business Council, especially given the draft report makes significant and ill-conceived findings and recommendations about the Australian Supplier Payment Code.

Payment times data

The Ombudsman’s report draws from one information source on payment times and costs, a 2019 report by Xero and Alphabeta. Some additional publicly available data on payment times that presents a different perspective is provided below.

illion’s *Late Payments September Quarter Analysis 2019*[4] found:

- 75 per cent of payments by firms across the economy are made promptly (i.e. on time) –a rise of 3 per cent on the previous year.
- Late payments across the economy reached a new record low of just 9.1 days in the September quarter. Late payments times have fallen steadily in recent years – in 2011, late payments averaged 20 days. Late payment times by large businesses fell by 3.4 per cent over the previous year to an average of 14.1 days.

Atradius Payment Performance Barometer[5]

3. See https://www.supplierpaymentcode.org.au/independent_review
4. Illion, Australian Late Payments Analysis: September Quarter 2019, accessible at https://www.illion.com.au/2019/11/13/australian-late-payments-analysis-september-quarter-2019/
5. Atradius Payment Practices Barometer, May 2019, accessible at https://atradius.com.au/reports/payment-practices-barometer-australia-2019.html.

- Atradius conducts an annual survey of over 1700 companies from eight countries (Australia, China, Hong Kong, India, Indonesia, Japan, Singapore and Taiwan) on corporate payment practices in the Asia Pacific region.
- Australian business had average payment terms of 24 days from the invoice date in 2019. This is two days shorter than in 2018 and well below the 32 days average for Asia Pacific.
- Australian businesses have the shortest payment terms in Asia Pacific.
- 68% of Australian businesses surveyed do not anticipate changes in the payment practices of their business customers over the coming months. 21% anticipate an improvement, while only 11% expect a worsening in the form of an increase in late payments.

Xero 'Paying the Price' report [6]

Xero and Alphabeta released a report in 2019 called 'Paying the Price', which claimed $115 billion in payments from large business to small business are late each year. We make the following observations about the report and believe the findings need to be subjected to greater scrutiny before being used to support policy change.

- The report selectively makes findings about 'late payment' by large business - it does not make findings about late payment by government or businesses of other sizes, which it acknowledges also occur.
- When the report says "Large businesses pay an estimated 53 percent of SMB invoices late", the source data for this statement is that "just over half of trade credit invoices sent by Xero subscribers are paid late". In other words, 53 per cent of *all* invoices are paid late whether the customer is a small, medium or large business or from government. Our concern should be *all* late payments to small businesses, so it is not clear why the report singles out large business only for further analysis.
- The report says that the identity of small businesses' customers is anonymous. This suggests that the quoted results for 'large business' payments are therefore assumptions.
- The report does not examine the legitimate reasons for late payments (e.g. that the invoice could be incorrect).
- Data in the report is contrary to data provided by illion e.g. Xero says 53 per cent of all invoices are paid late with an average late payment of 23 days beyond the due date; Illion says 25 per cent of all invoices are paid late with an average late payment of 9.1 days beyond the due date. illion claims its Commercial Bureau is the largest database of business-to-business payment information in New Zealand and Australia.
- The findings need to be used carefully if being used to support any pro-regulatory proposals, as any economy-wide measures to regulate payment times would also impact on late-paying small businesses and governments.

6. Xero Small Business Insights, Paying the Price, 2019 accessible at https://www.xero.com/small-business-insights/new-report-the-economic-impact-of-big-businesses-paying-australian-small-businesses-late/

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