



FIFOCAPITAL
BUSINESS FINANCE

Response to
ASBFEO SCF Position Paper

26 February 2020

This Page is Intentionally Left Blank.

Contents

Foreword.....	1
Executive Summary.....	2
Responses to the Ombudsman’s Questions for Comment.....	2
Further Considerations	9
Appendix A: Carillion.....	10

Foreword

It is encouraging to see that the Ombudsman, and Kate Carnell have officially stated that Supply Chain Finance (SCF) is a legitimate and effective tool to free-up cash flow for small and family businesses. My concerns now are that the practices utilised by one or more SCF providers and their clients, together with how the Australian finance and business press have been reporting this matter, has unfairly damaged the reputation of (SCF) and clouded the true benefits available.

Case in point, 1st Feb 2020 the Sydney Morning Herald reported that the Ombudsman claims Invoice Finance/Factoring is good, Supply Chain Finance is bad. This statement is simply too broad brush and, in many cases, not true. We believe the article is misleading small business owners into thinking Invoice Finance (typically debt) is better for them than Supply Chain Finance (non-recourse cash/non-debt). We'd argue a non-debt finance solution is better for business in most instances.

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.

Give small business this freedom, build in a corporate supplier responsibility programme together with a way of naming and shaming big businesses for bad conduct, and you create a commercial marketplace where businesses can trade together on an equal footing whilst empowering smaller businesses to have a stronger voice.

I encourage the Ombudsman to continue to bring to the public's attention the unethical behaviours, bullying and manipulation of suppliers (large and small) and by doing so 'lifting the lid' on subjugator tactics, such as, big businesses incorporating 'non-assignment' clauses in their contracts in order to control the smaller supplier from being able to use factoring or sell the debt in the event of a default purely for their own convenience, behaviours that are considerably more widespread and controlling than SCF.

Please note, where we refer to SCF, we refer to SCF in its purest form, and in the form that Fifo Capital has brought to the Australian market, which is very different to other organisations quoted to have an SCF product.



Wayne Morris

Fifo Capital Australia Pty Ltd

Executive Summary

This submission is in response to the Supply Chain Finance Review Position Paper as published by the Australian Small Business and Family Enterprise Ombudsman (Feb. 2020).

Six questions have been raised by the Ombudsman which we have addressed in this submission with further detail on matters we feel are extremely relevant.

Responses to the Ombudsman's Questions for Comment

1. Consistent Small Business Definition

a. For consistency, should there be a single definition of small business for payment terms?

There is no one single definition that can be used to define small business and to this point it would be problematic. For example, some industries are more labour-intensive than others. As an example, look no further than the tech sector vs. the engineering sector where a tech business with a turnover of \$100m and 80 staff is very different to an engineering business with a turnover of \$50m and 180 staff. If we were to only use employee count, we would incorrectly misclassify both businesses.

Additionally, this tactic would mean we misclassify overseas businesses with what looks like a small business in Australia as a small business, yet this could easily be a satellite office of 5 people serving an Australian client base via an overseas team of 200 people generating \$200m revenue from said client base.

b. If so, what should that definition be? (For example, \$10m turnover?)

The definition requires two variables, for example turnover and employee count, or profit and employee count.

The Australian business sector would be far simpler to understand if businesses had to publish their annual accounts, a process that has been in place in the UK for a considerable period of time, which would help clearly define business types.

2. Enforceable Payment Times

a. Is there a need for a mandatory Supplier Payment Code?

We believe that a mandatory Supplier Payment Code could be too aggressive, yet if the examples as provided by the Ombudsman are based upon true cases, for instance the example on page 14 'Gabe', then a review of the Supplier Payment Code should be considered and further real examples like 'Gabe' be ascertained to establish if a review is required and areas of weaknesses addressed.

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

Any proposed Commonwealth Government's Payment Times Reporting Framework needs to understand SCF first, which, unfortunately Australia seriously lacks at this time. If SCF is operated in the same way Fifo Capital provides to its clients (i.e. a truly collaborative way) then SCF is irrelevant to the framework,

as our model champions buyer/customers sticking to the agreed invoice due date, and they themselves paying Fifo Capital to extend terms. This means the supplier is paid on the agreed due date but are free to take payment earlier if they choose. In this instance the product is irrelevant as the supplier is paid at worst on 30 days.

