Business Council of Australia

SUBMISSION

Submission to the Australian Small Business and Family Enterprise Ombudsman Inquiry into Payment Times and Practices

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Contents

The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This is the Business Council of Australia's submission to the Australian Small Business and Family Enterprise Ombudsman's inquiry into payment times and practices. The inquiry was set up to examine concerns raised with the Ombudsman by small business suppliers about the timeliness of payments by larger businesses.

The submission sets out the Business Council's recommendations and responds to questions raised in an issues paper released by the Ombudsman. Our submission supports a voluntary payments code and industry-led initiatives to address small business concerns. An appendix details current payment practices and performance in Australia.

Key points

- Competitive and financially strong small businesses are fundamental to economic growth, and healthy cash flow is critically important to their viability. Large and small businesses are deeply connected meaning the long-term success of one depends on the success of the other, as does Australia's overall prosperity.
- Business Council members value their relationships with small and medium sized businesses. The Business Council acknowledges there can be harmful effects on small business cash flow when large purchasers use their leverage to extend payment terms, or when a business of any size pays late. A change of culture and practice is needed.
- Average payment times to suppliers have fallen across the economy. However, many small business suppliers face worsening payment times and there is a need to do better.
- This is why the Business Council proposes to work with other industry groups and the Ombudsman to develop a strong, consistent code for paying small business suppliers. The code would draw on approaches in other countries and support commercial flexibility while addressing the power imbalance between large and small business.
- On time payment should be as much of a priority as prompt payment. For many companies, reliable and on-time cash flow is preferable to short payment terms that are unreliable, frequently late and hard to plan for.
- Proposals to introduce new regulation of supplier payments would add unnecessary costs and risks for the economy and should not be pursued. Regulation would stifle the capacity of business to negotiate terms suitable to each sector, add new compliance costs (potentially for businesses of all sizes) and impede innovation. It could encourage business to default to the maximum terms permitted, or deal less with small business.
- Signatories to a well-designed voluntary payments code could commit to:
  - pay small business invoices promptly and on time
  - set clear definitions for payment terms and timings of payment runs
  - offer multiple payment methods to make it easier to pay (for example, Electronic Funds Transfer, payment cards, supplier chain financing, dynamic discounting, etc.)
  - report on compliance with the code and publish a note to the annual report.
- In addition the Ombudsman could publish a 'Golden Rules' book that sets out best practice, hold small business supplier events to explain what suppliers can do to avoid delays in payment, and work with large businesses to identify and promote best practice procurement and payment policies for small business suppliers.

Key recommendations

- The Ombudsman and industry should:
  - raise awareness of the harmful impacts on small businesses when payment periods are extended or payments are late without justification, and
  - promote prompt and on-time payment (by businesses of all sizes and governments) to small business suppliers.
- The Ombudsman, the Business Council and other industry groups should work together to develop a voluntary industry code for prompt and on-time payments to small business suppliers and to promote industry-led small business procurement policies.
- Any new voluntary code and associated policies should be reviewed for their effectiveness within 12 months of commencement.

Main submission

This inquiry has been set up in response to concerns expressed by small business about the time that some large businesses take to pay their invoices. Small business can be more vulnerable to late payments and less able to negotiate favourable terms.

Current payment practices in Australia[1]

Average payment times have fallen in recent years. Dun & Bradstreet reports that average time taken to settle invoices in Q3 2016 was 44.8 days, down from 54.8 days in 2013. PricewaterhouseCoopers data shows Days Payable Outstanding falling from 61 days in 2011 to 49 days in 2016.

However, Dun & Bradstreet also report that, while the majority of payments are made within 30 days, one in 12 payments are made over 60 days. One per cent of payments are over 120 days.

Lengthy or late payment affects SMEs in many ways, including by impacting on the owner's own personal finances and the ability to cover other expenses like rent and energy costs.

Payment times are driven by business policies and practices, which are set to manage working capital effectively and in accordance with payment systems and payment runs. Payments times can also be impacted by the liquidity of firms and errors in the invoicing and payments processes.

Payments practices in Australia differ by sector and are changing as a result of commercial, financial and technological innovation. A range of tools are used, including supply chain finance, electronic invoicing, self-billing, payment cards, discounting for early payment, and enhanced payments systems.

Long payment times can be due to the conduct of businesses of all sizes, and governments, including suppliers. Whether they are a cause for concern can depend on whether they are offset by other terms and conditions or factors, or can be efficiently resolved through negotiation or dispute resolution.

1. This section draws from research in the appendix to this submission.

As recognised in the issues paper, some large companies have put in place specific arrangements to pay small businesses and local suppliers faster or to make it easier for small businesses to be paid. For example, BHP Billiton Australia grants 30 days or less payment terms to small businesses and Coca Cola Amatil Limited is investing in payment systems improvements (See Boxes 1 and 2).

Box 1: BHP Billiton Australia

In recognition of the circumstances faced by small businesses and other organisations with respect to financial and other considerations, Business Council member BHP Billiton Australia grants standard 30-day or less payment terms to businesses in the following categories:

- small business
- local community suppliers whose primary business location is in a community close to one of our operations
- suppliers that are 50 per cent or more Indigenous-owned and demonstrate a commitment to the employment and training of Indigenous people.

