This is a blog that I recently posted that addressed the issue of payment terms.

In this article I discuss extended payment terms and how they can be commercially attractive to SMEs. I raise concerns about a potential 2 tiered payment term system for Australian businesses. It is not about late payments (which I loathe).

The federal opposition party has recently referred SME complaints about unfair payment practices of extended payment terms and reverse factoring to the ACCC. We will watch this space with interest as ACCC and ASIC investigate. I have no doubt that the well-meaning intentions are to alleviate pain for SME and to attempt to facilitate a fair playing field.

Current indications are that we'll most likely end up with a legislated 2 tier system, where SMEs must be paid within 30 days. As I see it, that leaves us with big business suppliers gaining the unfair sales advantage of being free to choose terms to suit the client.

The unintended consequences for SMEs need to be considered before the debate concludes. There is no "one size fits all" solution and SMEs should have the capacity or ability to opt out of 30 days terms where it is in their commercial interests.

What are Extended Payment Terms?

Extended Payment terms, particularly of 30 and 60 days, are a commercial reality and can give a well-funded and astute SME a competitive advantage. There are many reasons they may want to negotiate extended payment terms with their clients such as:

- It builds trust in a commercial relationship and brings customer loyalty.
- It facilitates larger orders, that equals more sales.
- Larger orders let you negotiate bigger discounts with your own supplier of raw materials.

Imagine the case of the business owner with a large working capital balance currently sitting in his bank account. With interest rates so low, he may consider that a better use of his funds involves offering his clients extended payment times. His large cash balance gets utilised to fund more production of product and therefore he can sell more. He gets a decent percentage increase in sales because his clients order more now that they have 60 or 90 days to pay for it. It does make one wonder why this hard working and smart business owner is being disadvantaged by this possible intervention.

Why Would I Agree to Extended Payment Terms?

A business dealing with an SME might accept extended payment terms for the following reasons:

- It may enable them to hold more stock than they otherwise would as they have more time.
- It might allow a large retailer to take on a less proven product on the chance it might take longer to sell.
- May mean that they can negotiate out of consignment or 'sale or return' terms which are worse.

What is Reverse Factoring?

Reverse factoring has been available for decades and is the financial services product that forms part of the ACCC complaint. It will most likely be referred to ASIC relating to the provision of financial services. Reverse factoring is used by large corporates who typically have longer than usual standard payment terms. Reverse Factoring is customer provided finance. They offer to pay an outstanding SME invoice within 14 days or on their due date, but the payer of the invoice is actually an invoice finance company. To receive the funds in this time period, the SME must agree to receive their invoice value, less a fee.

I've found instances that where companies are dealing with a reverse factoring provider, they have precluded the SME having access to their own debtor finance solution. The SME is pretty much told, deal with our provider or wait for your funds. This can be unfair as debtor finance (also known as invoice finance or invoice factoring) is often a better value solution for the SME. The unintended consequence of reverse factoring is that the SME gets the worse end of the deal.

It is my preference that the government does not intervene in the case of extended payment terms. I have faith that business owners can successfully negotiate commercial agreements that suit them and their business.

There's also an abundance of market solutions to help business owners deal with the cash flow implications of extended payment terms. They include debtor finance, purchase order finance, and trade finance.

It is part of our role as an industry and provider of financial services finance solutions to help educate business owners and their advisors. We should be ensuring that business owners have the financial know-how to make the most of their own potential business opportunities.

Creating a two tiered system on Australian businesses is unlikely to make the playing field fairer. If the government and regulators really want to have a positive impact on the cash flow of small business in Australia, it may be more productive to focus their energy on tardy and habitually late payers of business invoices and enforcing penalties to help change their behaviour.