II. Auditing and issuing fines or other sanctions for non-compliance?

Any fines or sanctions for non-compliance need to come with a robust framework, which must be tested at all levels to ensure it is fair, commercially viable and appreciative of the multiple factors within supply chains. It is often not as simple as Business(A) supplies Business(B); therefore, Business(B) should pay on 30 days. Both businesses A and B, irrespective of size have considerations which need to be accounted for. When SCF is run as per Fifo Capital's model, most issues cease to exist.

Example

Bob runs a widget manufacturing company and sells these widgets to his big customer XYZ. Bob's widgets are one part of many widgets that go together to make the final product customer XYZ sells.

Customer XYZ can't tell for certain how many of Bob's widgets are either delivered faulty or will develop a fault upon immediate use, and therefore need to test the widgets. Testing of the widgets requires 7 to 10 days to complete. Additionally, Bob's widget is fitted on a production line and further testing needs to be done once 3 other widgets from other suppliers are connected to Bob's widget, this takes a further 4 weeks to complete.

By manufacturing the widgets, Bob understands the process and he cannot guarantee the quality of the widgets. For customer XYZ, the cost of finding faults with Bob's widgets after assembly could go as far as having to recall all finished goods.

Customer XYZ cannot afford for a complete recall and therefore have no option other than to run these testing processes. The relationship works that Customer XYZ pays Bob on 45 days.

Customer XYZ want to introduce Supply Chain Finance because they want to pay on 90 days terms to help their cashflow and working capital in order to support further growth. Therefore, Customer XYZ signs up to Fifo Capital Supply Chain Finance and uses Fifo's platform STREAM (Australian-built propriety platform) to pay Bob.

Bob is still paid in 45 days 100% of the invoice amount, but he now has the option to accelerate payment so as to be paid even earlier if he wants on any invoice he wishes, while at the same time and to no detriment to Bob Customer XYZ is paying Fifo on day 90.

Bob is happy because he is in **full control** of when he is paid, there is no debt, no delayed payments and if he wants to be paid early, he can at no risk to his business. Bob decides to introduce his other customers to Fifo Capital Supply Chain Finance, they too like it and sign up. Bob was factoring invoices and has given notice to that lender, the registrations that lender has over the Bob's business are now removed and the second mortgage on Bob's family home that the old lender had is also removed. For the first time Bob has great cashflow and no debt in his business, has a stronger working relationship with all his customers and his and his family's home is no longer at risk.

We have previously discussed with the Ombudsman some high-level thoughts on monitoring the extension of terms and believe there should be more discussions around this in order to identify how to monitor this action better. Recent wins by the Ombudsman

and 'naming and shaming' is all that's needed, as evidenced with two recent cases. Where a big business is not responding to being named publicly, with a viable reason, then it is the duty of the Government to intervene or to empower a body to assist.

3. 30-Day Payment Term Standard

a. For consistency, should there be an economy wide 30-day payment term mandated?

An economy-wide 30-day payment term could only come with several assumptions. One of which is that all businesses of certain sizes are the same. However, this is a far too general stance to be commercially viable. While it is frustrating that some big businesses are poor payers, we should exercise prudence in our assumptions. Not all \$100m turnover companies are the same, with profitability, cash flow and working capital all differing business-to-business and sector-to-sector.

Additionally, it is easy to see why a smaller business would give 60-day terms to a 'Bluechip' client and 30-day terms to a small client. The Bluechip client comes with more certainty of payment and longevity. We might argue 60-days is too long, but if at the outset the supplier and buyer are happy with this then it begs the question why would we interfere (this is very different to a big business moving terms after they were agreed, as pointed out below)?

We believe there are three areas an economy-wide programme could work, and these focus on manipulation and bullying:

- I. **Late payment** – not paying promptly, i.e. on the agreed due date.
- II. **Extending terms** – extending suppliers terms from what was agreed to something later.
- III. **Big businesses hoarding cash** – situations such as where big businesses have short payment terms with their own customers, but not with their suppliers. Large supermarkets are a classic example of this, paid by their customers, the general public at the point of sale, the till, yet they still want 30/60-day terms with the small suppliers they use. These supermarkets net huge profits, yet make their suppliers wait for payment.