Importantly, a supplier that does not qualify for standard 30-days payment terms, but is nonetheless experiencing significant financial hardship, may also be granted exemption from the standard 60-day payment terms and alternative payment terms.

Source: BHP Billiton

Box 2: Coca Cola Amatil's programs assisting small business suppliers

In 2016, Business Council member Coca-Cola Amatil Limited had a total of 5900 suppliers in Australia, of which 4200 would be classified as 'small suppliers' with an annual spend of less than $50,000.

Supplier finance

SPC Ardmona, a Coca-Cola Amatil subsidiary (SPC), introduced a supplier finance program for fruit growers in 2007-08 to assist them in managing their payments. SPC's payment terms are 65 days for fruit growers and 14 days for tomato growers (end of the week from delivery). Through supplier finance, fruit growers can access their payments ahead of their payment terms and SPC is offered a discounted price in return.

All SPC's fruit growers have signed up to the program. After the successful launch with fruit growers, supplier finance was then rolled out to SPC's general suppliers. Most SPC suppliers are on supplier finance except for international suppliers, government agencies and medical centres.

Better payments system

Coca-Cola Amatil is responding to feedback around difficulties that small business suppliers experience using large payment systems like its own payments system, Ariba, and the possibility of fees for use of those systems. Coca-Cola Amatil is currently trialling Ariba Light Enablement, an email-based tool that streamlines and expedites the payment process for smaller suppliers without involving any fees.

Source: Coca-Cola Amatil

The problem to be addressed

A critical first step is to ascertain the scale and scope of the problem.

The available evidence shows a fall in payment times across the economy and the majority of invoices paid within acceptable timeframes. However, many small business suppliers face worsening payment times and there is a need to do better.

Where businesses or governments are using their negotiating leverage to unduly extend terms or are regularly paying late with impunity, and this is having harmful impacts on small business, a change in culture and practice is warranted.

Late payment, in particular, can have very damaging effects on suppliers from: unreliable cash flow, labour tied up in trouble shooting tasks, and in general a negative impact on the buyer–supplier relationship. Late payment can affect supplier relationships across multiple stages in the supply chain and ripple through the system.

It is important to recognise the difference between a 'long payment term with reliable payment timing' and 'paying late' (i.e. after the due date). For many companies, reliable and on-time cash flow is preferable to short payment terms that are unreliable and frequently late. The former may reflect an agreed and settled arrangement that suits both parties, and any response considered by this inquiry should be flexible enough to allow for this type of arrangement.

The issues paper says that many small businesses do not feel they can speak up against what they consider to be unfair payment practices by larger companies or governments, because of the fear of damaging the commercial relationship. The Ombudsman is well placed to address this problem by being the collective voice for small business suppliers, explaining to the broader market the impact that long payment times can have on a small business's cash flow and encouraging businesses and governments to pay promptly and on time.

Options for reducing payment times for small business suppliers

The inquiry will consider a range of 'market-based and regulatory' solutions, as set out in the issues paper. The Business Council's view is that, subject to any eventual findings by the Ombudsman, non-regulatory measures be strongly preferred and tried in the first instance. Regulation should only be considered after non-regulatory actions have been properly tested.

There are a number of non-regulatory options that could be considered:

- raising awareness of the impacts of long payment times on small business – some companies may not be fully taking these impacts into account when framing their procurement policies
- identifying and highlighting best practice payments policies
- promoting voluntary industry or company policies relating to small business payments.

The Business Council proposes to work with other industry groups and the Ombudsman to develop a code for payments to small business suppliers, taking into account elements of voluntary payment protocols used in other countries that are suitable to Australia (see Box 3). While the elements would be developed through consultation, signatories to an Australian prompt payments code could commit to:

- pay small business invoices promptly and on time
- set clear definitions for payment terms and timings of payment runs
- offer multiple payment methods to make it easier to pay (Electronic Funds Transfer, payment cards, supplier chain financing, dynamic discounting, etc.)
- report on compliance with the code and publish a 'payment on time' note to the annual report (similar to the publication of other 'good governance' performance indicators not required by law or the ASX).

All purchasing companies should be made aware of these options for improving payment times to small businesses and be encouraged to adopt them on a day-to-day basis.

The code should be competitively neutral and preserve a level playing field between large businesses that sign on to the code and their competitors. It should be clear, efficient and proportionate and avoid adding unnecessary costs or interfering with growth-enhancing innovation. It should lead to a demonstrable improvement in payment times and practices.

A performance assessment of any new Voluntary Code should occur within 12 months of its commencement.

In addition, it is recommended the Ombudsman work with industry to complement the Code with these initiatives:

- publishing a payment policy ‘Golden Rules’ book for governments, industry and companies that sets out best practice
- identifying and promoting procurement and payment policies within business and government that take account of the interests and needs of small business suppliers
- holding small business supplier events to explain drivers on cash flow, and what suppliers can do to avoid delays in payment, or what offers exist to access faster payment, and how they work.

Supplier businesses should be made aware of the options available to them to improve payment times. These include: making use of supplier finance, accessing payment cards and other mechanisms designed to make it easier to receive payment from customers, and improving invoicing processes to avoid mistakes.

Educative initiatives could also ensure small businesses properly utilise the opportunities available under the current ‘security of payment’ legislative framework and the development of business skills and capability necessary to operate successfully.

There are also existing (or proposed) government policies in place that small business suppliers can use to address allegations of anti-competitive or unfair business conduct, including:

- industry codes of conduct (e.g. the Food and Grocery Code, the Horticulture Code, Franchisee Code, etc.)
- the extension of the unfair contract terms provisions to small businesses
- streamlining and promoting collective bargaining permissions
- the Ombudsman’s other roles to provide access to dispute resolution services to assist businesses to resolve disputes without resorting to costly litigation; and ensure that government policies take into account the needs of small businesses and family enterprises
- the appointment of a small business commissioner at the Australian Competition and Consumer Commission (ACCC).

Unconscionable conduct provisions exist to protect small businesses from ‘conduct which is so harsh that it goes against good conscience’ (ACCC). Small businesses have legal rights to pursue breach of contract under common law.

Regulation has high risks and costs

Proposals to introduce new regulation of supplier payments would create high and unnecessary costs and risks for the economy and should not be pursued.

Payments relationships should be about two parties coming together and agreeing a mutually acceptable set of contractual arrangements. Regulation would interfere with commercial flexibility and innovation and potentially disrupt the efficient operation of markets.

The proposals in this submission should be able to address in a targeted way any problems arising from a power imbalance between parties, or from late payment, and avoid the costs and risks of regulation. The fall in average payment times and the widespread practice of paying within acceptable timeframes indicates that there is not an economy-wide problem warranting regulation.

Regulation would require rules and definitions to be developed and applied to everyday transactions. It would introduce new administration and compliance costs, adding to Australia's already high existing stock of regulation and the growing cumulative regulatory burden on business that diverts from productive activity.

Regulation could be harmful to small business. Regulation of payments could be made to apply to all purchasers, including small and medium sized businesses. Regulation risks deterring larger businesses from trading with small businesses due to additional cost and risk. Many businesses that pay on short terms today may extend their payment terms out to an arbitrarily determined and regulated maximum timeframe for payment, if that approach were adopted in the law.

Generally, any regulatory proposals that are made in a policy review should be demonstrated to have been developed in accordance with the government's own rigorous public policy making rules in the *Australian Government Guide to Regulation*. Principles of best practice regulation include:

- Regulation should only be considered if a clear problem exists and regulation is the only solution.
- Regulation should be proportionate, efficient and simple.

The Business Council considers that regulation should only be considered if the non-regulatory proposals in this submission fail to improve payment times to small business suppliers.

Box 3: Elements of supplier payment protocols in other countries

United States of America

- The *SupplierPay* voluntary code was introduced for large businesses in 2014. It has over 40 corporate signatories committing to lower the working capital costs of small business suppliers, including through faster payments or by offering financing solutions to access working capital at lower cost.
- *QuickPay* was introduced in 2011 to speed up government agency payments to small business contractors, with a goal to pay within 15 days.

United Kingdom

Prompt payment code

- The 'Prompt Payment Code' is a voluntary industry code of conduct administered by the Chartered Institute of Credit Management. Code signatories undertake to 'pay suppliers on time', 'give clear guidance to suppliers' and 'encourage good practice'. There are currently over 1900 signatories.
- 'Signatories undertake to pay suppliers within a maximum of 60 days (in line with late payment legislation requirements), to work towards adopting 30 days as the norm, and to avoid any practices that adversely affect the supply chain.' A Code Compliance Board investigates contract terms that are 'grossly unfair'.

Late payment legislation

- Unless there is a pre-existing agreement, late payment is defined as 30 days after the customer receives the invoice or the date of delivery (whichever is latest). Any agreement with payment terms over 60 days must be fair to both parties. Interest and debt recovery costs can be claimed for late payment of an invoice.

Duty to report on payment practices

- Commencing in April 2017, all large businesses (turnover >£36m; over 250 employees or balance sheet >£18m) must report on payment practices biannually.
- Reports must include descriptions of payment terms and processes for dispute resolution, statistics on payment times, and statements on practices like whether the organisation offers e-invoicing and supply chain finance and whether sums are deducted from payments as a charge for remaining on a supplier's list.

Europe

- The European Union Directive requires payment within 60 days. The EU Directive is implemented into national law in various forms and levels of enforcement. For example, in France the maximum term is 60 days from invoice date or 45 days after monthly statement.
- Failure to comply with these provisions may lead to a fine of € 375,000 for companies and € 75,000 for an individual and may be imposed by the French Authority for Competition Policy, Consumer Affairs and Fraud Control (DGCCRF).
- In Germany, the maximum term is '60 days after invoice date or receipt of a correct invoice, whatever is later.' Government agencies have to settle within 30 days. Small businesses can sue companies for not paying on time, and standard late fees and penalty interest rates have been legislated.

Source: United Kingdom, United States and European Union government websites

Responses to the issues paper questions

Question one: Are payment times or trade credit an area of credit in the economy that requires monitoring and regulation by the federal government?

Payment times and trade credit arrangements should, in the main, be negotiated between commercial parties to support the efficient operation of markets. Contract law is the primary mechanism for businesses of all sizes to take action when there is very late or non-payment by a purchaser. There is arguably however a legitimate role for government to monitor payment terms and times for small businesses and to raise awareness about commercial arrangements that are causing undue damage to small business's ability to trade. Government can identify and recommend options that businesses (and governments) can adopt for more prompt and on-time payment to small business. Regulation should only be considered if non-regulatory policies have been tried and tested.