We should be mindful that for many instances suppliers and buyers are free to trade with each other under terms that are mutually agreed upfront, therefore attempting to regulate this could be antagonistic in situations where both buyer and supplier have freedom to engage or not engage.

What is wrong is where, like we've seen recently, bigger business pushing out payment terms at the expense of the smaller business, where big businesses agree on payment terms, yet always pay late, or where they introduce a trade-off for paying the supplier on time.

b. For government contracts, how could 30-day payment terms be made to flow down supply chains to small business suppliers?

This is quite simple. The government has a duty of care to inspect the contracts that their contractors have with suppliers and to demand that those contracts do not have any clauses stopping suppliers being able to assign the debt, this single action alone would enable liquidity in supply chains. In addition, the government should review its own

contracts and procedures to ensure non-assignment clauses are not used by any government department.

4. SCF As a Real Choice

a. **Should SCF be available to small business to reduce payment times from 30 days to better?**

There needs to be more information and rigor in the commentary regarding SCF to fully explain the concept. Currently, the financial and business press have only reported SCF as a tool to pay suppliers on the original due date after their client has moved terms from 30 to 90 days. SCF does much more. Used correctly, SCF unlocks the shackles around business trade, but unfortunately, owing to what seems like the misguided practices of a few, the financial and business press have missed this valid point.

SCF, as provided by Fifo Capital, is a major non-debt form of finance for a small business, other than the big business paying earlier than 30 days. It is not a tool to enable manipulation and abuse of suppliers but is a mobiliser of liquidity and fuels trade.

Example

Company ABC has a supplier that provides raw materials on account. The supplier, Raw Materials Pty Ltd gave a \$100k credit limit 'on account' for Company ABC and expect payment on 30-day terms.

Company ABC is growing at a rapid rate and want to purchase more from Raw Materials Pty Ltd, yet income from new work does not arrive in time to pay down the account held with Raw Materials Pty Ltd, often leading to Company ABC being put on stop.

Both parties are frustrated as Company ABC have had to resort to importing from an overseas supplier rather than give their business to Raw Materials Pty Ltd due to the \$100k credit limit on account.

Company ABC asks Raw Materials Pty Ltd to join their SCF programme and explains it would allow them to pay Raw Materials Pty Ltd on 30-days, and also give Company ABC the ability to pay earlier as well.

Raw Materials Pty Ltd give a 5% discount for COD payments, yet prior to joining Fifo Capital Supply Chain Finance, Company ABC never had the cash to be able to pay COD and benefit from this offer.

Both parties beginning trading using Fifo Capital Supply Chain Finance. Raw Materials Pty Ltd are happy to be paid on 30-day terms 100% of the invoice amount but keep their \$100k credit limit in place.

Customer XYZ uses SCF to pay Raw Materials Pty Ltd on COD terms, but extends terms to 60 days with Fifo Capital, this means they can buy more from Raw Materials Pty Ltd and do away with using the overseas supplier. Customer XYZ takes advantage of the 5% discount, which is more than enough to cover the costs of using the SCF facility and allows them extended terms without it affecting their trading terms with Raw Materials Pty Ltd, who are happy as now they have a non-recourse customer buying double the quantity from them on COD terms, a true win-win solution.

b. What forms of SCF are of the greatest benefit to small business?

Reverse Factoring or Dynamic Discounting type solutions are the best form of SCF due to the nature of how they work. A market-place solution plays too heavily on Suppliers need for cash and can exploit weaker suppliers, particularly when buyers and suppliers are naming rates and entering into bidding wars. In this situation the highest discounts win, but what about those suppliers who do not have the margins to give big discounts. A truly collaborative SCF programme does not discriminate suppliers, all can access it and use it, no one is forced into a beauty parade of discounts as a marketplace type supplier payment programme encourages.

The form of SCF which is of greatest benefit to small businesses must include:

- a. Opt in/opt out – suppliers can use the facility as and when they please
- b. Non-recourse payments – once the supplier is paid, from their perspective the transaction is settled
- c. No bidding – between customer and supplier
- d. Open for all – any supplier that wishes to join the programme can
- e. Freedom to select invoices
- f. Freedom to select when paid

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?