Question two: What mechanisms exist that enable SMEs to manage late payments or extended payment times?

SME 'suppliers' have a number of options available to them, in addition to legal rights to pursue breach of contract for late payments under common law. These options include making use of supplier finance, accessing purchase cards and using electronic invoicing mechanisms designed to make it easier to receive payment from customers. Small businesses can also improve their invoicing processes to avoid mistakes that may be a cause of the late payment.

Question three: What burden should SMEs carry regarding late payments or extended payment times for contracts they enter into?

Gross or regular late payment creates a substantial burden for SMEs to bear and which this inquiry is aiming to reduce. Late payments are a particular problem for SMEs because of, in most cases, the unplanned disruption to cash flow.

Question four: What role should industry participants (industry leaders, peak bodies, large and small businesses) have in addressing payment times and practices?

Industry participants should be aware of and highlight the problems associated with paying late, especially for small business, and promote best practice procurement by all businesses and governments.

Question five: Outside of legislated payment times and practices, are there any other industry initiatives which promote faster payment times and practices?

There are many preferred alternative approaches to legislation, including:

- a voluntary code where code signatories commit to pay promptly and on time, set clear definitions for payment terms, clarify timings of payment runs, and report on practice
- publishing a payment policy 'Golden Rules' book for industry and companies that sets out best practice

- holding small business supplier events to explain drivers on cash flow, and what suppliers can do to avoid delays in payment, or what offers exist to access faster payment, and how they work
- publishing a 'payment on time' note to the annual report, similar to the publication of other key performance indicators of 'good governance' that are not required by law or ASX.
- identify and promote procurement and payment policies within business and government that take account of the interests and needs of small business suppliers
- offer multiple payment methods to make it easier to pay (Electronic Funds Transfer, payment cards, supplier chain financing, dynamic discounting, etc.)
- standardise payment terms and design guidelines for best practice procure-to-pay processes.

Question six: What incentives are there for large businesses to offer fast payment policies, or participate in voluntary industry programs for faster payment to suppliers?

Business Council members value their relationships with small and medium sized supplier businesses. It is in the long-term interest of large businesses to have a stable, viable and productive supplier base, which is dependent on sound management by suppliers of their working capital and cash flow. It is also in the interest of large business to set payments policies in support of this outcome rather than manage a compliance burden due to additional regulation. These incentives would apply to purchasing businesses of all sizes – large, medium or small, and governments – not only large businesses.

Question seven: What role should governments take to address payment times and practices?

Governments should monitor their payments to small business suppliers and implement internal policies for prompt and on-time payment. Many are already doing this.

Question eight: How can governments promote readily enforceable payment times and practices without legislation?

Governments can raise awareness of the need for prompt and on-time payment of small business suppliers, promote best practice and encourage the take-up of voluntary industry schemes. Regulation should not be considered until non-regulatory approaches have been tried and tested.

Question nine: Would increased information about payment times and practices of businesses promote better payment culture and should this information be publicly available?

The available evidence shows that payment times have fallen considerably in recent years, from 54.8 days to 44.8 days, on one measure. It also shows around one in 12 payments are over 60 days.

Notwithstanding the general downward trend in payment times, the issues paper reveals that late payments are occurring more frequently and large businesses are extending trade credit payment terms.

More detailed information about payment practices by industry and business size can help to highlight where there are specific problems and enable purchasers to act, or for targeted responses to be designed. In particular, information on the prevalence of late payment by businesses of all sizes could be useful in promoting the reduction in its incidence.

It takes significant work to produce detailed payments information, as transactional data needs to be accumulated and interpreted. A simple reporting of average payment time does not provide insight into 'late' payments, nor into the length of payment terms, or the practices in each industry. More granular information should be collected and reported.

Question ten: Which of the regulatory options would small business find most beneficial?

This is a question for small businesses to answer, however, it is noted that an effective voluntary or self-regulatory approach is generally a lower-cost solution for all parties than regulation.

Question eleven: Are there other regulatory options governments could pursue to address payment times and practices?

The Business Council considers that regulation should only be considered if non-regulatory proposals, such as those suggested in this submission, fail to improve payment times to small business suppliers.

Appendix: Payment times and practices in Australia

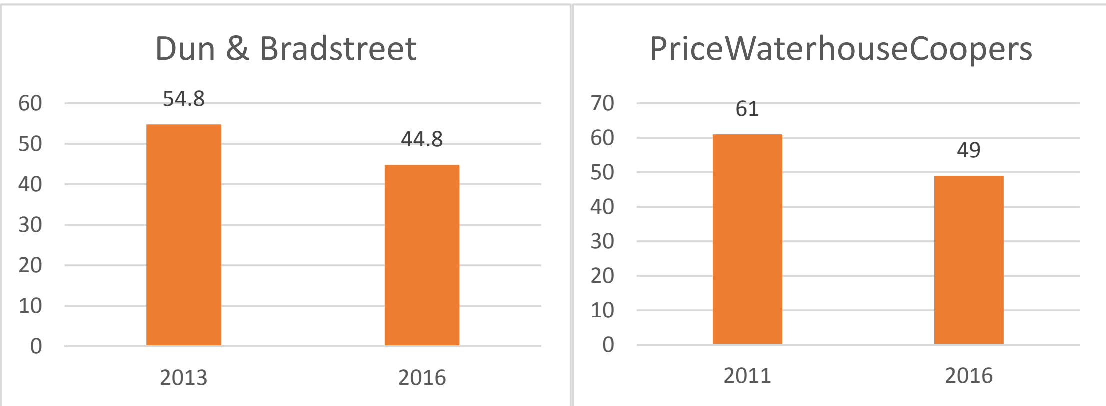
Current payment times in Australia

Current and trend data on payment terms and late payment

Around half of sales by Australian businesses include a credit period and half are on a cash basis (Atradius). Where credit is involved, payment times across Australia are at historic lows according to the latest reporting on trade payments data by Dun & Bradstreet and PricewaterhouseCoopers.

Dun & Bradstreet, drawing from its trade payments database which contains the payments data of many large businesses, reports that average time taken to settle invoices in Q3 2016 was 44.8 days, down from 54.8 days in 2013.[2] PricewaterhouseCoopers data shows Days Payable Outstanding falling from 61 days in 2011 to 49 days in 2016.[3]

Figure 1: Payment times have fallen



Source: Dun & Bradstreet, 'average time taken to settle invoices' and PriceWaterhouseCoopers 'days payable outstanding'.

According to the PwC Global Survey, the Australasian (Australia and New Zealand) average Days Payables Outstanding of 51 days is the second lowest among the surveyed regions.

2. Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, *Australian Prompt Payment Protocol Discussion Paper*, Australian Government, July 2013, p. 6.
3. PwC, *2016 Australian and New Zealand Working Capital Survey*, November 2016.

Table 1: Days payables outstanding international comparison

Region	Average Days Payables Outstanding
USA/Canada	47
Australasia	**51**
Americas	59
Asia	62
Africa	64
Europe	65
Middle East	70

Source: PwC, Bridging the Gap, 2015 Annual Global Working Capital Survey, p. 25, available at www.pwc.com

Atradius reports that Australian businesses find domestic business customers pay faster than business customers from the rest of the Asia-Pacific:

- In Australia, a larger proportion of unpaid trade receivables after the due date arises from foreign trade (57.6%) than from domestic trade (40.3%).
- Australian businesses generally have a stronger focus on payments management to protect cash flow than their Asia-Pacific counterparts. [4]

Despite the downward trend in payment times, a sizeable portion of payments are made over lengthy timeframes in Australia, as asserted in the issues paper. Dun & Bradstreet report that, while the majority of payments are made within 30 days, one in 12 payments are made over 60 days. In Q3 2016:

- 72 per cent of payments were within 30 days
- 20 per cent were within 31 – 60 days
- 5 per cent were within 61 – 90 days
- 2 per cent were within 91 – 120 days
- 1 per cent were over 120 days.

Late payment can have harmful effects on small businesses. According to MYOB:

- 77 per cent of SMEs have experienced a business impact due to customers not paying on time
- Late payment affects SMEs by impacting on the owner’s own personal finances (35 per cent) and the ability to cover other expenses like rent and energy costs (32 per cent)
- 52 per cent of SMEs find that late payment affects their stress and anxiety levels.[5]

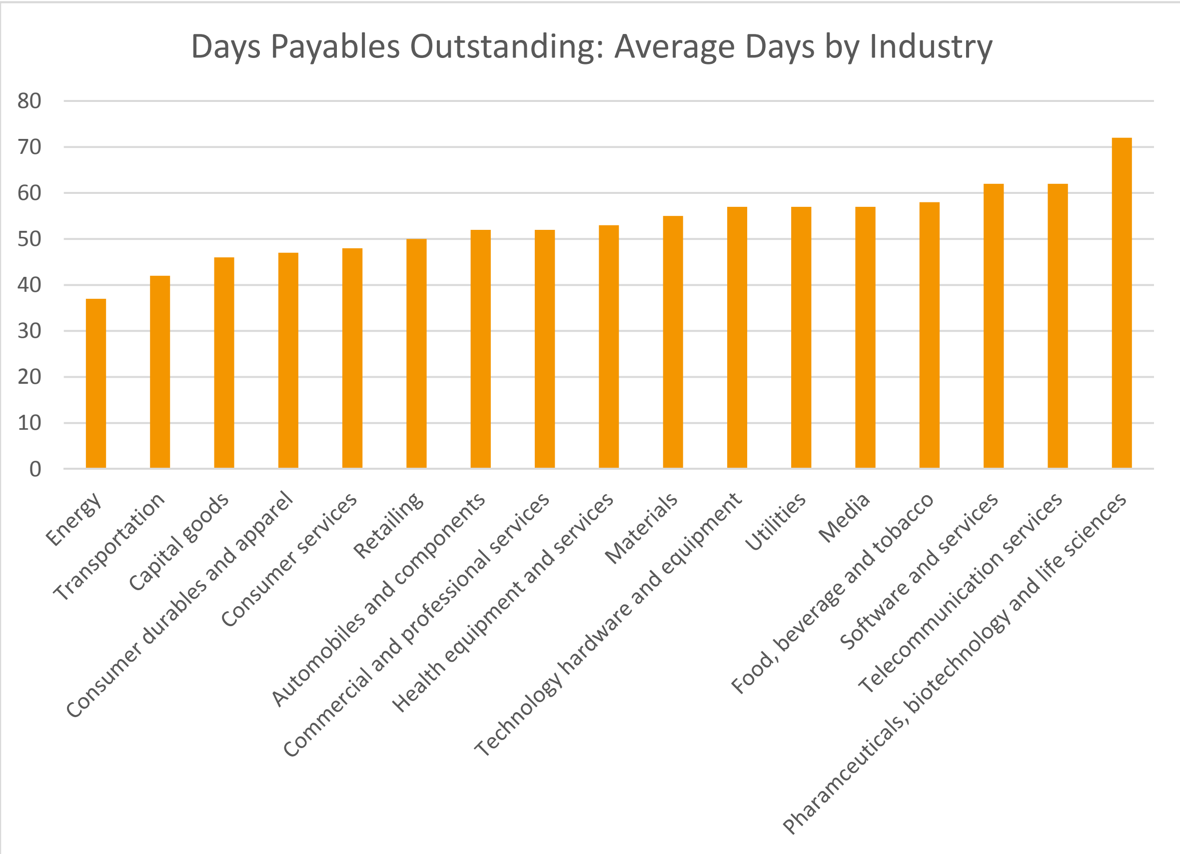
According to Atradius, 24 per cent of suppliers expect an increase in payment terms over the next 12 months, while 8 per cent expect a reduction.