In short, the answer is yes, clearly in the case of Carillion, a top accounting firm did not know how to report it and Moody's clearly did not understand it.

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?

Of course, there should be consistency, but also there should be clear understanding of when SCF is a trade payable and when it is short-term finance.

c. How do small and family business accountants become educated as to what SCF is and what its implications are for reporting?

A finance industry-lead approach could play a part, however, with this comes challenges with take-up or a willingness to learn about non-traditional finance offerings such as SCF. Therefore, it will not guarantee education and may require tertiary institutions to take more of an active role.

6. Further questions.

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?

A small business should be able to control the sharing of data with a finance provider, but we see no requirement for a small business to have to share this with a big business, unless there is a reciprocal arrangement and on equal terms.

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?

If the SCF programme provides the small business non-recourse debt-free payment, why would the contract with the buyer be relevant? This is no different to a bigger business using a credit card to make payment, they wouldn't share their credit card contract. However, where there is recourse to the supplier (apart from fraud) then this would be different. The provider should not be in cahoots with the bigger business mining smaller business information to squeeze them for discounts. Building on this, where the SCF programme is optional to the supplier, as in Fifo Capital's model, once again there is no relevance as to the finance agreement between the customer and financier.

c. Is there a role that the ACCC needs to play in regard to unconscionable conduct or third line forcing? Are there any other areas that the ACCC should consider?

Where the supplier is free to opt in or out, and the three types of manipulation are dealt with, then there is no third line forcing and no need to monitor.

d. Should a contract providing SCF in any form be regulated as to how it is implemented/utilised by a big business?

No. The rule should be set that bigger businesses cannot use SCF to manipulate smaller businesses and if this is the case and suppliers can opt in or out of the SCF programme, then self-regulating and commerciality prevails.

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?

With Fifo Capital's proprietary platform, a small business can have all the SCF programs they are a part of in one place, one platform, one log in, a platform that can integrate with all leading accounting software.

f. Should the SCF provider report the effective annualised rate of interest charge/discount?

This is an area of confusion for many and we must understand that financial solutions like SCF are not business loans. The SCF provider is not giving the supplier a facility, finance or loan (if they are then this is not SCF). The SCF provider is purchasing the invoice from the Supplier on a non-recourse basis, which again is different to invoice finance/factoring. It is the same principal as one person buying a debt from another person. Therefore, the supplier is agreeing a discount on an invoice-by-invoice basis, on the invoices they wish and on the early payment terms they want. The supplier has no line fees, non-utilisation fees etc, they are simply agreeing a fixed discount on each invoice if they choose to take payment earlier than the originally agreed due date.

Assuming an SCF provider bought an invoice for \$100,000 at 2% for 30 days then there would have been a cost of \$2,000, the supplier would account for this as a \$2,000 discount on \$100,000 of sales. They would not annualise this to 24% (assuming all months are equal) because no loan was involved.

If this was a business loan of \$100,000 at 2% per month, then it would be accounted for as a liability and the finance cost would be \$24,000 or 24% p.a.

Yet to arrive at \$24,000 of costs under SCF, \$1,200,000 of invoices would need to be financed at 2%. Each invoice is an individual asset, as determined on the supplier's balance sheet as a trade receivable, each asset is a single item bought at 2% discount. The supplier would account on their P&L as \$1,200,000 of sales and \$24,000 of discounts.

To further validate this, if a supplier gave a 2% discount to clients for 30 days early payment, they are not giving 24% annual discount, each transaction is separate and as like SCF it is transactional. To this point, suppliers do not annualise early payment discounts available to their customers, in other words if a supplier offered 5% discount for COD, this isn't 60% p.a, it is 5% discount on the purchases paid COD for the year.

g. Should the effective annualised interest rate/discount be reported publicly as a "comparative rate"?

No. See answer to 'f' above.

h. Is there a role that the Australian Securities and Investments Commission (ASIC) needs to play?

Yes. Given ASIC's role is to protect consumers in the financial system against unfair practices and misleading or deceptive conduct and unconscionable conduct, it is critical that ASIC understand how SCF should be truly utilised so as to hold the businesses accountable if they adopt unethical behaviours in the operation of SCF facilities.

i. Is there a role that the Australian Financial Complaints Authority (AFCA) needs to play?