4. Atradius, *Atradius Payment Practices Barometer*, October 2016.
5. MYOB media release, ‘Late payments causing more than a headache for SMEs’, 27 October 2016.

Payment times by industry and government agency

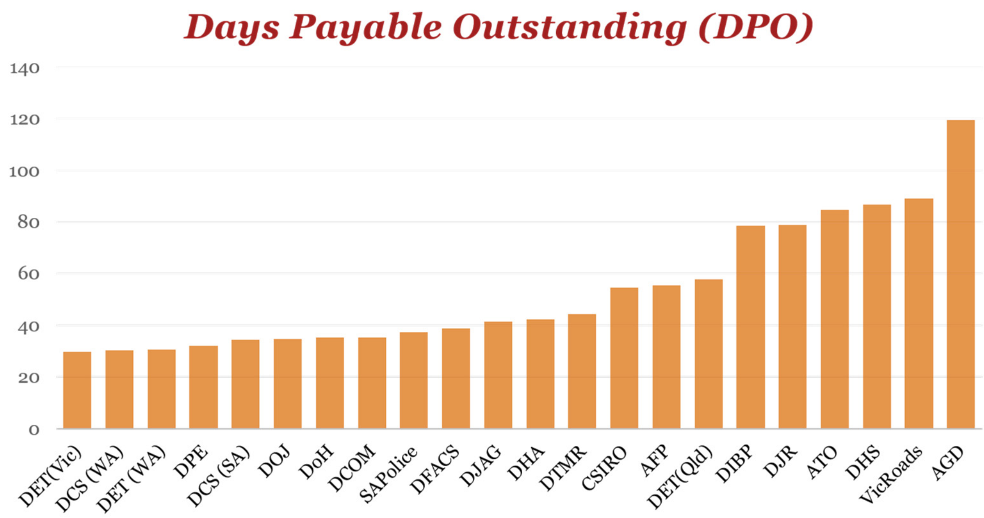
PriceWaterhouseCoopers analysis presented in Figures 2 and 3 below shows the disparity in payment times across the economy and by government agency.

Figure 2: Average payment times by industry



Source: PwC analysis

Figure 3: Average payment times by selected government agency



Source: PwC analysis of the latest annual reports of: Victorian Department of Education and Training; WA Department of Corrective Services; WA Department of Education and Training; NSW Department of Planning and Environment; SA Department of Corrective Services; NSW Department of Justice; Queensland Department of Housing and Public Works; WA Department of Commerce; South Australia Police; NSW Department of Family and Community Services; Queensland Department of Justice and Attorney-General; SA Department of Health and Ageing; Queensland Department of Transport and Main Roads; CSIRO; Australian Federal Police; Queensland Department of Education and Training; Commonwealth Department of Immigration and Border Protection; Victorian Department of Justice and Regulation; Australian Taxation Office; Commonwealth Department of Human Services; VicRoads; SA Attorney-General's Department.

Payment practices by corporations

The recent reduction in payments times, and the differences that occur across industry and government, reflect the different and changing nature of commercial relationships where trade credit is involved.

This inquiry is considering cultural change and policy options for reducing payment times for small businesses, which is a worthy objective. When considering options it is necessary to understand how the various payment practices that occur across the economy impact on businesses. The simple measure of 'payment times' does not always reflect the real impacts on a business's cash flow or ability to trade.

Business impacts also depend on whether a payment practice is part of a long-term relationship with repeat commercial engagements (where payment times are well understood and can be planned for), or is a one-off payment (where a late payment is unexpected and adds to risk). Another relevant factor is the ease of invoicing (e.g. monthly statements are easier to manage than many single invoices) and the payment method (e.g. the use of charge cards can facilitate payments).

The different approaches by company and by sector, and the multitude of commercial, financial and technological payments mechanisms in the market, reveal a complex set of arrangements at work. In considering policy options, it will be important not to unduly interfere with or disrupt arrangements that have emerged to suit different market conditions or business models, but to specifically address any identified problem associated with payments to small business. An evidence-based and methodical approach is needed to avoid unnecessarily interfering with the efficient operation of markets and payments innovation.

Analysis of payment practices

Setting payment terms

Supplier payment terms can be set either by the supplier, the purchaser or via negotiation.

In many cases the larger party determines the payment terms, which tends to be a more efficient arrangement for all parties. It standardises processes around terms, meaning a negotiation can focus on product and price and that competing offers can be compared fairly. Most large purchasing companies have a procurement policy that defines a standard payment term. However, these terms can and often are being overridden in negotiations (e.g. a shorter payment period in exchange for a price discount).

As recognised in the issues paper, some large companies have put in place specific arrangements to pay small businesses and local suppliers faster (See Box 1 earlier).

Differences by sector

Different norms tend to prevail by sector of the economy. For instance, quite different approaches are taken in the tourism, agriculture, manufacturing and construction sectors:

- The tourism sector tends to operate on a prepayment or immediate payment basis with their customers. It is very unusual to pay for a hotel stay, restaurant bill or airline ticket on invoice with a payment term.
- Agricultural producers delivering to retail companies tend to operate on short payment terms towards farmers. This is likely driven by the low capital base of the typical farmer in the region, requiring quicker payment to finance seed, fuel and labour to bring in the next harvest.
- In the manufacturing sector, the costs and risks of consignment storage can be a factor in determining the time of payment.
- In the construction sector, supplementary documentation may be needed to demonstrate that a stage of work has been completed to standard before an invoice can be accepted.

Financing, discounting and technological mechanisms

There are many financing, discounting and technological mechanisms used in association with payments that are beneficial to the parties; some of these are designed to make it easier to pay small businesses (see Box 2 earlier).

Supply Chain Finance availability

Supply Chain Finance is an arrangement where the buyer offers to the supplier immediate payment after invoice approval, with the payment discounted (relative to a payment made at term) at the rate of the buyer’s cost of borrowing. In effect, the buyer passes on its generally lower borrowing cost to the supplier, which generates a positive outcome for both parties. (Many large companies can borrow low rates of interest compared to the overdraft account of a small business.) The terms can be negotiated between the parties but in general the discounting cost is borne by the supplier.

Electronic invoicing

Electronic invoicing is becoming more available for small and family businesses. By producing an invoice as an electronic file and emailing it to the buyer, it can be made more immediately available for processing as opposed to sending by mail. The later the buyer receives the invoice, the longer it takes to 'start the clock' until invoice maturity.

Self-billing

Based on mutual agreement, the buyer prepares the supplier's invoice itself, based on what was delivered and purchase orders in place. The buyer then sends the invoice and the payment to the supplier. This guarantees an error-free invoice and avoids manual work for both parties for preparing, sending, scanning and assessing invoices.

Payment cards

Payment cards are generally credit cards that are lodged with regular suppliers and are used to simplify the transactions, particularly for high volume, low value transactions under a certain amount (for example, $5000 for travel, stationery, maintenance, spare parts or irregular temporary labour services). Operating on a payment card guarantees next day cash flow for the supplier. Payment by a purchaser via a credit card is a similar option, involving deduction of a merchant fee.

Discounting

There is a widespread practice among supplier businesses of all sizes of discounting the invoice in exchange for faster payments (e.g. within 14 days instead of 60 days). The agreed terms may set out multiple payment times and amounts with discounts applied (e.g. part payment within 30 days, rest within 90 days). In the recent decade, 'dynamic discounting' has grown in use. Suppliers can request payment at any time during the maturation of the invoice, and the discount is calculated on a per-day basis, and on demand – even on day 57 of a 60-day net payment term.

Invoice financing

Invoice financing, while declining in popularity, is still in use by some companies. The business sells its accounts receivables to a third party (a 'factor') at a discount, in return for immediate cash.

Supplier action for late payment

Suppliers can take action against poor payers. Some suppliers may add a premium charge to the invoice (e.g. 5 per cent, or flat fees for collection letters) for late payers. Or suppliers may require immediate payment from customers who are deemed to be of low creditworthiness due to frequent late payment. In a healthy supplier–buyer relationship, both parties should be motivated to settle issues amicably, as paying late has adverse impacts on both parties.

Improved payments systems

Companies are upgrading their payments systems to make it easier for suppliers to submit invoices and to speed-up processing of payments. Technology is being used to speed-up invoice reconciliation and checking functions. Online payments systems are easier for suppliers to access and to track payments.

Payment practices by governments

As shown earlier, payment times vary considerably across governments and their departments. Recently a number of governments have introduced payment policies for small business suppliers. The Australian Government imposes a general requirement that:[6]

- agencies pay small businesses within 30 days from the date of receipt of an invoice for contracts up to $1 million
- payment beyond 30 days incurs additional penalty interest payments to the small business (so long as greater than $100).

Similar policies to pay small businesses within 30 days or pay interest exist in New South Wales and Queensland.