Yes, but no different to what AFCA already do.

Further Considerations

Appendix A includes our response to the article in the AFR regarding Carillion

SCF is a finance product which its use must be **at the control** of the supplier. If the supplier doesn't need early payment, then they should have the freedom not to use it. If the supplier needs cashflow finance, then SCF outperforms Invoice Finance every time, and for one simple and basic reason. **A payment made under real SCF is done so to the supplier as debt-free non-recourse cash payment**, in other words, the supplier is paid in full and final. Therefore, they will close the invoice as PAID in their accounting system. Yet with most invoice finance (factoring) solutions the financier is only advancing the supplier funds until the invoice is paid – this is debt and recourse to the supplier.

There is a seismic difference between Supply Chain Finance and Invoice Finance/Factoring and small businesses need help to understand this.

Below are links to two articles recently published which demonstrate the further requirement to explain SCF as reporters and business advisers are still struggling to understand the financial tool and are either mis-quoting the Ombudsman or mis-representing the product.

Articles after the Ombudsman Position Paper release, claiming SCF is Payday lending:

17/2/20 <https://www.theaustralian.com.au/business/labor-urges-asic-to-investigate-big-business-payment-schemes/news-story/75d1b9d1edaff0e8afc63537518d29df>

10/2/20 <https://www.theaustralian.com.au/business/financial-services/greensill-tightlipped-on-cimic-payday-lending-scheme/news-story/638816ae9c73c2cd55dc06acfef708d8>

Appendix A: Carillion

25/09/2019 the AFR published an article on Carillion, with commentary around SCF, unfortunately that article only gave part of the true picture.

Below is our response to that article, which unfortunately the AFR chose to ignore and which leaves Australian businesses misguided on the true facts, including Santander reporting via their supply chain finance programme that \$91m of payments to suppliers had been met. In other words, suppliers on the SCF programme had been paid and Carillion's crash had no effect. However, the small businesses using invoice factoring for their Carillion invoices were impacted, with many having to repay the advances they had received from their financier (except for those who had trade credit insurance) and several others who subsequently ceased trading as a result of being unable to absorb the bad debt. In other words, put more crudely, those suppliers utilising Carillion's SCF facility dodged a bullet.

Additionally, at no point had Carillion forced their SCF programme on their suppliers, a point I can personally attest to, as many of these suppliers were our clients, using the SCF programme I led in the UK, and more than once the group CFO openly said, 'we can't force our suppliers on our programme'.

Supply Chain Finance, a modern-day phenomenon in trade finance or a "controversial" financing arrangement with hidden risks?

A recent Moody's research report might lead to questioning the validity of [reverse factoring](#), a type of Supply Chain Finance, and implementing it as a major contributor to the downfall of a number of prominent companies in the UK and Spain. One such example is Carillion, the UK's second biggest construction firm before its January 2018 collapse.

But what was really going on that Moody's missed?

Carillion failed because it was locked into many government contracts which became unprofitable. Arguably the group CFO did not correctly recognise contract impairments and losses, and its board did not warn investors of the risks. They ended up being catastrophic.

In 2013, Carillion payment terms to suppliers certainly weren't great, that's a fact, suppliers grumbled but still took on the contracts with Carillion and reverse factoring was used to offer those suppliers the ability to be paid early for a fee.

Here's the key bit – which Moody now recognise – accounting for reverse factoring liabilities was included in trade creditors not net debt. It was signed off by the internal auditor Deloitte who were paid millions of pounds, some research reports as much as £10 million, to report on risk management and financial controls, and rubber stamped by KPMG the external auditor. A key ratio of solvency is the net debt-to-EBITDA ratio, which remained unaffected. So the Carillion rating remained strong. It's fair to argue that a reverse factoring programme is not on-balance sheet debt when it is part of a collaborative financing arrangement, essentially complementary to core financing. But, when it becomes so large that it is fundamental to a business, it can no longer be called operating debt. It should be reclassified as financing. In the case of Carillion, trade payables were pushed to the extreme, funding losses on many of its contracts. And no one picked it up.