A concern with this approach is that contract size is not a perfect determinant for a small business and so it does not always impact small businesses only. For instance, if a larger business has a $500,000 contract with a government agency, then the 30-day rule will apply, however the larger company can very likely afford (and be willing to accept) a much longer payment term. Rather, annual revenue or number of employees should be the deciding factor. Also, some small businesses may have only one or two contracts so a $1 million threshold is quite low, and may exclude many small businesses.

Drivers of payment practices in Australia

Working capital management

Company management has a duty to the shareholders of a business to manage working capital so that the business is operated as a going concern and is maximising profitability. A basic definition of working capital is accounts receivable, plus cash and inventories, less accounts payable.[7]

A business can improve its management of working capital through faster receipt of payment from customers, minimising inventories on hand, or extending the time it takes to pay suppliers, resulting in a better cash position.

Different companies have different strategies for managing working capital, and some will have a preference for longer supplier payment terms. This may be driven by their own

6. Australian Government, *Supplier Pay On-Time or Pay Interest Policy*, Resource Management Guide No. 417, November 2016.
7. A key metric is ‘days working capital’ (defined as average daily working capital x 365 days divided by annual sales revenue). A reduction in ‘days working capital’ signifies more efficient use of available resources and supports greater profitability.

cash flow requirements, for example, industries that tend to receive payment on very long payment terms are likely to seek longer-term payment terms with their suppliers.

For example, a retailer's main business is to distribute supplier products to end consumers. This means the retailer has to hold stocks in warehouses and outlets for lengthy periods that delay cash receipt. They may also sell to the end consumer on credit, further deferring cash receipts for very long periods. This type of business might then consider it to be fair and reasonable to seek arrangements to pay its suppliers after cash is received (which could be an extended period of time after the goods were received).

As discussed earlier, however, average payment times are falling. PwC observes that the recent general trend towards shorter payment times is, instead, probably driven by the search for cost opportunities in the procurement process from 'early payment' discounts. Companies are taking advantage of the offer from suppliers of discounts for paying early. This may change should interest rates increase – currently the cost of cash is very low, so paying early and taking discounts is more attractive.

Dun & Bradstreet also speculates that lower interest rates have reduced returns to purchasers from holding cash and created less of an incentive to extend payment terms.

It is possible too that higher business confidence means companies are more confident and willing to pay earlier, as opposed to times when they are not confident and prefer to hold on to cash for longer.

Payments logistics

The frequency of the buyer's payment runs impacts on payment terms and times. The cash balance at the end of the month is important for listed companies, so they tend to introduce 'end of month' payment terms that lead to payment on the first working day after the cut-off date. Typically a second 'sweeper-run' in the middle of the month is done for payments to suppliers who submitted an invoice too late for the cut-off date. The regularity of payment times allows the supplier to plan ahead for its cash receipts and organise payouts around these dates.

Best practice is to align payment terms to payment run frequency, otherwise the lack of synchronisation creates a risk of late payment.

Drivers of late payment

Late payment refers to invoices that are settled beyond the agreed payment term. Arguably this is of greater concern than the setting of payment terms.

Reasons for late payment can include: liquidity problems experienced by the purchaser, complex payment procedures or banking system challenges.

Some businesses may intentionally use late payments to help finance their business (working capital) particularly if the purchaser is experiencing a cash shortfall, sometimes caused by late payments of their customers. According to a recent Dun & Bradstreet survey, 31.4 per cent of businesses responded that if they were in the difficult position of being unable to pay their total bills, they would choose not to pay a supplier rather than miss a payment on a credit card, bank loan or overdraft.

Reasons for late payment can include actions or missteps by the buyer or the supplier. Common supplier errors include: paper invoices being sent to the wrong billing address; the postcode missing from address; sending invoices to the buyer instead of the invoice handling facility; general mistakes on invoices (price, quantity and the ordered goods/services); ambiguous contracts; and other claims. Also, there may be a general misunderstanding by the supplier of payment terms within the terms and conditions, or misunderstandings in regard to payment run frequencies (e.g. fortnightly or monthly).

Reasons for late payment due to buyers' conduct may be due to ineffective processes to manage the procure-to-pay process or master data issues.

If invoices are sent electronically and match the purchase order in quantity and price, and the buyer's processes and systems run effectively, invoice approval can be done within seconds ('Automatching'). If any of the aforementioned problems occur, however, delays can easily mount up to weeks. Validating invoices on the buyer's side can require significant manual labour when invoices do not follow the requirements, or processes at the buyer's side do not run effectively.

Conclusion

- Payment times have fallen in recent years, probably due to companies preferring to take discounts for early payment and technological improvements. They also vary across the economy. They need to be assessed within the wider commercial relationship and against changes in payment technologies and practices.
- Where long payment times occur, two main contributing factors are lengthy payment terms and late payment. Long payment times can be due to the conduct of businesses of all sizes and governments.
- Long payment times may or may not be a cause for concern, depending on whether they are offset by other terms and conditions or factors, or where they can be resolved through negotiation or dispute resolution. In some cases they are attributable to the conduct of the supplier.
- A minor but significant proportion of payments are being paid on long terms or long after invoice maturation and creating a legitimate cause for concern for small business.
- In recognition that small businesses can experience harmful impacts from extended payment terms or late payment, some governments and larger businesses have policies to facilitate prompt payment or have financing arrangements to improve the supplier's cash flow. More can be done to expand these practices and widen understanding of the impacts of late payment for small business.

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