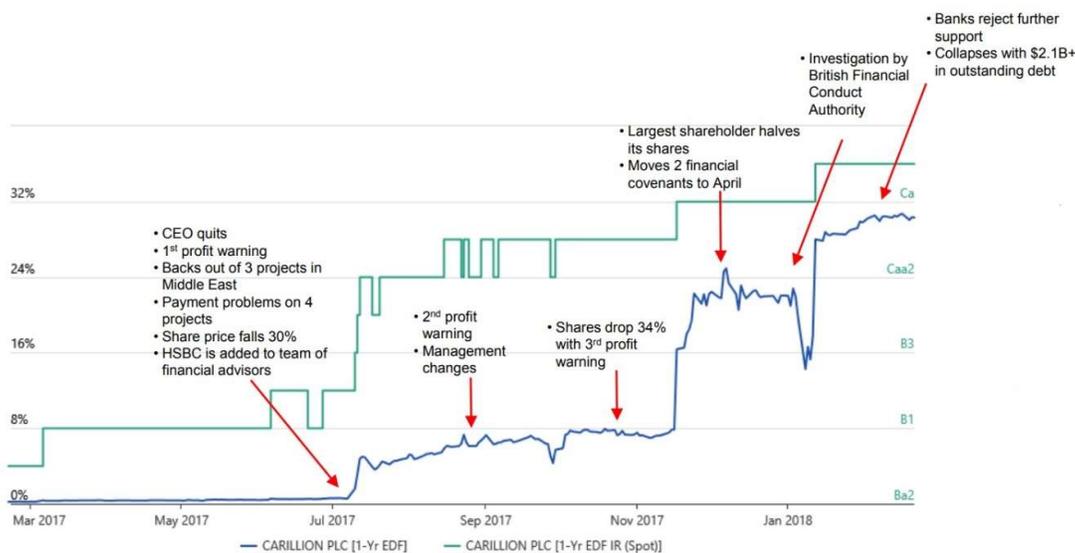
In the wine bars of London it would become known as "a moody rating on a do-little audit." It was the accounting that was "controversial."

In March 2015, a city analyst highlighted the extended trade payables problem. That's when the hedge funds started shorting the stock. The sharks were circling as Carillion kicked ever harder to stay afloat. By October of 2015, 20% of the stock of Carillion had been shorted. The groups bankers kept extending credit. And so it went on.

So what were Moody saying at the time? The figure below comes straight from [Moody's Early Warning Toolkit](#). The Expected Default Frequency "EDF" measures the probability of default within the next 12 months with the equivalent rating on the right axis. It shows that as late as July 2017 the EDF was only 0.22%, equivalent to Ba2 to Ba3. In simple English that translates to near investment grade – a low probability of default but with some speculative elements. Not much wrong there then?!

On 10th July 2017, Carillion came clean. A "shock" profits warning, contract impairments of £845 million, costs not counted, income from contract variations that were never going to be paid, suspended dividends, a pension fund hole and an unmanageable debt pile were all disclosed. The Carillion share price collapsed, and its debt was re-rated as junk.

How had the hedge funds spotted all this more than 2 years earlier? Was the use of a reverse factoring facility so hidden that it disguised reality? Or, **were the analysts and accountants examining grains of sand on the beach as the tsunami rolled up the shore.**



When it failed, the fall out was catastrophic – billions of losses, a pension fund that collapsed, the taxpayer stepping in to cover essential services in roads, schools and hospitals. Up to 30,000 suppliers that had extended credit without using the early payment facility collectively lost £2 billion.

But one of the key points to note is that the suppliers that had entered the reverse factoring arrangement were underwritten and paid in full. Santander reported that they paid out £91 million to suppliers.

Was Supply Chain Finance to blame? How can it be? Was it bad for the suppliers that used it? Clearly not. Suppliers were paid in full, the cost of the finance was far cheaper than factoring, and there was no-recourse to them, additionally, the supplier controlled if they did or didn't use it.

When a business abuses their supply chain, this should be challenged, it's not the financial product at fault, and certainly not when the financial product's core aim is to remove debt in the supply chain.

Ultimately the market will judge. It won't be preached to. The evidence shows that Supply Chain Finance is a product of today, releasing liquidity for millions of small companies and underwriting risk in a new and innovative way. Time for a re-think...?